

DIRECT COMMUNICATIONS GROUP

Postal Regulatory Commission
Submitted 6/30/2008 4:24:17 PM
Filing ID: 60360
Accepted 6/30/2008

MEMORANDUM

TO: THE POSTAL REGULATORY COMMISSION
FROM: ALAN ROBINSON
SUBJECT: COMMENTS ON DOCKET NO PI2008-3, REPORT ON UNIVERSAL POSTAL SERVICE AND
THE POSTAL MONOPOLY
DATE: JUNE 30, 2008

These comments are presented in response to Commission' s Order Nc 71A. These comments represent my views not that of any of my current or previous clients. They are based on twenty-eight years of experience working for government, transportation, logistics, postal, mailer, and mailing industry supplier clients. During this period, I have seen both how the Federal government has tried to change the economic regulations affecting railroad, truck and intercity bus industries, and how service providers, customers, and communities have reacted to change. I was a member of the staff of the Interstate Commerce Commission during the passage of trucking deregulation and the Motor Carrier Ratemaking Study Commission with the responsibility of looking at how further changes in truck and intercity bus regulation would affect how carriers in these industries would meet their legal service obligations to small communities and rural areas.

The Postal Regulatory Commission has a particularly difficult task in writing this report. There are numerous competing interests that need to be balanced with the charge that Congress set before it. More importantly, the Commission has the challenge of dealing with both our romantic attachment to the mail and the historical role that the Postal Service has played as well as the reality that the role in the economy that the Postal Service fills today and the future no longer fits that historical image.

As these comments are long, I have provided a table of contents following these initial paragraphs to aid the reader through this document.

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1. EXECUTIVE SUMMARY

Specifying a new universal Service Obligation for the Postal Service is a challenging proposition. This memorandum highlights some of the background necessary to develop a customer focused Universal Service Obligation and how a customer focused approach would be applied to a number of the topics that the Commission raised.

If there is one thought that the reader should draw from this memorandum, it is the importance of the customer in discussing the Universal Service Obligation. By tying universal service to the customer, one can link the obligation directly to a party that has an economic interest in the service that the Postal Service provides. By defining the sender as the customer, the universal service obligation for the service purchased can also be known to the party buying the service prior to the service being purchased. Also senders, due to their economic interest in the delivery of their mail, have the ability to challenge the Postal Service if it fails to meet its obligation.

A sender's interest in the service includes all activities of the Postal Service up and until the item is placed in a location where the recipient can collect it. To the extent that the location that the Postal Service uses as a delivery point increases the willingness of recipient to look at what the sender asked the Postal Service to deliver, then the delivery service becomes more valuable. Clearly delivery to a door is more valuable to the sender as it reduces the cost of recipient to retrieve his items increasing the likelihood that will be looked at and acted upon. However differences in delivery costs of door delivery and cluster box delivery relative to the difference in recipient willingness to look at the mail may be too great to justify delivery to the door.

By focusing on the customer, and more specifically the sender as customer, obligations to recipients become implicit in obligations to senders. This is not to say the recipients do not have a significant role in ensuring that the Postal Service meets its obligations to senders. By communicating satisfaction or displeasure with service, recipients can help the Postal Service improve its ability to offer a delivery service that offers delivery of hard-copy communications that will be read by the recipient and a parcel delivery service that provides secure delivery.

Without customers, there would be no mail to be delivered and any plan to set obligations that drives away customers would be counter productive. Also, the Postal Service is now primarily a provider of service to non-household customers who send quantities of mail in each mailing. The Postal Service's reliance on this segment of the mail market will continue to grow as the number of retail customers, particularly customers that send documents are shrinking at an increasing rate. Therefore, to the extent that a Universal Service Obligation sets costly requirements to serve retail customers, it could potentially increase overhead costs that would be born by the by wholesale or bulk customers. In addition, any additional requirements to serve retail customers could have the effect of diverting management attention from those customers that will sustain the Postal Service.

In general, I believe that the framework of a Universal Service Obligation should be customer focused. As such it should:

- Be an obligation to the Postal Service's customers, who are the senders of mail
- Be set at levels that are economically tenable;

- Be enforceable in a manner that would require the Postal Service to meet its commitments by either improving service or improving its transparency about what its true capabilities are,
- Be publicly known to all senders of all products;
- Be flexible to reflect the needs of customers of specific products in a manner that obligations may not be identical for all products;
- Be flexible to reflect different needs of retail and wholesale customers; and
- Be flexible to reflect changing market conditions.

Finally, it is my view that a customer focused approach to the universal service obligation would be close to the common carrier obligation that transportation common carriers now have to their customers. Most importantly, if the obligation is like the common carrier obligation it would be clear to whom the obligation applies, something that is clearly not obvious now. Therefore, I believe it is important that the Commission take a serious look at the Common Carrier Obligation for transportation companies as it evaluates options for the future.

2. UNDERSTANDING THE POSTAL MARKET

The United States Postal Service is only one supplier within a much larger hard-copy communications and package collection, transportation, processing, and distribution industry. This industry supplies households, businesses, government entities, and other organizations that need to:

- Solicit, conduct, and complete transactions
- Distribute advertising, news, and other types of information
- Communicate with friends, family, and business associates
- Deliver packets and parcels.¹

2.1. MAIL IS PART OF A LARGER COMMUNICATIONS/GOODS SUPPLY CHAIN

The Postal Service participates in a number of different communications and parcel delivery markets and, in some of those markets, it faces substantial intra-modal and inter-modal competition.² While it is easy to think of the Postal Service solely as a national entity, it participates in the full range of local, regional, national, and global markets. As such, its overall market position reflects both competitive strengths and weaknesses in individual sub-markets, most of which are significantly more finite than either the current rate structure or marketing initiatives would indicate.

¹ Packets are defined as packages less than two pounds, parcels are defined as packages over two pounds. The USPS only handles parcels weighing less than 75 pounds but there are other members of the industry that handle the heavier weight packages.

² Intra-modal competition is competition with a firm performing similar services for hard-copy communications or parcels. Inter-modal competition is competition with an alternative media including telephone, facsimile, television, radio, and e-mail, websites and information services accessible through the internet.

Table 1 illustrates the full range of competition facing the United States Postal Service over its full range of product offerings. With the exception of periodicals, the table identifies products not based on pricing categories but based on the type of object that the Postal Service handles or could handle. For example, “the deferred/ground correspondence and documents” category includes all of the Postal Service’s letter and flat mail other than advertising and periodicals.

As Table 1 notes, the United States Postal Service faces some competition in virtually every postal function and market. In end-to-end delivery, the Postal Service faces competition for every major product that it handles. Intra-model competition is most intense in the express/overnight market and the deferred/ground parcel and packet markets where the Express/parcel carriers dominate the head-to-head competition with the USPS. In other markets, intra-model end-to-end competition is less obvious but still quite real.³ Inter-model competition includes modes with long history of consumer use including telephone, facsimile, broadcast TV, broadcast radio, and cable TV and newer competitors that include satellite radio, and numerous communications modes accessible via the internet.⁴

In individual segments of the postal production process, the Postal Service faces competition from firms that serve the end-to-end market, firms that specialize in one or more of the functions involved from sale of the postage to delivery as well as the mailer themselves. For many of these markets, the Postal Service is a limited competitor as private suppliers now dominate the provision of collection, transportation, and origination sortation of the mail of large quantity mailers. In other markets, for example in the delivery of periodicals, local delivery companies handle only a small quantity of high value publications that require early morning or other form of expedited delivery.

This extensive display of competition helps illustrate the Postal Service’s unique position within the postal marketplace. For those customers that demand the delivery of non-urgent, hard-copy communications, the Postal Service, alone or in conjunction with the services of other firms is nearly the only provider. However, this dominant position is not without limits, as all of these hard-copy customers are seeing increased preference for alternative modes of delivery from the recipients of their messages. In addition senders in cost-cutting moves have created financial incentives in the form of either additional fees for hard copy documents or discounts for accepting electronic delivery of documents traditionally prepared as a hard-copy document and delivered by the Postal Service or an express carrier. These moves have been strongest in financial services, travel and performance ticketing. For airlines driven by competitive pressure to cut costs, these incentives along with gradual consumer acceptance of electronic ticketing, so greatly reduced recipient preference for hard-copy tickets that the airline industry completely eliminated the paper ticket as of June 1, 2008.⁵ Both the Federal Reserve and individual firms within the financial services industry have conducted numerous consumer behavior studies over the past two decades tracking changes in payment

³ The majority of daily and many weekly newspapers, once delivered by the Postal Service, are now delivered through a private carrier force. Similarly, numerous local advertisers distribute flyers to the door or participate in merchandiser publications that are also delivered by private carriage. Private and contract carriage (employee and contractor provided) is used to deliver inter-organizational documents bypassing the Postal Service.

⁴ These include but are not limited to e-mail, broadcast e-mail, web-sites, pop-up ads, display ads, paid search positioning, and wiki postings.

⁵ The elimination of hard-copy tickets took nearly 18 years from the time United Airlines first began exploring the possibility of electronic delivery until its elimination.

methods and electronic banking in order to understand the demographic, service quality and financial incentive influences that are necessary for a bill payer to prefer an electronic payment option and a bill, statement, or insurance policy recipient to prefer electronic delivery. Given both the cost savings associated with electronic payment and electronic delivery and the intense demand of financial service firms to reduce costs in light of financial losses caused by investments in subprime mortgages and mortgage based structured investments, we can expect that these firms will try to find the appropriate mix of incentives and penalties to move their customers to electronic alternatives.

For periodicals, just like hard-copy correspondence, the Postal Service, usually in conjunction with the efforts of a printer and/or other service providers is the primary means of delivery. However, the periodical market that the Postal Service serves is experiencing a competitive challenge as their hard-copy, advertising and subscription based business models face challenges from preferences of many and in particular younger consumers for the delivery of content electronically. Internet based delivery has created alternative delivery channels that existing hard-copy and new electronic-only publishers for general-interest consumer, special-interest consumer, and business content are exploiting in response to customer demand.⁶ The shift in consumer preferences means that the remaining recipients of hard copy periodicals are those that place the highest value on having the copy in hard-copy form. At a minimum, this may mean that the quality of service provided by the Postal Service and/or other participants in the delivery process will need to be higher. In addition, traditional views of publishers as to the willingness and ability of recipients to pay for delivery may be changing.

For advertising the choice of mail verses other delivery modes has always been determined by the economic bottom line. Mail must provide a greater return for the advertising dollar than that available from alternative delivery mode. As many customers have options in both end-to-end as well as upstream services, and some have alternatives for delivery services, the Postal Service's ability to compete depends on its ability to either offer a better or cheaper service, subject to constraints that recipients may place on the delivery mode or carrier that they prefer the sender to use.

⁶ Examples of new periodicals that are delivered almost exclusively electronically are the Politico and Bloomberg News. While the Politico is a hard copy newspaper, most readers receive their content electronically for free. Similarly, Bloomberg News, while supporting television and radio networks, primarily delivers content via the internet.

Table 1 Major Postal Market Segments and Operators That Directly Serve Them

Market Segment	Retail Services	Collection	Transportation	Processing	Delivery	End-to-End
Overnight Correspondence and Documents	Express/Parcel Carriers, USPS, Office Supply Retailers, Private Postal Operators, Postal Contract Stations	Express/Parcel Carriers, USPS, Office Supply Retailers, Couriers, Postal Contract Stations, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Contract Carriers, Private Carriers, e-mail, wiki postings, website postings
Overnight Packets (Parcels Under Two Pounds)	Express/Parcel Carriers, USPS, Office Supply Retailers, Private Postal Operators	Express/Parcel Carriers, USPS, Office Supply Retailers, Couriers, Postal Contract Stations, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers
Overnight Parcels (Parcels Over Two Pounds)	Express/Parcel Carriers, USPS, Office Supply Retailers, Private Postal Operators	Express/Parcel Carriers, USPS, Office Supply Retailers, Couriers, Postal Contract Stations, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers
Deferred/Ground Correspondence and Documents	Express/Parcel Carriers, USPS, Office Supply Retailers, Private Postal Operators	USPS, Postal Contract Stations, Private Carriers, Contract Carriers, Presorters, Lettershops, Printers	USPS, Private Carriers, Contract Carriers, Presorters, Lettershops, Printers	USPS, Private Carriers, Contract Carriers, Presorters, Lettershops, Printers	USPS, Private Carriers, Contract Carriers	USPS, Contract Carriers, Private Carriers, e-mail, wiki postings, website postings
Deferred/Ground Packets (Parcels Under Two Pounds)	Express/Parcel Carriers, USPS, Office Supply Retailers, Private Postal Operators	Express/Parcel Carriers, USPS, Office Supply Retailers, Couriers, Postal Contract Stations, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	USPS, Parcel Shippers, Internal/Presort/Contractor Arrangements	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers

Market Segment	Retail Services	Collection	Transportation	Processing	Delivery	End-to-End
Deferred/Ground Parcels (Parcels Over Two Pounds)	Express/Parcel Carriers, USPS, Office Supply Retailers, Private Postal Operators	Express/Parcel Carriers, USPS, Office Supply Retailers, Couriers, Postal Contract Stations, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers	Express/Parcel Carriers, USPS, Couriers, Private Carriers
Magazines and Newspapers	N/A	USPS, Private Carriers, Contract Carriers, Presorters, Lettershops, Printers	Express/Parcel Carriers, USPS, Couriers, Private Carriers, Contract Carriers, Printers	USPS, Private Carriers, Contract Carriers, Printers	USPS, Couriers, Private Carriers, Contract Carriers, Printers, Newsstands	USPS, couriers, Contract Carriers, Private Carrier, e-mail, wiki postings, websites
Advertising and Marketing Material	N/A	USPS, Private Carriers, Contract Carriers, Presorters, Lettershops, Printers,	USPS, Private Carriers, Electronic, Publications, Internal/Presort/Contractors	USPS, Private Carriers, Electronic, Publications, Internal/Presort	USPS, Private Carriers, Newspaper delivery /Magazines, Contract Carrier	USPS, Contract Carriers, Private Carrier, television, radio, telephone, e-mail, websites
International Letters, Documents, Packets and Parcels	Express/Parcel Carriers, USPS, Office Supply Retailers, Private Postal Operators	Express/Parcel Carriers, USPS, Couriers, Remailers, Foreign Postal Services, Presorters, Lettershops, Printers, Contract Carriers, Private Carriers	Express/Parcel Carriers, USPS, Electronic, Foreign Postal Services, Private Carriers, Remailers, Contract Carriers, Couriers, Airlines	Express/Parcel Carriers, USPS, Foreign Postal Services, Private Carriers, Contract Carriers, Couriers, Remailers, Presorters, Lettershops, Printers	Express/Parcel Carriers, USPS, Foreign Postal Services, Private Carriers, Contract Carriers, Couriers	Express/Parcel Carriers, USPS, Foreign Postal Services, Couriers, Contract Carriers, Private Carriers, e-mail, wiki postings, website postings

Notes:

2.2. THE ECONOMIC IMPACT OF THE POSTAL INDUSTRY IS SUBSTANTIAL

The economic impact of the postal industry includes three components. First, there is the direct impact relating to the creation of mail and the collection, preparation, transportation, sortation and delivery of mail and parcels. Second, mail generates economic activity through sales generated through the advertising that it delivers or because it is a cost-effective method of delivering parcels, books and periodicals. This is the economic impact of the industry's customers. Third, the industry generates economic activity through the purchases of firms and employees involved in the creation, preparation, transportation, sortation and delivery of mail and parcels. The first two components had an economic impact in 2006 creating 8.3 million jobs and generating \$1.2 billion in revenue from the firms involved.⁷

2.2.1. Direct Impact

The Postal Service has described the postal industry as a "value chain" having several layers. The inner layer includes the USPS, its delivery competitors, and the mailing services industry. This includes organizations that provide support to mailers: including creative designers, address and list managers, lettershops, service and presort bureaus responsible for processing the mail, printers, and transporters of mail. The direct impact also includes the economic activity of suppliers that provide the paper, ink and other components that are required to create mail. Finally, this layer includes the suppliers to the Postal Service, as it uses outside suppliers to provide services that are often performed in-house by its competitors. In total, this layer in 2006 was responsible for at least 4.5 million jobs and \$255 billion in revenue.

2.2.2. Economic Impact of Customers

Customers of the postal industry are responsible for 3.8 million jobs and produce \$946 billion in revenue. This includes both the economic activity exists generated by mail advertising and the sales of firms that use the mail for delivery regardless of the method used to sell the product.

Mailers use one of four types of direct-marketing advertising to generate sales. These include catalogs, non-catalog direct mail, inserts in non-advertising mail, parcels, and periodicals, and direct response advertisements in magazines delivered by mail.

The postal industry and the Postal Service in particular, are critical for the successful creation of vibrant businesses that depend on parcel delivery. The 2002 Commodity Transportation Survey estimated that parcel carriers delivered \$987 billion in goods or 11.8% of the value of all goods transported.⁸ Express carriers may have carried as much as an additional \$265 billion or 3.2%.⁹ This

⁷ All figures in this section were derived as part of a soon to be published study estimating jobs and revenue of firms within the mailing industry for the EMA Foundation. Data on jobs is derived from information collected by the Department of Labor in its Occupation Employment Statistics Program for 2006, the 2002 Economic Census and by the Global Insight study, *The Power of Direct Marketing*, published by the Direct Marketing Association in 2007. Data on revenue is derived from information collected by the Department of Commerce in the 2002 Economic Census, the 2006 Survey of Manufacturers, and the 2008 Survey of Current Business and by the Global Insight study, *The Power of Direct Marketing*, published by the Direct Marketing Association in 2007.

represents a significant growth from 2003 when these parcel carriers handled 9.6% of the value of all shipments and express carriers handled as much as 2.4%.

2.2.3. *Impact of Industry purchases*

Industry purchases have a multiplicative economic effect. The U.S. Department of Commerce' s Bureau of Economic Analysis' s Regional Input-Output Modeling System (RIMS II) is the most widely accepted model of measuring economic impact of individual businesses. Using this model to examine the jobs impact of just four segments of the postal industry identifies 3,214,292 jobs above and beyond the jobs within the firms themselves.

Table 2: General Economic Effect of Selected Industries

Industry	Jobs in the Industry	Bureau of Economic Analysis Jobs Multiplier	Total Additional Jobs Created
Postal Service	737,112	1.465	1,079,869
Couriers and Messengers	434,400	1.005	436,572
Printing	596,623	2.472	1,474,852
Advertising	99,865	2.233	222,999
Total	1,854,288		3,214,292

Note: The multiplier reported by the Bureau of Economic Analysis calculates total jobs created by one job in an industry. This multiplier is reduced by 1 (one) in order to identify jobs outside of the industry.

2.3. HOW DEFINITION OF THE USO COULD AFFECT THE POSTAL SECTOR AND THE ECONOMY

To the extent that changes in the USO affect the ability of the Postal Service to remain a cost effective provider of hard-copy communications and parcel delivery services, then those changes can affect the viability of the Postal Service and therefore the viability of the postal sector. In particular, the Commission should be cognizant that:

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- 1.1. 8 table 1a. shipment characteristics by mode of transportation for the united states: 2002, http://www.bts.gov/publications/commodity_flow_survey/2002/united_states/html/table_01_a.html The estimate of the value of shipments here is substantially greater than the sales generated by mail advertising and the sales of non-store retailers and publishers that primarily use parcel carriers to delivery by mail.

⁹ The figure for air carriers includes air express carriers such as FedEx Express, UPS, DHL and USPS Express Mail.

- Mail is the primary means for many businesses to identify new leads, new customers, and draw business activity to their services, retail stores and websites.
- Given that mail is the most effective marketing tool for businesses that serve either a specialized market or a geographic market too small to be served by other electronic or print media, most of the firms that would be most affected will not be actively involved in this proceeding.
- To the extent that an overly expansive universal service obligation adds costs to the production of postal delivery services, these higher costs act like a tax on those industries and those activities that benefit from the infrastructure. Given the role of the Postal Service in generating and accommodating commercial activity, higher postal costs acts as a tax on the attempt of businesses to find customers, close sales, and distribute product.
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3. FOUR PRELIMINARY STEPS THAT MUST BE COMPLETED BEFORE BEGINNING STUDY OF THE USO AND THE MONOPOLY

In its request for comments, the PRC starts with postal law and how it appears to define universal service. However, the six characteristics that the PRC identified do not provide a context within which a working definition of universal service would make sense. Therefore, I believe that the PRC needs to focus on the following four topics prior to delving into the specific questions that it has posed in its request for comment. These topics are:

1. Who are the Postal Service' s customers?

The answer to this question provides a framework to measure the benefits, costs, and risks of policy change. The definition of customers has multiple dimensions. These dimensions include wholesale (bulk) vs. retail (single piece) customers and within these groups customers can be further be divided between those who send items at commercial rates or legislatively advantaged rates. Distinctions among wholesale customers also include those with local, regional and national distribution requirements.

In addition, to defining customers based on how they present their product to the Postal Service, customers are defined based on what they demand from the Postal Service. On a basic level, mailers demand delivery of items of different shape and size, currently categorized as letters, flats, parcels, and large parcels. Regardless of shape, the Postal Service' s customers demand one of two types of services. Most customers demand an as-soon-as-possible service tied to an expected elapsed time from tendering to delivery. Other customers demand a specified delivery date, although this demand is often met by a mailer tendering their mail on a specific date with an understanding that the expected elapsed delivery time will allow their product to be delivered on the specified date.

Finally, in understanding the postal service' s customers, some thought needs to be focused on the recipient. In doing so, the Commission needs to determine if the recipient' s needs are independent of thz of the sender' s. Iraddition, the Commission

needs to look at how the method of physical receipt of the mail has changed over time, the consistency of receipt location across both residential and business addresses, whether all receipt methods have the same level of security, and the differences in legal protections that exist between the receipt of mail and the receipt of other hard copy and electronic communication.

2. What are the characteristics of the mail items to be delivered and the business model of creating those items?

An understanding of the answer to this question is important for accurate modeling of the potential for inter-modal and intra-modal competition. The characteristics of the item to be delivered often determines who is capable of creating the particular item and if additional mail preparation is necessary to minimize delivery costs. An item's characteristics include the physical qualities of the mail piece, the address and barcode qualities, the quantity to be tendered in an individual mailing, delivery date requirements, and the timing of when the mail would be tendered to the Postal Service. The business model of creating mail items describes the competitive structure of the mail creation market(s) and therefore provides guidance as to how the market for creating mail would affect inter-modal and intra-modal competition today and under changes in universal service and postal monopoly scenarios.

3. How do social obligations and legal restrictions affecting Postal Service operations, pricing, and product innovation affect the cost of the USO?

In establishing postal law, Congress placed significant social obligations that increase costs and reduce revenues that a rational competitive business would not undertake. Any economic model used to estimate the cost of the USO should explicitly identify the social obligation costs that are modeled and those that are excluded. For those social obligations that are not modeled, the economic analysis should at a minimum identify why they are excluded and an estimate of how these obligations could affect the universal service obligation costs as defined by the model.

4. What are the legal service obligations of Postal Service competitors?

Postal Service competitors in the United States have legal obligations to their customers that in many respects have characteristics similar to those that the Commission identifies as potentially part of a Universal Service Obligation. As there is a substantial body of law dating relating to the obligations of transportation companies that dates back over 100 years, this creates the opportunity to set an obligation for the Postal Service that already has legal precedents and puts the Postal Service on a level playing field with many of its competitors.¹⁰

¹⁰ While the Postal Service has competitors that are not express and parcel carriers, the legal obligations of these carriers are less clear. The obligations noted in this section generally apply to transportation companies and land line telecommunications firms. Those firms providing services that permit the delivery of content over the internet either in the form of e-mail, attachments to e-mail, or within web pages do not currently have the obligations noted here. It is not clear what legal obligations firms that provide services that prepare and transport mail prior to it being tendered to the Postal Service have.

The next few sections of these comments provide a more detailed examination of these four questions.

4. WHO ARE THE POSTAL SERVICE' S CUSTOMERS

The question as to who are the customers of the Postal Service is important in setting the framework for understanding the postal market and evaluating both policy and economic issues associated with the universal service obligation and the mail. Identifying the Postal Service' s customers will help identify to whom the Postal Service has obligations. The focus of this section is to provide hard data on who the customers of the Postal Service are today and in the future and provide an understanding as to how the customer mix affects questions regarding universal service requirements and other policy issues

4.1. IS THE CUSTOMER THE SENDER OR THE RECEIVER?

All network industries have both senders and receivers. In all of them, the customer is the purchaser of the service provided by the network. Depending on the nature of the network, the customer can be the sender, the receiver or both.¹¹ Legislative and regulatory policy is heavily determined by questions of access to the network by whether the sender or recipient is the primary customer of the network. Usually, but not always the network' s customer is the party that places the higher value on what the network handles or purchases the product that the network transports or transmits.

For example, in the provision of electricity transmission and natural gas transportation services, the customer is the purchaser of the electricity or natural gas. While access to the network is required in order for the generator of electricity or provider of natural gas to sell their product, they have traditionally not been charged a fee to access the network and thereby sell their product. Furthermore, the reliable billing system that exists for the ultimate consumer allows the firm that delivers the product to reliably collect from the ultimate consumer both the charge for energy service purchased and the transportation/transmission of the service from the power plant to the customer. Depending on the size of the customer, they may chose the provider of the power purchased, the network path employed to deliver the power, and even the distribution connection to their location¹² More recently, the business of producing electricity and its transmission and delivery were broken into separate markets. In this model, the relationship between the generator of electricity and the recipient of the electric power remains unchanged and the receiver and buyer remains the customer.

Telecommunications and the internet represent an example of a network where both the sender and recipients are in fact customers of the network. These networks charge both senders and receivers to access the network. Landline users are charged fees for access to the network and may be charged message unit or per-minute charges for each call they make with rates varying depending on what part of the worldwide telecommunications network they use. Cellular phone customers pay charges for both incoming and outgoing calls with exceptions for incoming charges from selected

¹¹ Merriam Webster defines a customer as "one that purchases a commodity or service." Dictionary by Merriam Webster AOL.

¹² In fact unregulated propane and fuel oil delivery provides the clearest example of why the customer of power is the recipient as the user of the propane or fuel oil has to both arrange for the purchase and its delivery.

calls originated at numbers determined by the terms of the wireless contract. For internet services, customers are charged for monthly and in some cases hourly fees for access to the network. Charges, to senders of internet content, exist in two primary forms. First they are charged for access to the network, with charges based on the demand that they place on their local provider. Second, they are charged for web hosting with charges depending on how often recipients access the information they post on their websites.

In transportation services, the customer is the party paying the bill regardless of whether they are the sender or receiver. In all cases, the carrier, before carriage, knows the party responsible for payment; otherwise the service is not provided. Charges are made on an individual shipment basis and no network access charge is applied. Determining whether the sender or receiver is the actual customer of a transportation service depends on the agreement between the sender and recipient as to who is responsible for arranging transportation. Difficulties that air, motor, rail, and water carriers have had in collecting freight charges from low-volume recipients have caused carriers to demand that senders pay unless the purchaser of the goods transported has sufficient economic interest to influence the choice of transportation carrier and the carrier can trust the recipient to pay the transportation charges.

For the Postal Service, the party that pays the bill, and therefore the customer, is generally the sender of the mail, or purchaser of the counter service. The party that receives the mail pays for the service only in cases of parcel returns and business reply mail where the receiver sees an economic value in picking up the mail charges.¹³ As the customer in the mail market is usually the sender, the customer in the mail market is most similar to the customer in markets for transportation services and less similar to customers in power and telecommunications markets where the recipient of the item transported is the customer.

The sender's role as customer in the mail market has existed since the creation of the penny post when Roland Hill first recognized that senders valued delivery of messages more than recipient valued their receipt and unless senders were charged for the service delivery would be regularly refused. The effort's of individual customers for removal from mailing lists of advertising mail suggests that the difference in the value of the mail to senders and recipients that influenced Roland Hill is still a characteristic of the mail market.¹⁴

4.2. THE RELEVANCE OF THE CUSTOMER IN DEFINING UNIVERSAL SERVICE

By tying universal service to the customer, one can link the obligation directly to a party that has an economic interest in the service that the Postal Service provides. By defining the sender as the customer, the universal service obligation for the service purchased can also be known to the party buying the service prior to the service being purchased. Also has the ability to challenge the Postal Service if it fails to meet its obligation.

A sender's interest in the service includes all activities of the Postal Service up and until the item is placed in a location where the recipient can collect it. To the extent that the location that the

¹³ The customer for free services, such as mail for the blind, is less clear as the sender may have an institutional interest in sending the mail, and the recipient clearly desires what is being sent.

¹⁴ In some instances, individuals have begun lobbying state legislatures to promote do-not-mail legislation that would make refusing mail even easier.

Postal Service uses as a delivery point increases the willingness of recipient to look at what the sender asked the Postal Service to deliver, then the delivery service becomes more valuable. Clearly delivery to a door is more valuable to the sender as it reduces the cost of recipient to retrieve his items increasing the likelihood that will be looked at and acted upon. However differences in delivery costs of door delivery and cluster box delivery relative to the difference in recipient willingness to look at the mail may be too great to justify delivery to the door.

By focusing on the customer, and more specifically the sender as customer, obligations to recipients become implicit in obligations to senders. This is not to say the recipients do not have a significant role in ensuring that the Postal Service meets its obligations to senders. By communicating satisfaction or displeasure with service, recipients can help the Postal Service improve its ability to offer a delivery service that offers delivery of hard-copy communications that will be read by the recipient and a parcel delivery service that provides secure delivery.

4.3. NON-HOUSEHOLD CUSTOMERS ARE THE PRINCIPAL SENDERS

Non-household customers send the vast majority of mail handled by the Postal Service. These customers include businesses, non-profit organizations, and federal, state and local governments. The Postal Service has reported that over the past decade and a half, non-household originating mail has remained at just under 90% of all mail sent. While mail has grown dramatically during that period, the differences in percentages associated with particular mail flows illustrates that mail has increasingly become a primary means for non-households to communicate and send parcels to households and for households to communicate back to these entities.

Table 3: Mail Flows of Domestic Mail

Percentage of Total Domestic Mail by Source and Destination			
	1987	2002	2007
Household to Household	4.8%	3.6%	2.7%
Household to Non-Household	6.4%	8.0%	6.7%
Household to Unknown	1.0%	1.0%	0.5%
Non-Household to Household	56.6%	66.1%	68.8%
Non-Household to Non-Household	30.9%	20.6%	20.0%
Unknown to Household	1.3%	0.7%	1.3%
Total	101.0%	100.0%	100.0%
Total Mail to Households	61.4%	69.7%	71.5%
Total Mail Sent by Non-Households	87.5%	86.7%	88.8%
Total Mail Sent to or from Non-Households	93.9%	94.7%	95.5%
Sources: USPS, <i>2003 Household Diary Study</i> , Table A1-1. USPS, <i>2007 Household Diary Study</i> , Table A1-1.			

Non-household originating mail is different than consumer mail in that most is intended to reach large number of recipients in a single mailing. Table 4 presents the division of mail sent by non-households.

Table 4: Mail Volume by Type in Fiscal Year 2007

Mail Type	Volume (million pieces)	Percentage
Single Piece Household	23,677	11%
Single Piece Non-household	19,373	9%
Bulk Non-household	168,351	80%
	211,401	100%

Source: RPW Fiscal Year 2007

Ninety percent of all mail sent by businesses use postal products that can only be sent in quantity. This represents 80% of all mail.

The economics of serving bulk senders of mail is different from that of serving single piece mailers. Bulk mailers are more knowledgeable of mail services, rates and service quality and therefore require a different acceptance and customer relationship mechanism than single piece customers. As bulk senders are far less numerous than single piece senders, the breadth of the network required to accept mail is less for bulk senders. To the extent that bulk senders require that mail be picked up at the point of origin, the volumes often are substantially larger than volumes that are regularly delivered and may require a specialized operation to transport the mail from the production facility to a postal facility.

Bulk mailers have substantially more economic interest to manage mail costs. The economic value of mail sent by bulk, non-household mailers comes from the type of mail that they send. Most of this mail is in the form of advertising including advertising contained in periodicals, which represents 71.3% of all mail delivered to households.¹⁵ Mail advertising generates sales of \$759.1 billion and collects millions in donations to non-profit organizations. Bills represent 12.4% of household mail.¹⁶ Timely delivery of bills has an economic value as their delivery drives payments and improves the cash flow of billers. Finally, the Postal Service handles parcels from mail order and internet retailers whose ability to attract repeat customers depends on the quality of the delivery service.

¹⁵ United States Postal Service, *The Household Diary Study: Mail Use and Attitudes, 2007*, Table A1-3.

¹⁶ Ibid.

Given the economic value of bulk mail, these mailers have invested in improving the knowledge and skills of their mailing departments in order to minimize mailing costs and maximize the service that they receive from the Postal Service. With this knowledge, bulk mailers have mastered complex tariffs and complicated mail preparation rules for the products that they send. Bulk mailers also have strong interests in changes in postal operations and constitute all of the members of the Mailer Technical Advisory Committee as either individual firms or mailer associations. Bulk mailers rapidly took advantage of the opening of upstream processing and transportation markets and now either perform those functions themselves or contract with third parties to perform those functions.

Bulk non-household mailers also differ from single piece mailers in that their mail creation process is often part of an automated printing and mail piece assembly process. In addition, much of what they send is sent with a predetermined production schedule, a required delivery date, or a required repetitive delivery schedule (e.g. daily, day of the week, day of the month, etc.). As such their mail can more easily allow the Postal Service and/or competitors to design production, transportation, and delivery networks to meet their requirements.

Bulk mailers are considered the most vulnerable to competitors if the postal delivery monopoly were eliminated. The cost of selling an alternative service is simpler as there are fewer purchasers that must be contacted. To the extent that those competitors can schedule their deliver days to meet the needs of mailers, they can draw customers more easily.

4.4. RETAIL CUSTOMERS

Retail customers are postal customers that purchase mail services a single letter or parcel at a time. Retail customers use First Class, Priority Mail, Express Mail, Parcel Post, International Mail and all of the Postal Service's special services. Retail customers also rent mail boxes. Retail customers are an important but declining market. In 2007, they generated 20% of postal volume and 42% of postal revenue.¹⁷ This is a significant decline from 2001 when retail customers generated 28% of postal volume and 51% of postal revenue.¹⁸ These figures overestimate the importance of the retail market as they assume that all Express, Priority, Mailgram, Parcel, and International volumes are tendered one piece at a time. These figures also assume that all special services are purchased as individual transactions.

The Postal Service's retail customers are primarily household customers. In 2007, household sent 55% of single piece First Class mail which is an increase from 51% in 2002.

Regardless of whether the single piece customer is a business or an individual, the retail customer has certain needs that are similar to bulk business customers. In particular, given the number of retail customers, they, as a group, need the Postal Service to offer as broad a geographic scope of service as do bulk business customers.

Retail customers do have special needs that are distinct from those of bulk customers. Retail customers require:

¹⁷ Calculated from the 2007 fiscal year Revenue Pieces, and Weight report

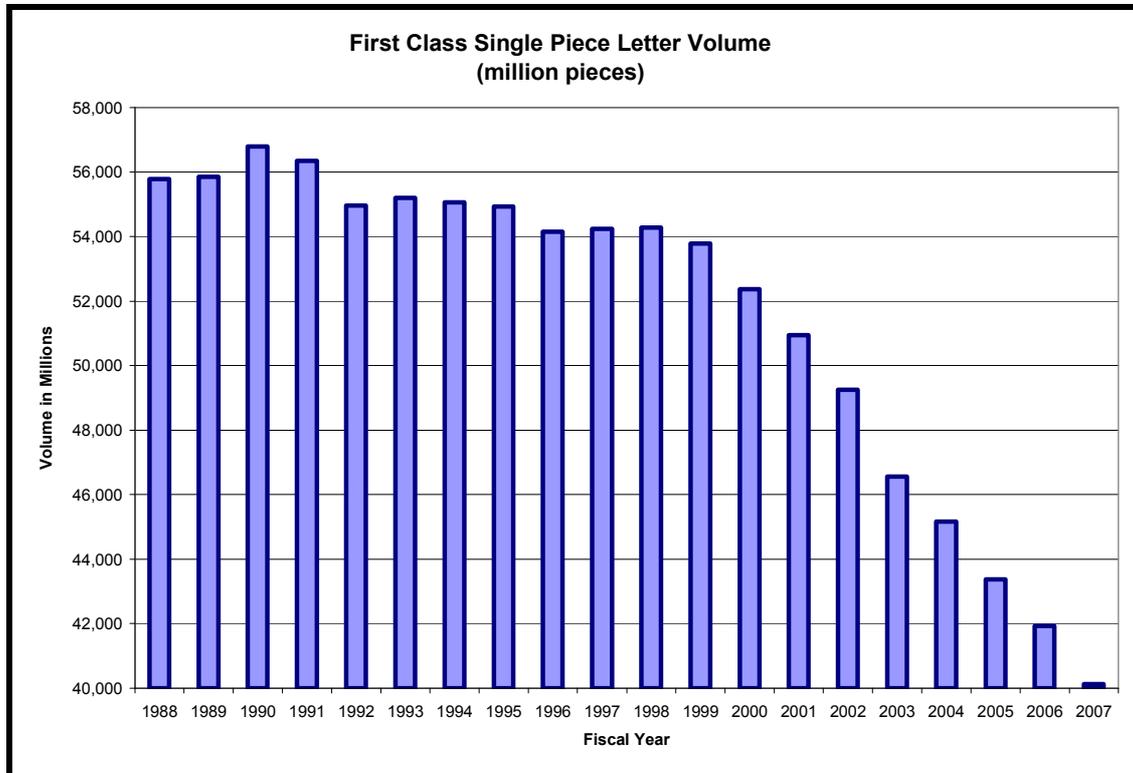
¹⁸ Calculated from the 2001 fiscal year Revenue, Pieces and Weight report

- Convenient access points from which to purchase services and postage;
- Convenient points to tender mail and parcels to the Postal Service;
- A simple means of accessing a postal services – one stop shopping for delivery to all points;
- A clear understanding of the service quality offered by the various products;
- Payment terms comparable to that offered by other merchants; and
- A pricing scheme with a level of complexity similar to that employed by other carriers and/or the purchase of other low priced items.

The primary difference between retail customers and bulk business customers is in the nature and cost of the transaction and handling of the mail. Retail transactions involve the handling of single pieces. As such, each piece must be individually weighed and postage sold and checked. Even retail customer mail that is not tendered to the Postal Service at the same time that postage is sold has more costs associated with sale of postage and the collection of mail pieces at delivery points, collection boxes or post offices. Finally, retail mail customers require more transportation and mail processing effort by the Postal Service than wholesale mail. Some of this is due to the fact that the mail is collected and must go through facing, cancelling, and outgoing sortation processes that are not usually performed with wholesale mail. Additional cost costs from the fact that retail mail is less likely to adhere to address and mail piece standards that automation handles easily.¹⁹

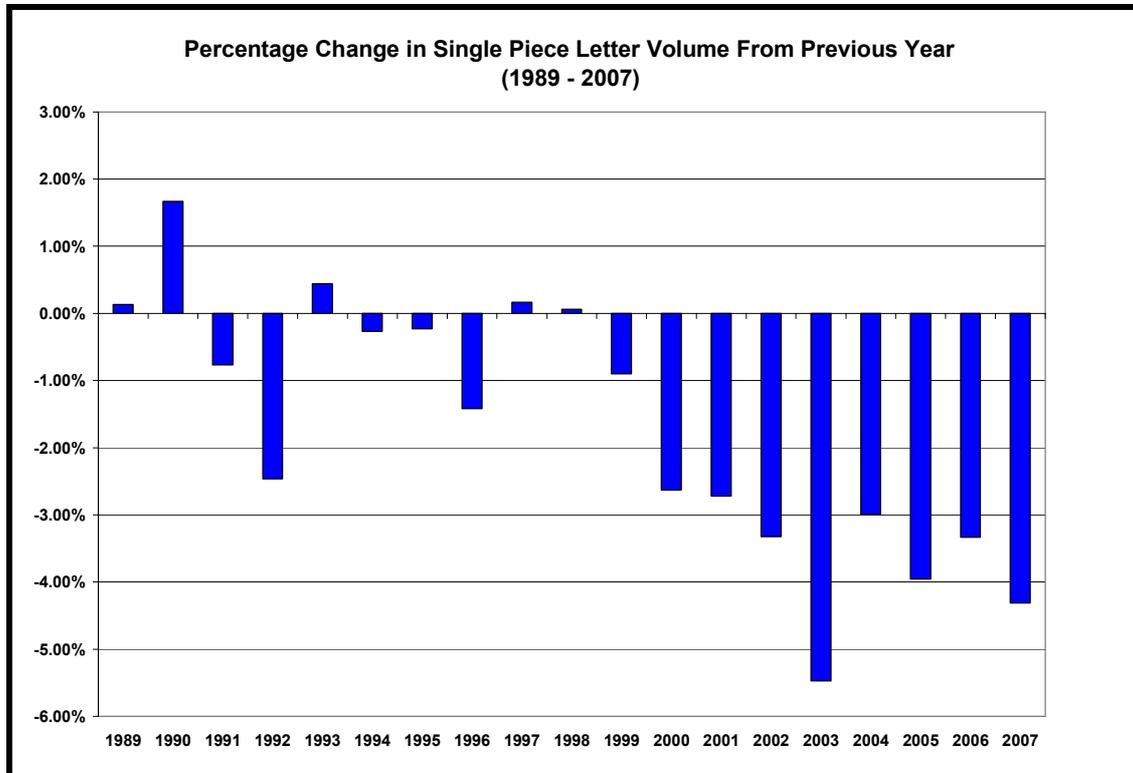
A significant challenge in serving retail customers is that the retail postal market is a market in rapid decline. The decline of the retail market is most notable by looking at the most important retail product, single-piece letter mail. Single-piece letter mail generates 64% of all retail revenue and an even larger percentage of single-piece volume. This product has experienced a consistent decline since 1999 as illustrated in Figure 1.

¹⁹ For a more complete description of the extra costs associated with serving retail customers see Haldi, John and John T. Schmidt. 2000. “Controlling Postal Retail Transaction Costs and Improving Customer Access to Postal Products,” published in *Current Directions In Postal Reform*, edited by Michael A. Crew and Paul R Kleindorfer Boston, MA. Kluwer Academic Publishers

Figure 1: Single Piece 1st Class Letter Volume

Source: RPW FY 1988 through FY2007

What is even more troubling about this market is the pace of decline. Figure 2 illustrates the year over year change in single piece letter volume. As this figure shows, the rate of decline has been increasing throughout this period. While a number of internet application and broadband access explanations may describe why the decline in single piece letter mail is accelerating, just knowing that the Postal Service's retail customer market is in decline is critical in looking at the question of what the universal service obligation should be for these customers. As retail customers are the primary users of post offices, an increasingly negative business trend in that market raises red flags about the future viability of the Postal Service's retail network. It also suggests that the Postal Service may have the opportunity to use the processing and transportation capacity freed up from serving retail customers to compete with the private sector in providing upstream activities.

Figure 2: Illustration of the Rate of Decline of Single Piece Letter Volume

Source: RPW FY 1988 through FY2007

4.5. DEVELOPING A CUSTOMER FOCUSED UNIVERSAL SERVICE OBLIGATION

This section has illustrated a number of key factors that should influence how postal policy is defined and implemented. In particular this section has shown that:

- The Postal Service' s customers are the senders of the mail. While recipient' have an interest in how mail is received, the sender' s economic interests drives decisions about the geographic scope of services demanded, the frequency of delivery, and the timeliness of delivery.
- Senders have a real need for delivery to every American address. Mailers, whether bulk or individual, have the need to send to a broad set of addresses. Combined, the community of mailers creates the demand for a delivery service capable of delivering to every address. As such, universal service becomes a business imperative to serve postal customers. The recent success of Airborne and FedEx in challenging the dominance of UPS' s nationwide ground delivery network only occurred once those companies offered the service to every address in the continental United States.
- Senders have a real need for the Postal Service to treat recipients well. Given that the proportion of advertising content is high and growing, the value of the

delivery of mail is greater to the sender than the recipient. Keeping recipients happy, improves their willingness to accept the advertising.

- The Postal Service serves both wholesale or bulk business and retail customers. Postal policy should reflect the difference in sophistication and understanding of postal operations and costs between business and retail customers.
- The Postal Service's primary customers are business mailers and even households send most of their mail to business. As such, the Postal Service is primarily serves commercial needs.
- As a commercial service, demand will exist for universal delivery of mail as long as mail remains an economically viable means of communication and goods delivery.
- Retail, or single piece, customers have unique needs. These needs reflect the fact that these customers need a means of purchasing services and accessing the network that is more time consuming and costly than that offered to bulk customers.
- The retail market is declining creating challenges in setting service requirements for customers whose demand is falling.

5. MAIL CHARACTERISTICS AND MAIL CREATION

While mail characteristics affect the competitive options for both retail and wholesale markets, they have a more significant impact for customers whose mailing needs put them in the wholesale market. Regardless of the characteristics of mail pieces sent by mailers in the retail market, the mailer is responsible for making all decisions about how delivery will occur. This is true even for mail pieces, such as wedding invitations, that must be created and sometimes addressed by firms specializing in creating the particular type of mail. Also, given the number of retail mailers, time related characteristics create an almost random but potentially predictable profile of when the mail is to be tendered to the Postal Service and what part of the postal network will be employed.

For wholesale mailers, the physical and address characteristics can be identified through a series of dichotomies.²⁰ These include:

- Are the physical characteristics of the mail piece such that the sender has the capability to create the piece?
- Does the mail piece require special printing equipment to create a specified look that limits the firms that can do the printing?

²⁰ Clearly, there are additional mailing specific characteristics that affect competition including the volume of mail within a particular mailing, the geographic area over which the mailing is to be delivered, the delivery density of mail pieces within that geographic area, and the distance between the mail production facility and geographic area where delivery is to be made.

- Does the mail piece require special binding, wrapping, or tabbing equipment that limit the vendors that can create the mail piece
- Is a barcode applied when the address is printed or not?
- Are mail piece addresses printed in a sequence meeting preparation requirements or not?
- If a mail piece is eligible for drop-ship discounts, can the entity that created the mail piece do all of the transportation necessary to gain the discount or not?

Given the answer to these questions, wholesale customers of the Postal Service will decide if they will create the mailing themselves, use an outside party to create and prepare the mailing, or use an outside party to code, sort or transport the mail to minimize delivery costs.

Over the past few years, concentration among vendors that print, prepare, and transport mail has increased even as volume has grown. In general, there is only one firm in all but the largest cities that provides pre-sort services. The number of printers capable of printing catalogs and magazines has shrunk through mergers to the point that three printers control most of this market. These larger printers have made significant investments in equipment that allow more personalization of catalogs and magazines that allow them to compete in markets for a broader range of advertising, bound periodicals and catalogs. Similarly, local and regional printing markets have become more concentrated. Finally, the number of firms that transport parcels to gain drop-ship discounts have shrunk to the point that divisions of United Parcel Service and FedEx nearly control this market.

As the market for mail creation has become more concentrated, models of the cost universal service and the risks of eliminating the monopoly should reflect the impact of this concentration. Clearly, if the number of potential customers is limited, then the cost of marketing to those customers would be limited and the potential reward of snagging a customer would be much greater. Furthermore, in a concentrated market of senders, a competitor may have greater opportunities to attract sufficient volumes in defined geographic areas to make a competitive service profitable outside party, the condition of the item upon the completion of the production process relative to preparation requirements of delivery carriers, and the location of production facility.

6. WHAT SOCIAL OBLIGATIONS AFFECT THE COST OF UNIVERSAL SERVICE?

Universal service is only one of many policy goals that Congress has set in developing postal law. Many of these policy goals reflect the origin of the Postal Service as a government department and like other government departments are designed to influence the behavior of both postal management and customers. Some these goals provide protections to employees, communities or advantaged customers. A recent Federal Trade Commission report examined the financial implications of all policy goals including universal service and concluded that postal law imposes a net cost to postal customers of between \$243 and \$713 million dollars.²¹

²¹ Federal Trade Commission, *Accounting for Laws That Apply Differently To the United States Postal Service and Its Competitors*, December, 2007, p.64.

The purpose of this section is not to identify all social obligations, but to point out that they need to be addressed. The most obvious of these social obligations that would affect the cost of universal delivery service and the financial impact of removing the monopoly are advantaged rates that exist for certain classes of mail that may not cover their incremental costs. It should be cautioned that some advantaged rates may make economic sense for the Postal Service as advertising has become an increasing share of the mail stream. Offering advantaged rates, for delivery of items of value to recipients makes recipients more willing to accept advertising that has more value to the sender than to the recipient.

Similarly restrictions on closing employee staffed post offices, the types of services and products that can be offered in a retail facility, pricing flexibility that includes offering non-uniform rates for wholesale mailers depending on delivery cost or regional competitive conditions, and management flexibility to manage labor and capital assets all can impact the results of economic models. All of these restrictions affect management's ability to react to changing market forces and intr-modal and inter-modal competition. To the extent that the Commission plans to use a multi-period iterative model to reflect actions by competitors and counter-actions by the Postal Service, restrictions on actions could have a significant impact on results.

7. WHAT OBLIGATIONS DO OTHER TRANSPORTATION COMPANIES HAVE?

Earlier in this memorandum, postal customers were identified as similar to customers of other transportation services, and in particular the customers of parcel and express carriers. Therefore, looking at the legal obligations of these carriers should put the question of what the universal service obligation of the Postal Service should be into a competitive context.²²

While economic regulation of most transportation services, were eliminated in the 1980's carriers offering interstate transportation still have licensing requirements. Carriers providing parcel-delivery service on the ground as a trucking company need only register with the United States Department of Transportation. In registering, the carrier must describe the services that they plan to provide, demonstrate financial fitness and pay a modest registration fee. Carriers providing both common and contract carrier services must file separate registrations for each type of service. No state or local licensing is required.

Parcel carriers offering transportation of parcels by air have similar registration requirements. Carriers can file as both a carrier and freight-forwarder and as a common and contract carrier. As an air carrier, the carrier handles the actual air transportation of the parcels as well as the incidental ground transportation. As a freight forwarder, the provider contracts for the actual air transportation. All of the national private-sector carriers providing parcel service in the United States

²² While the Postal Service has competitors that are not express and parcel carriers, the legal obligations of these carriers are less clear. The obligations noted in this section generally apply to transportation companies and land line telecommunications firms. Those firms providing services that permit the delivery of content over the internet either in the form of e-mail, attachments to e-mail, or within web pages do not currently have the obligations noted here. It is not clear what legal obligations firms that provide services that prepare and transport mail prior to it being tendered to the Postal Service have.

provide service under their carrier license. Some of their international services for all carriers are provided under freight forwarder licenses. As with ground parcel services, state and local governments are pre-empted from regulating entry or exit of air carriers and freight forwarders.

The legal obligations of the Postal Service' sinter-modal or intra-modal competitors depend greatly on whether the service the competitor offered is provided as a contract or common carrier. If the firm operates as a contract carrier, then its obligations are specified in its contracts with its customers. Enforcement of contracts is subject to standard contract law procedures and may be subject to state consumer protection and fraud statutes as well as the jurisdiction of the Federal Trade Commission in cases where stated obligations are deceptive. If the firm provides the service as a common carrier, then it has additional legal obligations that come from a long history of legal decisions regarding the special obligations of common carriers. Enforcement of common carrier obligations of DSL and dial-up providers is performed by the FCC. Responsibility for enforcing common carrier obligations of transportation firms is unclear. However, with the possible exception of air courier and express services, no Federal agency has jurisdiction and no state law applies to enforce these obligations.²³ Still these obligations are real, enforceable by court order, and based on legal precedent that pre-date the existence of all Federal economic regulatory agencies. As these obligations reflect the obligations of competitors, and have similarities to potential concepts of universal service they need to be considered along with universal service frameworks employed in other postal administrations and telecommunications firms.

Most of the Postal Service' s transportation competitors offer their services as common carriers. As such, they promise to provide service specified under their license and the terms specified in the carrier' s tariff with reasonable dispatch. The term "reasonable dispatch" generally means that the carrier will provide the services that it advertises. Courts have determined that a carrier providing service under "reasonable dispatch" must provide the transportation service to all customers within the "normal time in transit for a similarly situated shipment." If a carrier offers an advertised schedule, or detailed description of services offered and origins and destinations served, the schedule acts as prima facie evidence of providing service under reasonable dispatch. By operating as common carriers, the private sector carriers have an obligation to not discriminate among similarly situated customers.

All of the private carriers provide detailed descriptions of their advertised services in their published tariffs, on websites and in published service guides that include promised delivery times from all origins. These schedules include all points within the continental United States. The number of points identified in the service guide within Hawaii and Alaska vary from carrier to carrier.

The carrier's reasonable dispatch requirement allows the carrier to provide different levels of service to different areas. For examples, next day delivery services to remote rural areas often have later guaranteed delivery times than what is offered in other areas. Carriers can charge shippers different prices depending on the delivery point as well, so to reflect cost differences some private sector carriers charge higher rates to delivery to household address than they charge to business addresses and charge more for delivery to rural areas.

²³ The Surface Transportation Board has the responsibility for enforcing the common carrier obligations of railroads but not motor carriers of freight or passengers. The Surface Transportation Board is currently exercising its authority through the following proceeding:

Significant differences exist among carriers regarding the service quality that private sector carriers promise to provide under their common carrier obligation depending on the shipment's origin and destination. As individual carriers networks are different, the specific service obligations (delivery times) vary slightly between carriers depending on the shipment origin and destination.

The common carrier obligation has characteristics similar those identified by the Commission as pertaining to the Universal Service Obligation. Specifically, the similar features are as follows:

Geographic Scope – All three national carriers, DHL, FedEx, and UPS hold themselves out to deliver to all addresses in the United States. Regional carriers and local couriers, such as Eastern Connection, specify more limited geographic areas within which they promise to deliver to all addresses.

Range of Product Offerings – All carriers provide both written and web accessible tariffs to their customers. All products identified in their tariff are covered by the common carrier obligation. For the large parcel carriers this includes all services that they advertise to the general public. Carriers do limit certain products to geographic areas where their network goes. For example, carriers do not offer ground delivery of parcels to addresses that require transport by air.

Access to Postal Facilities and Services – Carriers offer access to their services to all customers willing to pay the appropriate rate. Facilities and drop boxes that accept packages and documents for delivery to all customers that seek their services. Companies that require pick-up of parcels for delivery can schedule a pick-up at all addresses within the United States. Carriers have no requirements that they provide access to retail customers at any level of convenience. However, carriers have made a great effort to make their services accessible to both retail and wholesale customers. For example, United Parcel Service has over 8,000 retail access points in company franchised locations, and office supply stores, and thousands more locations that are either independent or franchises of other retail mail stores. Other carriers have similar but less extensive retail networks.

Frequency of Delivery – Carriers promise to deliver items requiring delivery to most addresses on all working days which are Monday through Friday excluding a limited number of Federal Holidays. To a limited extent these carriers also offer Saturday delivery but at an extra charge.²⁴ As the obligation is to the sender, the frequency of delivery depends on whether a particular recipient has items that need to be delivered. As their delivery commitments are set to transit time, delivery frequency is dependent upon the volume of items being sent to a particular recipient and when the senders shipped the items to be delivered.

Rates and Affordability – The common carrier obligation regarding rates only requires that the carrier charge all similarly situated customers provided service as a common carrier the same rate. As such carriers have substantial flexibility in setting rates as a common carrier as long as all similarly situated customers have access to those rates. To the extent that a carrier wants to offer a rate to a specific customer based on the transportation profile of the shipments that the customer plans to ship over time, then the carrier usually offers that service under a contract with the shipper. However, given that no two customers have the same profile of origins, destinations, shipment

²⁴ Private sector carriers have traditionally not delivered on Saturdays as most businesses are not set up to accept parcels on Saturdays.

frequency distributions, and shipment size distributions, such a rate technically would likely be permissible under a carrier's common carrier authority.

Parcel carriers do offer different rates for customers that have an account with carrier and those that do not. As these are both tariff rates, they are both common carrier rates. Discounted volume-based rates, which are not published, are contract rates.

Quality of Service – All carriers have time based service commitments. For most shipments, these service commitments now include money back guarantees. In addition, carriers have commitments for picking-up parcels as part of their common carrier obligation. As the carrier's obligation to provide service is defined as providing "the transportation or service on reasonable request," the specification of pick-up and delivery requirements and limitations are presented to the customer prior to the customer's commitment to purchase the service.

As this brief description shows, the common carrier obligation may be sufficient to meet the needs of most mailers. The commitments of the private sector carriers have three differences from what is often discussed in a postal context.

First, carriers do not commit to delivery on Saturday at the same rate as delivery on other days. Parcel carriers exclude Saturdays because no one is available to accept delivery at most of their delivery addresses. As the Postal Service serves primarily households and do not require signatures upon delivery, they do not have this problem. In fact, senders of weekly magazines and advertising circulars may prefer Saturday delivery. Therefore, it would make sense for the Postal Service to offer a public commitment to Saturday delivery to meet the needs of its customers.

Second, private sector carriers have money back guarantees for most of their services. The Postal Service only offers such a guarantee for Express Mail. Traditionally, transportation companies did not offer money-back guarantees on their products. While service may have been reliable, carriers had no way of knowing the risk of paying claims on the guarantee. However, improvements in shipment tracking technologies that allowed carriers to measure the risk, and competition from new entrants that offered such guarantees have made such guarantees standard parts of the obligation of private sector carriers. As the Postal Service expands the use of the intelligent bar code and improves the consistency of its delivery service, it could expand its legal obligation to include such a guarantee for service quality either as part of standard tariff or at an extra cost.

Third, private sector carriers have no legal obligation to offer a specific level of access to their network for retail customers. While they try to make their services available to as many retail customers as possible their ability to serve the most rural or economically depressed area depends on the willingness of entrepreneurs to offer retail shipping services. The Postal Service does not have a specific requirement to offer retail access at any particular level either. However, it faces significant challenges in trying to switch its retail access model from one using employees to one using entrepreneurs and contractors that the private sector carriers do not face.

8. FRAMEWORK FOR A CUSTOMER FOCUSED USO

In general, I believe that the framework of a Universal Service Obligation should be customer focused. As such it should:

- Be an obligation to the Postal Service's customers, who are the senders of mail;
- Be set at levels that are economically tenable;
- Be enforceable in a manner that would require the Postal Service to meet its commitments by either improving service or improving its transparency about what its true capabilities are,
- Be publicly known to all senders for all products;
- Be flexible to reflect the needs of customers of specific products in a manner that obligations may not be identical for all products;
- Be flexible to reflect different needs of retail and wholesale customers; and
- Be flexible to reflect changing market conditions.

9. COMMENTS ON THE COMMISSION'S QUESTION:

In this section, I include some brief remarks on the Commission's topics not covered in previous sections of this memorandum. The goal of these comments is to highlight analytical issues that affect the topics of interest.

9.1. UNIVERSAL SERVICE AND GEOGRAPHIC SCOPE

The Universal Service Obligation should reflect the needs of all customers of a product subject to such an obligation. To the extent that customers of any postal product require delivery to all potential delivery points nationwide, then the obligation of the Postal Service to the customers of that product should reflect that need. If a postal product serves customers with a more limited geographic scope, then the obligation should reflect that scope.

The geographic scope of an obligation should be independent of service quality obligations that are tied to a particular product. For example, the Postal Service could have an obligation for a product to deliver to all points nationwide, but not be obligated to deliver to all points in the same number of days.

9.2. UNIVERSAL SERVICE AND RANGE OF PRODUCT OFFERINGS

A customer focused USO has an obligation to the customers of postal products. As such the Postal Service should have an obligation to all customers regardless of the product that they use. The existence of obligations for all products does not require that the obligation be identical across products, only that the obligation be appropriate for the customers of that product. The Commission needs to be cautious in setting a fixed obligation for individual products unless it has a mechanism to change those obligations to reflect changes in the needs of that product's customers.

For products handling parcels, regardless of whether they are subject to price caps, the Postal Service' s obligation should be similar in scope to that which DHL, FedEx, and United Parcel Service now have for their express and ground services. The growth of the market for parcel and express delivery has shown that this obligation has been acceptable to both business and consumer express and parcel delivery customers. Without compelling evidence that the Postal Service' s competitive and regulated parcel and express customers require obligations greater than that required of private sector carriers, then those obligations should be considered sufficient.

Given that the inter-modal and intra-modal competition that many of the Postal Service' s other products face is constantly evolving, the Commission should look seriously as to whether the obligations found for transportation common carriers to their customers are sufficient for the Postal Service.

9.3. UNIVERSAL SERVICE AND ACCESS²⁵

As noted earlier in this memorandum, the Postal Service serves two different types of customers that have very different requirements in terms of access to the delivery network. As such any access requirements associated with a customer should reflect whether the product that they are purchasing is wholesale or retail product.

In general the question of access should reflect the principle that similarly situated customers should have similar levels of access. As such, the type of access obligations set for wholesale customers would be different than for retail customers. In general, issues of access for wholesale customers reflect the postal operating network and probably do not need to go beyond access obligation that may exist for common carriers.

The question of access for retail customers is more difficult. Currently, the universal service obligation that the Postal Service has does not require identical levels of access for all retail customers. Postal retail outlets serving rural communities offer limited hours while outlets in urban and suburban locations are open during normal business hours, Saturdays, and Sundays during the holiday season. While a rural post office may provide a sense of identity to a community, the limited hours in rural areas severely limit the access that rural customers have to postal services as compared to customers in more urbanized areas. Furthermore, the Postal Service is not constrained in terms of how it must deliver retail services. It can allow other businesses including Hallmark stores, commercial mail receiving agents, and supermarkets to sell postal services. The Postal Service is constrained in allowing its contract stations to offer some parcel services due to security regulations.

Setting a specific universal service requirement for retail access is particularly difficult given the financial challenge of serving retail customers and the constraints that postal law has placed on the Postal Service offering non-postal products. These challenges can be seen in how both private sector United States carriers and foreign postal administrations have attempted to maximize their retail customer' s access to their networks.

²⁵ In its discussion memorandum that accompanied Order No.71, the section on access includes a number of questions on delivery. (See: Appendix A *Discussion Memorandum for Use in Preparing Comments on Universal Postal Service and the Postal Monopoly Laws*, p. 14) As a customer focused obligation is an obligation to the sender, and senders are expected to require a carrier capable of delivery to all possible addresses then delivery is not an access question. To the extent that the postal Service has an obligation to the recipient to deliver in a specific manner it is a social obligation of the Postal Service and it should be recognized as such.

In the United States, all three of the larger private sector carriers have stand alone retail outlets only in largest urban areas and at their distribution hubs. Otherwise, they use a mix of access options all of which have as their primary business services other than acceptance of parcels and express items. All private sector carriers have access to thousands of independent private mail receiving agencies who sell the delivery services of all commercial carriers who generate the majority of their revenue through products and services other than selling delivery services. UPS has at least 3,000 “UPS Store” branded franchisees that offer a host of mailbox, packing, copying, and office services in addition to selling a limited selection of office supplies. UPS also has counters in more than 2,000 Office Depot and Staples stores. DHL has counters in Office Max stores. FedEx offers its services through its company owned FedEx Kinkos (soon to be FedEx Office stores).

Even though these carriers have attempted to lower the cost of retail access by offering access in locations that can spread overhead and labor costs across multiple products and services, private sector carriers have found offering retail access a challenge to profitability. All private carriers charge retail customers that do not have a corporate account a higher rate than they charge other customers. United Parcel Service has faced challenges from its franchisees indicating that payments to franchisees may not be sufficient to make the franchise profitable. FedEx has indicated in its recent reports that the profitability of its FedEx Kinko’s outlets may not be up to their expectations.

Foreign postal administrations use a range of methods to economically ensure access for retail customers. In Europe and South Asia, postal retail facilities provide banking services, insurance services and other business that exploit the real estate and labor assets available. In addition, European postal operators have taken advantage of franchise and contract operations when they are available. Canada Post franchised a substantial number of retail locations in drug store chains in addition to its employee-staffed post offices which offer traditional mail services along with a limited number of office supplies and services.

Efforts to define the postal operator’s obligation to provide retail access has focused on geographic availability i.e. distance, of mail drop boxes and retail counter locations. For example, the German Postal Law specifies that the Deutsche Post must maintain 12,000 retail branches. The laws do not specify how the retail access is to be provided nor do they restrict the types of services that the postal administration can offer in addition to postal services in its retail locations.

The United States Postal Service does not have a history offering banking or most other non-delivery services that foreign posts offer. It offers only postal services and a limited number of non-postal services (phone cards, money orders, and packing material) at its retail outlets. The Postal Service has frequently demonstrated that many small rural post offices with a dedicated “postal only” market activity are uneconomic even if costs are held down by restricting hours of operation. The challenge of generating revenue in retail locations with limited sales is exacerbated by the decline in the retail mail market.

9.4. UNIVERSAL SERVICE AND FLEXIBLE DELIVERY METHODS

Much confusion exists around the terms “universal service” and “uniform service.” The Postal Service now offers its mailers delivery to every address in the United States. However, the Postal Service does not promise that the delivery process nor delivery quality is uniform across the Postal Service’s network.

The Postal Service uses multiple methods to deliver regular mail.²⁶ The various mechanisms that the Postal Service uses to deliver mail reflect its attempt to employ the most cost-efficient delivery method for geographic area to be served. For more rural areas, the Postal Service employs lower cost delivery methods in order to counter the lower geographic density that make rural delivery more expensive. Over half of all addresses are delivered using city carriers, members of the National Association of Letter Carriers. In rural and ex-urban areas the Postal Service uses rural carriers. In other rural areas, the Postal Service uses contract drivers to deliver mail. Most of these drivers are members of the Star Route Association. Using contractors to deliver mail to rural areas goes back to the origins of rural delivery. In some of the most rural sections of the United States, the Postal Service requires customers to use Post Office Boxes and does not offer door or neighborhood delivery at all.

The Postal Service serves seven types of delivery points to reach every postal customer: 1) a mailroom or reception area of an office; 2) a box or mail slot at the door; 3) a mail box on the curb in front of the delivery point; 4) an individual mail box clustered with other boxes on the curbside of a road; 5) a specifically designed cluster box serving multiple postal patrons that is set in a common area; 6) mailboxes within Post Offices provide free of charge where route delivery is not available; and 7) mailboxes within Post Offices rented by customers. Customers also have the option of using the service of a private mailbox, but from the Postal Service's perspective, such delivery locations are just like delivery to a mailroom or reception area in an office. The differences in the nature of the delivery point illustrates that not all recipients receive the same quality of service from the Postal Service.

The current universal service requirement does not require that mail be delivered six days a week. The current delivery schedule reflects operational and market imperatives and not a legislative mandate. While the Postal Service does deliver to most addresses six-days a week there are two important exceptions. First, the business addresses that do not use mailboxes or P.O. Boxes do not receive 6 days a week delivery because the recipient is only available to accept mail 5 days a week. The recipient has made the determination that delivery 5 days a week is sufficient. Second, the Postal Service does not stop at any address where there is no mail to deliver. While mail volume is sufficient today to cause 6 day a week delivery to most addresses, neighborhoods with lower mail volumes may see less than 6 day a week delivery to some addresses. This mostly affects mailers' attempts to use their mailbox as a collection point because the Postal Service is unlikely to pick mail up from that box if there is no mail to be delivered to it.

9.5. UNIVERSAL SERVICE AND QUALITY

Finally, universal service is not uniform in regard to the mailer's experience either. The Postal Service is just beginning the process of introducing modern, measurable service standards for most mail delivery products. The ability of the Postal Service and mailers to measure service quality is expected to improve as service quality improves. To date, the Postal Service has published First Class service quality commitments that show improving service quality but also service quality that varies depending on geographic area and the distance that the First Class mail travels. Service quality measures developed by mailers also show inconsistency in service across geographic regions and

²⁶ The Postal Service uses similar methods to deliver Express Mail and large parcels that may be delivered independently of the normal daily delivery service. Customers can also choose to have mail delivered to a Post Office as General Delivery or through the purchase of mailboxes.

between products using the same portions of the postal network. As time goes by, the expectation is that the new measurable service standards will result in more consistent service and more transparency as to what consistent service quality is achievable within the existing network.

As there is no expectation currently that mailers require guaranteed service for all delivery products, a delivery service component of a universal service obligation need be somewhat loose. Given that the Postal Service's ability to meet service commitments is similar to what parcel carriers had prior to the introduction of service guarantees, it would appear that a service commitment similar to what exists under the reasonable dispatch commitment of the common carrier obligation may be sufficient to provide customers with an understanding of the full extent of the Postal Service's service quality commitment.

9.6. UNIVERSAL SERVICE AND UNIFORM PRICING

Postal authorities have long chosen to charge a uniform price for their services, a feature that has its historical origins not in any USO requirement but in "postal efficiency". The famous Rowland Hill determined that, with the sophistication of early 1800s a uniform price would "reduce the overall cost of delivering the mail through lowering labor costs."²⁷ Hill's innovation engendered "penny post."

To the extent that arguments are made today that universal service requires uniformity in price, arguments are made that a complex tariff would be 1) disadvantageous to those either sending to or from areas of a country that are more costly to serve, 2) too complex for the average residential or small business mail user to comprehend or 3) necessary to allow for cross-subsidies between high and low cost customers of the same product in order to keep postal services viable for high-cost operating areas.

"...where the costs associated with collection and delivery in different parts of the country are averaged out, which means that people living in high cost (e.g. remote) areas are not disadvantaged and it also avoids the need for a complicated matrix of multiple prices which would have to be intelligible to and operated by the average user."²⁸

For the 80% of all mail that is tendered in bulk, mailers face not a uniform but a fairly complex tariff. Rates vary based on content, weight, distance, shape, degree of sortation, location where the mail is tendered to the Postal Service and other factors. For these customers, rates are uniform only to the extent that the Postal Service has not further segmented its markets through identification of cost and demand differences. The Postal Service offers the most uniform tariff only to those customers that send the 20% of all mail that is entered into the system one piece at a time. For these customers, a geographically uniform tariff is used only for single piece First Class mail and minimum weight Express and certain flat-rate Priority Mail items.²⁹ All other retail products are offered using

²⁷ See: Rawnsley and Lazar. 1997. "Managing the Universal Service Obligation." *IrEmerging Competition in Postal and Delivery Services*, edited by Crew and Kleindorfer. Boston, MA: Kluwer Academic Publishers

²⁸ See: Agar & Reay. 1997. "Postal Pipeline Liberalization: The Beginning of the End for the Uniform Tariff." *IrEmerging Competition in Postal and Delivery Services*, edited by Crew and Kleindorfer. Boston, MA: Kluwer Academic Publishers

²⁹ In addition all mail for higher priced Parcel Post, Priority Mail and Express Mail are handled using non-uniform tariffs.

a tariff that varies based on distance and weight. The tariff is somewhat uniform in that shipments of the same weight being shipped the same distance will be charged the same rate regardless of where the origin and destination is.

Private sector parcel and express carriers that offer service to every United States delivery address use an even more complex tariff for both their retail and bulk shipping customers. Their tariff includes, in addition to weight and distance based components, factors associated with specific geographic origins and destinations, rural locations and home delivery. By including these factors, private sector carriers can charge rates more reflective of costs associated with delivering to points that are distant from each other or points where customers are rarely home. The private sector carriers have continually reduced rate uniformity as their information systems have generated greater detail on the costs associated with individual customers and/or delivery points. By decreasing rate uniformity, private sector carriers have been able to offer a more universal service without creating an overly complex business transaction.

Both retail and bulk customers of the private sector carriers are capable of handling the complexity of “customer” specific rates that private sector carriers can offer. These carriers’ websites and retail locations can easily identify the price of sending parcels to any location in the United States. For bulk or larger scale customers, private sector carriers have created specific rate charts tailored to the specific distribution patterns of individual customers.

The Postal Service has not followed private sector carriers in offering even more shipment and customer specific rates. Whatever the reason the Postal Service has chosen to offer more uniform rates, it places itself at a competitive disadvantage by doing so. A strict adherence to uniform rates, when not required by law reduces the ability of the Postal Service to compete and encourages cream-skimming. Under its current pricing strategy, the Postal Service is at a disadvantage in low cost markets, while leaving it to serve the higher cost markets. Crew and Kleindorfer have noted that the Postal Service must fully employ non-uniform rates just like its competitors if it is to continue to have customers in competitive markets.³⁰

This conflict between universal service and uniform prices has been noted in countries where competition has expanded. Uniform rate restrictions have been loosened and the incumbent post granted more freedom to price competitively. Otherwise, the new entrants would take all of the market for serving “low-cost” customers, significantly reducing the volumes handled by the incumbent post.

9.7. THE LIMITS OF THE MAILBOX MONOPOLY

In looking at the impact of the mailbox monopoly, the Commission should note the limits of that monopoly. The mailbox monopoly only applies to addresses that have mailboxes. This excludes most business addresses within the United States where mail is or can be delivered without

³⁰ Crew, Michael A. and Paul R. Kleindorfer. 2002. “Putty-Putty, Putty-Clay or Humpty-Dumpty? Universal Service Under Entry.” In *Postal and Delivery Services: Pricing, Productivity, Regulation and Strategy*, edited by M.A. Crew and P.R. Kleindorfer. Boston, MA. Kluwer Academic Publishers

accessing a mailbox. As such, the mailbox monopoly has only limited impact on the 20% of mail sent between businesses as this mail is not delivered to a location with a mailbox.

The limited advantages of the mailbox monopoly are further identified when looking at the parcel markets that the Postal Service serves. The Postal Service is a dominant competitor in transporting parcels only for the sub-market of parcels that can fit into a mailbox, those parcels weighing less than 2 pounds.³¹ Within the sub-market of delivering parcels greater than 2 pounds, UPS and FedEx dominate. Furthermore, businesses use the Postal Service primarily to deliver to households, as about two thirds of Postal Service parcel deliveries are to households.³² Businesses use competitors to deliver to other businesses as over 80% of all of the volume of private sector carriers is delivered to a business.³³

10. CONCLUSION

Specifying a new universal Service Obligation for the Postal Service is a challenging proposition. This memorandum highlights some of the background necessary to develop a customer focused Universal Service Obligation and how a customer focused approach would be applied to a number of the topics that the Commission raised.

If there is one thought that the reader should draw from this memorandum, it is the importance of the customer in discussing the Universal Service Obligation. Without customers, there would be no mail to be delivered and any plan to set obligations that drives away customers would be counter productive. Also, the Postal Service is now primarily a provider of service to non-household customers who send quantities of mail in each mailing. The Postal Service's reliance on this segment of the mail market will continue to grow as the number of retail customers, particularly customers that send documents are shrinking at an increasing rate. Therefore, to the extent that a Universal Service Obligation sets costly requirements to serve retail customers, it could potentially increase overhead costs that would be born by the by wholesale customers. In addition, any addition requirements to serve retail customers could have the effect of diverting management attention from those customers that will sustain the business.

Finally, it is my view that a customer focused approach to the universal service obligation would create an obligation that is similar to the common carrier obligation that transportation common carriers now have to their customers. Most importantly, if the obligation is like the common carrier obligation it would be clear to whom the obligation applies, something that is clearly not obvious now. Therefore, I believe it is important that the Commission take a serious look at the Common Carrier Obligation for transportation companies as it evaluates options for the future.

³¹ Alan Robinson, *Competition With The United States Parcel Delivery Market*, published by Postcom, 2002

³² Household Diary Study, 2003, Figure 8.2b

³³ Ibid, Figure 8.2c