



Testimony of

The Honorable Edward J. Gleiman, Chairman

on behalf of the

Postal Rate Commission

Before the

United States Senate
Committee on Governmental Affairs
Subcommittee on International Security,
Proliferation and Federal Services

September 7, 2000

Chairman Cochran, members of the Subcommittee on International Security, Proliferation and Federal Services, thank you for the opportunity to provide testimony on the e-commerce activities of the United States Postal Service. In testifying today, I am expressing my own views, rather than those of the Postal Rate Commission institutionally. While the majority of my colleagues on the Commission would probably agree with many of the views I am about to present, they have not participated in developing this testimony.

We are here today because there is a growing interest and concern about the Postal Service's current involvement in e-commerce and other electronically based initiatives beyond its performance of conventional, or core if you will, postal services. As the GAO report presented by Mr. Ungar today demonstrates, there is a lot of uncertainty about the direction, financing, oversight, and even the extent of these initiatives. I commend the Subcommittee for addressing these difficult issues, and hope my remarks today can shed a little light on this murky territory.

I think GAO has done a good job of documenting developments since its last review covering the 1993 to 1997 period. The report paints a seemingly accurate, albeit surreal, picture of the state of current Postal Service activities: a wide variety of electronically based programs in various stages of approval and implementation. After

reading the draft GAO report, I asked the Commission staff to review readily available information from the Postal Service and its contractors about electronically based initiatives and compile a briefing book for my use. I have that briefing book with me today, and I would be happy to provide it for the Subcommittee's information.

Mr. Chairman, your letter inviting me to appear as a witness asked me to address "the application of major federal laws and regulations to the e-commerce initiatives of the Postal Service" in my testimony. I will do so, but with some trepidation, because of two concerns. First, I understand that the applicability of current laws to such services is largely uncharted territory, and there are few if any settled legal doctrines to be found in federal court decisions or other authoritative sources to provide guidance. Second, as the GAO report notes, there is a pending complaint proceeding before the Commission that concerns the legal status of Post_eCS service. Because the extent of the Commission's jurisdiction over this e-commerce initiative is a major issue to be resolved in the case, I must refrain from offering comments that could be misinterpreted as prejudging this issue. But I will try to address the question generally.

Looking at the primary body of law that applies to the Postal Service—the Postal Reorganization Act of 1970, enacted when the Internet was little more than a gleam in anyone's eye—it is difficult to find anything that would authorize the Service to introduce e-commerce initiatives as new products. The GAO reports the Postal Service's position that several provisions in the Act grant general authority to the Service broad enough to

encompass e-commerce activities, in addition to the specific power to provide “special nonpostal or similar services.” However, the Reorganization Act’s statement of the general duties of the Postal Service in section 403(a) must also be kept in view. This provision obliges the Service to offer efficient, reasonably priced postal services for conveyance of “written and printed matter, parcels, and like materials” and “such other services incidental thereto....” Likewise, section 101 declares as a matter of postal policy that the Service’s basic function is fulfillment of an obligation to provide postal services “to bind the Nation together through the personal, educational, literary, and business correspondence of the people.”

It is really hard to see a telecommunications horizon in this legal guidance. Now I agree that Title 39 does not contain language specifically prohibiting the Postal Service from offering non-postal services, but I am not convinced that Congress intended the absence of a prohibition to be interpreted as broad authority to compete with private businesses that offer Internet-related businesses, or other nonpostal businesses. I will have more to say about the implications of section 101 a little later.

The regulation of Postal Service e-commerce initiatives is also a question to which there is no clear answer. Chapter 36 of Title 39 requires the Service to file a request with the Commission prior to establishing any new mail classification for “postal” services. The Postal Service currently argues that, as long as a new service manipulates electrons and does not produce hardcopy mail, that service is not “postal,”

and therefore is none of the Postal Rate Commission's business. The Commission has not yet explicitly accepted or rejected that argument, and I should not offer an opinion for reasons already mentioned. I will note that, if the Postal Service position is correct, there may be a gap in regulatory oversight. But even so, I have to wonder why the Service did not consult with the Commission before introducing eBillPay service, which I understand results in the mailing of physical checks in envelopes at least some of the time. This would seem to make eBillPay a hybrid service akin to Mailing Online, which the Service requested and the Commission has recommended in two separate decisions.

The Postal Service offers several rationales for its entry into e-commerce, which the GAO report cites, and I will address each of these shortly. Before doing that, I would like to pose two basic questions: First, is there some compelling need for the Service to do this? If some current or potential customer of the Postal Service has been clamoring for new non-postal e-commerce services, I am not aware of it. The evidence I am aware of suggests that demand for electronic initiatives is limited to those that would make improvements or provide additional support for core Postal Service business. If there is some compelling need for non-postal e-commerce services, I believe it must originate somewhere outside the day-to-day business demands of operating the contemporary Postal Service.

Second, is there some compelling justification for any government monopoly to compete with private enterprise in this arena? Put another way, if the Postal Service had not taken the initiative to develop e-commerce products, would Congress pass legislation directing the establishment of a government-owned “start-up,” funded by users of the Postal Service, to compete with private Internet business firms?

According to the GAO report, the Postal Service cites four bases for viewing e-commerce products as appropriate for serving its institutional purposes. One rationale is that such services, in combination with its other functions and activities, should help to “bind the Nation together,” in keeping with the basic function prescribed in section 101 of Title 39.

This is a plausible rationale, but only if you overlook the fact that the United States is already “bound together” electronically by the private sector—initially by the telegraph and telephone but now by an ever-expanding variety of telecommunications media, including the Internet. Is the Postal Service suggesting that there is an unmet national need for publicly provided electronic services? If so, this would represent a major national policy finding, and accordingly should not be acted upon before investigation and very careful deliberation by Congress.

A second but related rationale is the Postal Service’s suggestion that, since “binding the Nation together” is part of its basic function, initiatives such as e-commerce

serve an appropriate objective in their own right by fostering national communications. The GAO report refers to this objective as “expanded universal access.”

This justification provokes another question: at some point, would pursuing the objective of binding the Nation together through new media change the Postal Service from a delivery company to a communications company? This may be what the Postal Service has in mind. If so, this would be contrary to the trend elsewhere in the world, where national telecommunications authorities are being separated from countries’ postal administrations and privatized.

Looking at the Service’s website the other day, I came across the Frequently Asked Questions section devoted to the Post_eCS service. Here is the Q. and A. I found particularly interesting. Question: “How does Post_eCS fulfill U.S. Postal Service’s primary mission?” The first sentence of the answer: “Post_eCS fulfills the Postal Service’s mission to ‘bind the nation together through its communications’.” I do not know what or whom this answer intended to quote, but it was not section 101. In any event, the diversification of the Postal Service from what has been a nationwide delivery service into a communications company would represent a major change in national policy, and as such should be decided publicly. If such a change is deemed appropriate, it might best be implemented through new legislation.

A third rationale offered by the Postal Service identifies technological improvements such as the Internet as sources of “opportunities for improved interaction

between the postal system and its customers.” While it does not claim that all-electronic products and services are becoming the “basic function” of the Postal Service, it says the particular electronic services it has chosen to introduce “serve as logical, supporting, ancillary, incidental enhancements of the postal system for the benefit of our customers.”¹

Evolution of postal services through the adoption of new technologies is well-established in historical precedent. As long ago as 1877, the Supreme Court recognized that the powers of the national postal service included employing “new agencies” or “instrumentalities of commerce” to “keep pace with the progress of the country, and adapt themselves to new developments of time and circumstances.”² This decision, and many other historical developments concerning postal innovation in the United States, are discussed in a study prepared for the Commission by Professor Richard Kielbowicz, entitled “Postal Enterprise: Post Office Innovations with Congressional Constraints, 1789-1970.” The Commission would be happy to provide copies of this study for the Subcommittee, and it will soon be available on the PRC website.³

¹ Draft GAO Report at 57.

² *Pensacola Telegraph Co. v. Western Union Telegraph Co.*, 96 U.S. 1, 16 (1877).

³ The Commission’s website, which hosts its electronic reading room and provides access to a variety of related information, is located at: www.prc.gov.

However, one question posed for the Postal Service's future is the following. If entry into e-commerce and other electronic initiatives is an appropriate evolutionary development for the national postal system, should current forms of oversight, governance and regulation evolve as well? The legislative history of the Reorganization Act makes clear that the PRC was created to protect monopoly ratepayers from being exploited and to protect the private sector from unfair competition. Congress did not leave the Service's Board of Governors to do this job alone. It therefore seems odd that the Postal Service now argues that its Board of Governors alone should protect monopoly ratepayers and private sector competitors in the e-commerce area.

The fourth rationale offered by the Postal Service notes that its current services are "deeply rooted in the traditions of this country and embedded in the current economic and social fabric[,] and invokes its authority to take advantage of technologies such as e-commerce to meet a challenge "to improve and build upon the services, capability, role, and customer relationships that it already maintains...."⁴

I agree that some electronic initiatives to date can fairly be viewed as extensions and enhancements of core Postal Service business. Delivery Confirmation makes use of the Internet to enhance Priority Mail and Parcel Post. Another example is Mailing Online, which harnesses the Internet to enable customers to produce and mail hardcopy messages from their electronic word processing files.

But other current initiatives do not build on any pre-existing service traditionally offered by the Postal Service. Illustratively, eBillPay does not improve or build upon any service currently offered. Instead, it offers a potentially all-electronic substitute for current bill paying transactions.

My point here is not that the Postal Service should be precluded from offering services that are categorically different from anything they have done before, although historically this has happened. As Dr. Kielbowicz's study documents, Congress precluded the pre-Reorganization Act Post Office Department from extending the scope of its core businesses by competing in new media such as the telegraph⁵ and telephone⁶ services. The point to be made here is that Postal Service forays into services with no clear connection to its core businesses raise important policy issues that ought to be considered in a forum beyond Postal Service headquarters and meetings of the Board of Governors.

⁴ Draft GAO Report at 58.

⁵ After funding a telegraph line between Washington and Baltimore for demonstration purposes in 1843, which was supervised initially by the Treasury Department and thereafter by the Post Office Department, Congress declined to approve further appropriations in 1845 and 1846, and the line was sold to a private company in 1847.

⁶ Despite initiatives begun in 1913 to acquire the Nation's telegraph and telephone lines and turn them over to the Post Office Department, and the Department's management of all wire communications as an emergency measure following the outbreak of World War I, Congress returned permanent control over wire communications to the private sector after one year of Post Office supervision.

And while I am on the subject of traditional postal services, let me say a few words about the privacy traditionally, and legally, accorded to mailers and mail recipients. The GAO report notes my comments earlier this year about the breadth of disclosure of customer information allowed under the Postal Service's Privacy Act statement for the eBillPay service. According to the report, the Service has since revised its Privacy Act statement, and says it does not intend to provide such information. As a general matter, the Service is quoted as saying that it will protect the privacy of USPS e-commerce customers better than private sector providers would because of the federal privacy laws.

Nevertheless, I remain concerned that personal information about users of e-commerce services might be disclosed, possibly to one of the Postal Service's "partners" in providing the services, under permissible "routine uses" under the Privacy Act. As evidenced by the Postal Service's initial eBillPay privacy statement, federal agencies have broad administrative discretion when it comes to sharing personal information; more, perhaps, than many of the proposals currently under consideration which would impose restrictions on the private sector. I believe this is an issue that should be carefully monitored in exercising oversight over the Postal Service's e-commerce activities.

One practical reason that has been advanced for the Postal Service's entry into e-commerce is reaction to new competitive challenges that may lead to substantial

declines in First-Class Mail volume and a resulting erosion of the Service's ability to fulfill its universal service obligation. Under this rationale, the Service invests in developing e-commerce activities as a means of cultivating new revenue streams to replace income lost to private delivery companies and electronic communications alternatives.

One variant of this rationale should be dismissed right away. Several years ago, certain postal officials promoted e-commerce and other initiatives as a means of "preserving market share" for the Postal Service. I cannot regard this goal as an appropriate objective for the Postal Service to pursue in the e-commerce arena. Starting from a base of hardcopy message and transaction mail, is it even meaningful to talk about the Service's "share" of electronic transactions? I do not think it would be realistic to regard even a small fraction of e-mail messages sent today as letters that have been diverted from the Postal Service.

But even the more respectable rationale of income replacement raises serious questions. First, who should finance the Postal Service's e-commerce initiatives? Again returning to the 1970 Reorganization Act, there is no basis in the legislative history for concluding that Congress contemplated the Postal Service's entry into nonpostal competitive businesses of this type. Perhaps this was for a good reason. The Postal Service has no sources of risk capital except its revenue from monopoly ratepayers. It has no willing investors who want to take risks for a potential return on

their investment. An ordinary firm entering a competitive market is constrained by its access to risk capital and its owners' tolerance for risk. After all, private firms have to use retained earnings or risk capital from investors—money that is not easily replaced.

The Postal Service is in a different position. Its capital is essentially free, and if it fails to earn the expected return, there are no adverse consequences. It has a source of monopoly revenues from which to replace the lost funds. Therefore, at best the Postal Service would be an anomaly in the nonpostal competitive marketplace. At worst, it would be a danger to other venturers because it does not have to play by the same set of rules that govern capital formation and risk.

Because the Postal Service can easily obtain risk capital from monopoly ratepayers, it may be tempted to make imprudent guarantees to other vendors when it enters the e-commerce market. Frequently, partners and contractors require guaranteed revenues. This happened in the market test of Mailing Online service. In exchange for low printing rates, the Postal Service guaranteed its printing contractor a minimum revenue of \$325,000. At the end of the test only about \$23,000 had been spent. The Service reportedly has paid more than \$250,000 to the contractor with no additional services rendered, and as of February 12 of this year there was a remaining balance payable. The potential size of these kinds of guarantees in the e-commerce arena may be much larger.

A related question is, who will manage and audit the costs and revenues of these initiatives? This is a significant consideration, because of the potential financial impact on monopoly ratepayers and other users of conventional postal services.

I share GAO's sense of confusion about the Postal Service's division of its activities into "e-commerce," value-added "eService" enhancements of existing services, "gray area," and "infrastructure" initiatives. It is important that the Postal Service not bury significant development costs of e-commerce products in baskets that fall outside e-commerce. The PRC must regularly deal with the issue of whether costs that the Service claims are common costs are, in fact, caused by a specific product. It will only be able to do so if the costs of e-commerce initiatives are properly accounted for and reported.

The Postal Service states that it intends to recover the "direct and indirect" costs of its e-commerce products. I believe that such products should satisfy the more appropriate standard of incremental cost, as the Commission advised GAO in its comments.

I also think it is important that the Service use fairly rigid definitions of e-commerce to prevent using revenues from profitable products only marginally related to e-commerce to show that the e-commerce basket is profitable overall.

Then there is the pragmatic, bottom-line issue of whether e-commerce products can reasonably be expected to produce a significant amount of revenue support to the

postal system. All things considered, I would have to say the signs are not encouraging.

In general, the Postal Service faces the same challenge of achieving profitability on which many private startups have foundered. As the GAO report observes, “[t]he competitive landscape is very fluid in the e-commerce area, where new competitors may rapidly appear and disappear.”⁷ Although USPS enters this arena with a distinct advantage in financial resources, and what may be an unmatched degree of bricks-and-mortar commercial presence, it is unclear whether the Service can effectively leverage these advantages to produce a significant net contribution to the support of its core operations.

Consequently, as someone close to this issue recently said, while the Postal Service may wish for a “golden spike” out there in the realm of e-commerce to produce huge revenues, the immediate prospects are much more modest.

From my perspective, the issue of the Postal Service’s participation in e-commerce is a difficult one involving many uncertainties, as the GAO report accurately portrays. The sources and extent of the Service’s authority to mount such initiatives unilaterally is not clear in the Postal Reorganization Act. Further, the applicability of existing regulatory requirements for the introduction and pricing of new conventional postal services is likewise uncertain.

On the merits of embarking on e-commerce initiatives, some of the rationales USPS offers appear to rest on questionable legal or practical assumptions. There is no apparent legal mandate, or compelling need, for broadening the mission of this government enterprise to include telecommunications services generally. In addition to the effects on private competition, postal ratepayers would have to fund such initiatives, and the net financial returns to the Postal Service may not justify the outlays.

Of course it makes sense for the Postal Service, like any good business in the current era, to adopt available new technologies into its operations to enhance productivity and add value to its core services. But pursuit of e-commerce for its own sake may only serve to distract postal management, and divert resources, from the critical demands of performing its public mission in a challenging new century.

⁷ Draft GAO Report at 15.