# Courtesy Envelope Mail--A Missed Opportunity?[1]

Gail Willette

Postal Rate Commission

Office of the Consumer Advocate

## 1. INTRODUCTION

The United States Postal Service is a quasi-government entity with revenues of $60 billion a year.[2] A substantial portion of the revenues, $34 billion, is earned from First-Class Mail. Of that $34 billion, a conservative estimate of transactions that involve bill payments is $4.3 billion. The Postmaster General recently testified that the loss of transactions coupled with competitive pressures eventually may cost the Postal Service $17 billion annually in revenues. According to 1997 Postal Service data, bills and payments of bills account for about 19 percent of the First-Class mailstream. Applied to 1999 volume, this would have meant the loss of almost 19 billion pieces.

---

[1] The views expressed in this paper are those of the author and do not necessarily represent the opinions of the Postal Rate Commission or its Office of Consumer Advocate.

[2] The United States Postal Service (USPS) is an independent establishment of the Executive Branch of the U. S. Government created by the Postal Reorganization Act of 1970. The Postal Service's ability to offer new services or to change rates of

The Postal Service faces a formidable challenge in the coming years. A great deal of attention has been focused on the impact of diversion of postal volume, particularly remittance mail, to electronic alternatives, which are becoming increasingly attractive to consumers. Many banks currently offer PC-based home banking and a variety of companies are offering bill payment, sometimes coupled with bill presentment, over the Internet. Consumers appear to be increasingly receptive to paying bills in this manner.

First-Class Mail comprises the largest volume service in the US postal system. In fiscal year 1998 the Postal Service processed 101.2 billion pieces of First-Class Mail. The number of pieces of Standard (advertising) mail was 82.9 billion. First-Class Mail provides the largest contribution to institutional or overhead costs, $14 billion in 1997 or about 70 percent.

An estimated 45 percent of First-Class Mail currently consists of bills and remittances.[3] It has been suggested that much of this mail will be lost to electronic substitutes over the next decade. To cope with such a change, the Postal Service will need to slow the loss of

---

existing services is regulated by the Postal Rate Commission (PRC), another independent establishment of the Executive Branch.

this mail, reduce expenses and find new sources to replace the revenue lost.

The Postal Service has expended several billion dollars to automate its mail processing operations.  One justification for these improvements is to prevent First-Class Mail from leaving the system for alternative media.  The cost savings afforded by these advancements during the past ten years have given rise to a series of discounts that are based on degree of preparation and size of mailings. Individual consumers and small-volume business mailers have been unable to take advantage of these discounts because they do not deposit mail in large enough quantities.

Over the period 1987 to 1998 the Office of the Consumer Advocate (OCA)[4] proposed discounts to allow consumers to benefit from automation advancements made by the Postal Service.  These proposals sought to create a new category of First-Class Mail called Courtesy Envelope Mail (CEM).  The Postal Service has consistently opposed these discounts, arguing that they would create

---

[3] See Cohen, Ferguson, Waller, and Xenakis (2000).
[4] The Office of the Consumer Advocate (OCA) is an independent litigation office within the Postal Rate Commission.  The purpose of the OCA is to represent "the

administrative problems, confusion among customers, and increased fraud. The Postal Rate Commission has nearly always recommended the classification changes without rate recommendations. These recommendations are termed "shell" classifications. The Board of Governors of the Postal Service has rejected each such recommendation concerning CEM.

The question of whether CEM would have been a successful service in a competitive mail service arena is an intriguing one. Individual postal customers would be paying less to mail printed or typed and prebarcoded envelopes used primarily for bill payments. These envelopes lower processing costs to the Postal Service. The Postal Service would be passing on its cost savings to individuals in the same manner as it has to large-volume mailers.

## 2. BACKGROUND

### 2.1. Docket No. R87-1 CEM Proposal

In Docket No. R87-1, OCA proposed a five-cent discount for a CEM mailpiece. CEM was defined as a preprinted single First-Class envelope bearing a nine-digit ZIP Code, a corresponding

---

interests of the general public, that is, consumers not otherwise represented before the Commission. 39 USC § 3624(a).

barcode, and a Facing Identification Mark (FIM).[5] Each proposed CEM characteristic was designed to make the envelope more compatible with the Postal Service's automation equipment and, ultimately, to facilitate the Postal Service's processing of single-piece First-Class letter mail.[6] Examples of the most frequently used CEM mail pieces are self-addressed return envelopes often called courtesy reply envelopes. These envelopes are provided by businesses to customers and used for bill payments, merchandise order forms, and communications with government agencies.

OCA's five-cent discount was premised on the fact that a preaddressed return envelope is not delivered by a carrier; rather, the envelope is delivered to a post office box or is treated as a firm holdout. Firm holdouts are not delivered, but picked up by the recipient. Further, the OCA argued that implementation of the CEM proposal would make the use of the Postal Service more attractive to the public and thereby reduce the potential loss of mail volume to

[5] Docket No. R87-1, Tr. 20/15011.
[6] Id. at 14970.

computer networks and telephone for the delivery and payment of bills.[7]

The Commission did not recommend implementation of OCA's CEM proposal. It sought to preserve the "attributable costs foundation for the proposed 25 cent nonpresorted First-Class rate."[8] However, the Commission did recommend adoption of a CEM classification change. It stated that the Postal Service would be able to recognize any cost differential and propose rates for both CEM and single-piece First-Class letter mail during the next omnibus proceeding.

To qualify for the Commission's proposed CEM category, a mail piece had to be a prebarcoded reply envelope or a Business Reply mail piece. Business Reply mail is paid for by the addressee. CEM requirements included a preprinted envelope with a ZIP+4 Code and corresponding barcode, an indication on the reply envelope that the envelope qualified for the CEM rate, and a post office box delivery address. Caller service mail is addressed to a post office box, even though this mail is not physically placed in a box.

[7] PRC Op. R87-1, para. 5036.
[8] Id., para. 5038.

In response to several arguments raised during the hearings, the Commission noted:

> The Postal Service will benefit because establishment of a CEM category will provide an inducement to mailers to place bar codes and FIM marks on the mail thereby reducing postal costing leading to increased efficiency. This fact outweighs the minor additional effort the Service faces to administer an additional rate category.[9]

2.2. Docket No. R90-1 Courtesy Envelope Mail Proposal

In Docket No. R90-1, the OCA proposed a three-cent discount for CEM. CEM requirements were further refined to include identification as a courtesy envelope as prescribed by the Postal Service.[10] Each mail piece characteristic was designed to make CEM mail automation compatible.[11] The CEM proposal allowed those unable to take advantage of bulk automation discounts, e.g., small businesses and individual mailers, the opportunity to pay a rate commensurate with the cost of their automation compatible mail. OCA took the position that limiting automation discounts to bulk mailings was not justified because automated processing of a single

---

[9] Id., para. 5056.
[10] Docket No. R90-1, Tr. 30/15676.

piece of First-Class Mail was shown to reduce costs on a per piece basis.[12] With the increase in First-Class rates, OCA reasoned that a First-Class single-piece automation discount would reduce the migration of bill payments from the Postal Service mailstream to alternate bill-payment media.[13]

In its opinion, the Commission stated that if cost savings from automation could be achieved by individual mail pieces and if the bulk mailing requirements needlessly barred small mailers from participating in automation discounts, then the time had come to eliminate bulk mailing requirements.[14] However, the Commission rejected the OCA's three-cent CEM discount proposal on the grounds that the cost savings identified were not distributed to all users.[15] Rather the Commission recommended a category it termed Public Automation Rate (PAR). A discount of $0.02 per piece was recommended for PAR. The Governors reluctantly accepted the rates proposed by the Commission in R90-1, but declined to implement

---

[11] Id. at 15634.
[12] Id. at 15534.
[13] PRC Op. R90-1, para. 5164.
[14] Id., para. 5177.
[15] Ibid.

PAR and sought judicial review. The court found that PAR lacked an adequate foundation in the evidentiary record of the proceeding.

2.3. Docket No. MC95-1 Courtesy Envelope Mail Proposal

In Docket No. MC95-1, an omnibus reclassification proceeding, the Postal Service proposed increased automation discounts that would be available only to mailers who mailed in bulk. The minimum piece requirement to qualify for the automation basic category under the Postal Service's proposal was 500. Individuals and small business mailers who mailed automation compatible pieces would receive no discount.

OCA argued that this violated the Postal Reorganization Act's classification goal of fair and equitable classifications for all mailers. Moreover, by not considering the needs of single piece automation mailers, OCA argued, the Postal Service was violating its own stated goal of adding classifications where significant operational or market considerations existed.[16] To remedy this perceived inequity, the OCA proposed a 12-cent discount for CEM.[17]

[16] Docket No. MC95-1, Tr. 23/10420.
[17] Id. at 10425.

The OCA argued that CEM met the reclassification criteria that the Postal Service had used to define subclasses in its proposal.[18] Specifically, CEM mail was said to: represent a homogeneous cost and market-based category; encourage a low-cost mailstream; allow the Postal Service flexibility in establishing modernized entry requirements; represent a mail category where significant market and operational needs exist; and, because CEM eligibility was not dependent on the contents of the mailpiece, further the Postal Service's goal of moving away from content-based rates.[19]

The OCA's proposed discount of 12 cents was based on a cost-avoidance figure of 13.4 cents.[20] The cost avoidance analysis took into account both mail processing and delivery operations.[21] OCA estimated CEM volume of between 3.9 billion pieces[22] and 6.5 billion pieces.[23] Given the range of potential CEM volume, the

---

[18] See USPS-T-1 at 21-37.
[19] Tr. 23/10422.
[20] Tr. 23/10425.
[21] For highlights of the costing methodology, see Tr. 23/10333, 10334, 10340, 10373.
[22] Tr. 23/10450.
[23] Id. at 10452.

estimated revenue impact of the CEM proposal for the test year would have been between $470 million and $783 million.[24]

Some participants and the Postal Service opposed OCA's CEM proposal.[25] Business mailers incurred the expense of preparing the envelopes, they argued, and should therefore receive any financial reward. They denounced the CEM proposal as fundamentally unfair to the businesses who provide mailers with reply envelopes.[26] They also claimed business mailers were penalized by the effects of deaveraging on the single-piece rate.[27]

The Postal Service again raised the issue of operational difficulties. One concern was that there might be an increase in short-paid mail as a result of the CEM proposal. It contended that the possibility of customers becoming confused, and thereby misusing CEM, should not be underestimated.[28]

---

[24] Id. at 10432.

[25] The Council of Public Utility Mailers suggested the Commission approve the CEM proposal but set an interim rate until the next omnibus case. CPUM Brief at 6.

[26] Brooklyn Union Brief at 8.

[27] RDA Brief at 5. Tr. 36/16326. The Council of Public Utility Mailers (CPUM) disputed this argument, claiming that it is the consumer who ultimately incurs the expense of CEM because the cost of envelopes is reflected in the prices consumers pay. CPUM Brief at 5.

[28] Id. at 16218.

In its decision, the Commission noted that the Postal Service's critique of OCA's cost-avoidance estimate for CEM did not rebut the existence of significant measurable cost savings.[29] The Commission also found it "improbable" that consumers would make the effort or investment to use computers to forge indicia, as the Postal Service had suggested, in order to obtain a discount.[30] The Commission also stated it was reasonable to anticipate that a discounted rate would be of significant benefit to lower income mailers.[31]

The Commission concluded that CEM remained worthy of recommendation as a discounted category of First-Class Mail, and recommended establishment of a CEM rate category.[32] However, it refrained from recommending a specific rate for the CEM category. It noted that its "first consideration is its potential financial impact, and the need to accommodate that impact in a case in which no class of mail is called upon to produce more, or less, total revenue." The Commission found that while the 12-cent discount proposed by the OCA was not necessarily unreasonable per se, "the prospective

[29] Id. at V-34.
[30] Id. at V-35.
[31] Id. at V-36.
[32] Ibid.

volume of discounted CEM pieces is somewhat uncertain and is cause for serious concern regarding the consequent financial impact."[33] The Commission thus recommended the CEM category purely as a mail or shell classification concept for the Governors' consideration, stating it would leave recommendation of a specific discount to a subsequent ratemaking proceeding.[34]

The Postal Service's Governors once again rejected the Commission's CEM recommendation.[35] The Governors opined that the amount of prebarcoding had risen to the point that now a very substantial majority of CEM, estimated by market research to be in excess of 80 percent, already was prebarcoded. They found this change highly relevant because the potential benefits of creating any worksharing discount can be closely related to the size of the available pool of candidate mailers who might be induced by the discount to convert from less-desired mail preparation practices to more-desired ones. Thus, potential benefits to the Postal Service

---

[33] Id. at V-36-37.
[34] Ibid.
[35] Decision Of The Governors Of The United States Postal Service On The Recommended Decisions Of The Postal Rate Commission On Courtesy Envelope Mail And Bulk Parcel Post, Docket No. Mc95-1, issued March 4, 1996 ("CEM Decision").

which normally might accrue from increased worksharing would be replaced by the prospect of deadweight revenue losses engendered by the grant of discounts with little or no offsetting cost savings.[36] The Governors also posited that the envelope provider would have no direct incentive to put a barcode on the envelope if not doing so currently because the financial benefits would be "bestowed primarily on those individuals fortunate enough to receive a high proportion of prebarcoded reply envelopes from entities desiring remittance mail."[37]

The Governors also feared that a CEM discount could cause the Postal Service to incur substantial window service and other costs.[38] The Governors' opinion went on to state that there would be a direct revenue loss in the hundreds of millions of dollars, which would have to be offset by rate increases for other types of mail.[39]

The Governors last concern addressed the general issue of fairness and equity. The Governors stated that household mailers already had benefited from automation because the savings realized from automated processing of household mail have been averaged

[36] Id. at 3.
[37] Id. at 4.
[38] Ibid.
[39] Ibid.

with the other costs of First-Class Mail, and used to mitigate overall First-Class rate increases.[40] It stated that when households use the CEM envelope provided by others, the return letter they mail has relatively low cost. "For the rest of their letters, however, sent in their own envelopes, often with hand-written addresses, households continue to deposit relatively high cost mail. Unless households were called upon to pay higher rates which reflect the higher costs of their mail that is not sent in reply envelopes (an approach advocated by no one in this case), a proposal such as CEM that would nevertheless allow them to pay lower rates which reflect the lower costs of their reply mail seems distinctly one-sided."[41]

3. THE R97-1 PROPOSAL

The OCA again proposed the establishment of a CEM discount in Docket No. R97-1. In this docket, responding to the Commission's desire to establish CEM, the Postal Service proposed its own version of CEM, called Prepaid Reply Mail (PRM). PRM postage would be purchased by the sender of the reply envelope and then billed to the customer at a discounted rate. The proposed

---

[40] Id. at 5.
[41] Ibid.

discount for PRM was three cents. Thus, under the Postal Service proposal, PRM would pay $0.30, rather than $0.33.

A key feature of the PRM proposal was that the postage would be paid by the business that generated the envelope and not by the user of the envelope. The OCA argued that this feature made PRM a fundamentally different product from CEM. Under current Postal Service regulations and operational practice, the cost avoidance of courtesy reply mail (CRM)[42] and PRM letters is the same. CRM envelopes would be transformed into CEM mail with only one minor alteration--the addition of a CEM indicator on the envelope informing consumers that they may use a discounted CEM stamp.

The OCA argued further that CEM costs to the courtesy reply envelope provider would be far lower than those of PRM. The mailer would not have to pay the PRM postage and there would be no need for the auditing system PRM would require.[43] Costs of administering CEM also would avoid the PRM auditing costs projected to be

[42] Courtesy reply mail is a preprinted return envelope (or card) provided as a courtesy to customers. The customer pays the postage.

[43] The necessity for a PRM auditing system and the proposed fees for such a system are discussed in USPS-T-32 at 41-42.

incurred by the Postal Service itself, which costs are the condition precedent for the PRM mailer fees.[44]

The Postal Service estimated that there would be 6.8 billion CRM pieces in Test Year 1998, based on then-available fiscal year 1996 volume data.[45] Performing the same calculation with 1997 data yielded only a slightly different result --7.3 billion CRM pieces. On this basis, revenue loss from CEM would amount to the difference between the proposed First-Class single-piece rate and the proposed CEM rate (three cents per piece) times the CRM volume. The maximum revenue reduction, then, would be $219 million ($0.03 x 7.3 billion).

Comparing CEM to PRM revealed that the two proposals were similar. Both were aimed at consumers and other small-volume mailers. The Postal Service seems to have introduced PRM as a response to the Commission's CEM recommendations in past proceedings. In addition, the two services had substantially similar goals. A primary concern of the Postal Service in the R97-1 proceeding was the threat of electronic diversion. Since invoices and

---

[44] USPS-T-32 at 41.
[45] USPS-T-32 at 42.

bill payments are the largest component of the First-Class Mail stream, the Postal Service believed that PRM "can help address the threat of electronic diversion and, at the same time, provide added convenience for the general public."[46] CEM also addressed the threat of electronic diversion by providing consumers a reduced price stamp to return bill payments by mail. The chief difference between CEM and PRM was that PRM postage would be paid by businesses and presumably passed on to customers.

The Commission recommended in favor of both CEM and PRM. The Postal Service Governors, however, rejected both CEM and PRM. The Governors' decision stated:[47]

> The evidence suggests that the costs of CEM could outweigh the relatively modest automation benefits intended to be distributed more directly to single-piece First-Class Mail users.

Table 1 summarizes the OCA's efforts to establish CEM.

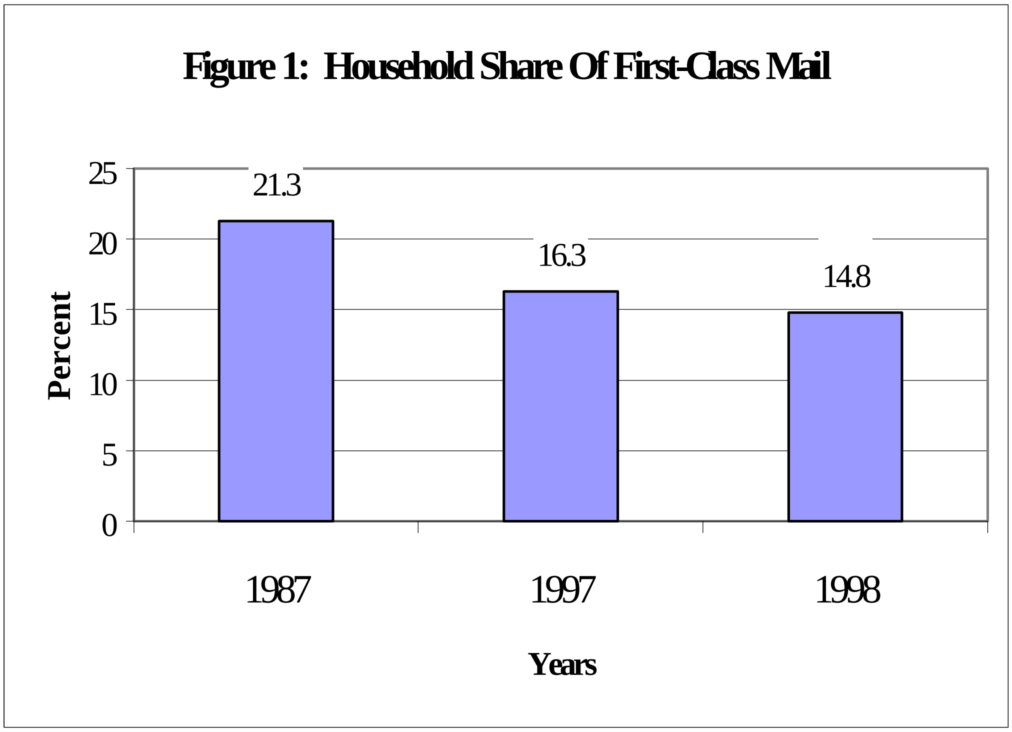
---

[46] Id. at 36-37.
[47] See CEM Decision. (1998).

**Table 1: OCA Proposals**

| Docket | R87-1 | R90-1 | MC95-1 | R97-1 |
|---|---|---|---|---|
| OCA Proposal | $.05 Consumer Discount | $.03 Consumer Discount | $.12 Consumer Discount | $.03 Consumer Discount |
| USPS Response | Opposed Based on Implementation Difficulties | Opposed Same as R87-1 | Opposed Same as R87-1 | $.03 Prepaid Mailer Discount |
| Commission Recommendation | Shell Only | $.02 "Public Automation" Discount Recommended | Shell Only | Shell Only |
| Governors Decision | Rejected | Never Implemented | Rejected | Rejected |

Recent studies indicate that there are significant changes taking place in household demand for postal services. Data suggest that revenue received by the Postal Service from households has declined and will continue to decline.[48] The Postal Service's data suggest that this trend will continue. According to the Household Diary Study, conducted each year, household-generated First-Class mail as a share of all First-Class mail is declining. Figure 1 summarizes the decline of this mail in percentage terms over an eleven-year period.




The total volume of First Class mail for fiscal year 1998 was 100.4 billion. Of that volume, nearly 15.0 billion pieces were generated by households. In 1987 households mailed about 17.0 billion pieces. The growth in First Class volume over the last decade

[48] See Wolak (1999).

clearly has come from the business sector. Figure 1 illustrates the decline in household mail's share of total First-Class Mail. In 1987 household-generated mail made up 21.3 percent of total First-Class Mail. By 1998, however, only 14.8 percent of First-Class Mail was generated by households.

The future of CEM or of any program resembling a consumer bill-paying discount seems quite uncertain. Currently the Postal Service benefits from having this "clean mail" in the system because it is less costly to process. While the Postal Service believes that a rise in the use of electronic services can lead to increases in First-Class Mail volume, it is difficult to predict whether these increases will be sufficient to offset the losses to other media.

The Postal Service has recently embarked on what appears to be a partnership with *CheckFree Corp* and *Output Technology* to offer Internet bill payments. Because the service is new and has not been examined or recommended by the Postal Rate Commission, its potential as a source of revenue to replace mailed payments is unknown. It is clear, however, that currently each mailed bill payment contributes an average of $0.18 to the overhead of the Postal

Service. In addition, there are many providers of Internet bill payment services, some offering other services as well. Entering a competitive market has proved difficult for the Postal Service in the past.

Establishment of a discounted rate for household-generated mail meeting requirements for reduced handling costs should have been a Postal Service priority. It is not known how much such a rate would have slowed diversion to other media; however, it seems clear that at least some of this mail would have stayed in the postal system.

The results of Docket No. R97-1 show that CEM would have raised the volume of First-Class Mail and furthered the goal of preventing mail from migrating to other media. The lost revenue was estimated to be simply $0.03 times the 7.3 billion pieces that would have migrated into the new category--$219 million. The price elasticity of single-piece First-Class Mail is estimated empirically to be about - 0.18. The 3-cent CEM discount could, therefore, be expected to increase the demand for First-Class Mail by 102 million pieces. Evaluating this new volume using the new lower after rates average revenue results in a $41 million gain in revenue. Thus, the anticipated revenue loss is reduced from $219 million to $178 million.[49]

In a competitive environment, a service like CEM undoubtedly would have been offered by now. The lower cost of processing this mail would justify such a discount, and demand elasticities indicate that such a service would generate more volume. Indeed, if the elasticity of CEM were shown to be higher than that of single-piece First-Class Mail, CEM would generate even more volume than anticipated.

3. CONCLUSIONS

The Postal Service has stated that its transactions mail is expected to decline over the next five years, yet projects that erosion of the transactions market is slowing.[50] In addition electronic media have produced some new volume, particularly in packages and advertising.

The Postal Service should seriously consider offering discounts for qualifying CRM envelopes to the household customer in the hopes

[49] The new lower after rates average revenue is calculated by removing the 7.3 billion pieces. Before rates volume was estimated to be 54,379,326 (000). Before rates revenue was estimated to be $21,567,504. Average revenue per piece was $0.39661. After rates volume was estimated to be 54,103,260 (000). After rates revenue was estimated to be $22,063,820. Average revenue per piece was $0.40781. The new average revenue per piece becomes $0.40376.

that fewer would be inclined to take advantage of alternative media. The technological innovations that have and will continue to erode First-Class Mail volume have been developing during the time that the Postal Service was rejecting discounts for consumers making bill payments. If, however, there is a temporary plateau in the erosion of transactions mail, the Postal Service has an opportunity to introduce cost-justified discounts for consumers and leverage their brand loyalty. Aggressive pricing of this category of First-Class Mail is critical to mitigating the impact of the loss of volume in future years.

REFERENCES

Cohen, Robert H., William W. Ferguson, John D. Waller, and Spiros S. Xenackis. 2000. "Universal Service Without a Monopoly." In *Current Directions in Postal Reform*, edited by Michael A. Crew, and Paul R. Kleindorfer, Boston, MA: Kluwer Academic Publishers.

Decision Of The Governors Of The United States Postal Service On The Recommended Decisions Of The Postal Rate Commission On Courtesy Envelope Mail And Bulk Parcel Post, Docket No. Mc95-1. March 4, 1996.

Reisner, Bob. "Understanding the Business Environment." *USPS Leadership*. 1(no. 3, September): 4.

United States General Accounting Office, *U. S. Postal Service, Development and Inventory of New Products*. November, 1998. GAO/GGD-99-15.

[50] Reisner, Bob, Understanding the Business Environment, Leadership, Vol. 1, No. 3, Sept. 1999, p. 4.

Wolak, Frank A.. 1999. "Changes in the Household-Level Demand for Postal Delivery Services from 1986 to 1994." In *Managing Change in the Postal and Delivery Industries*, edited by Michael A. Crew, and Paul R. Kleindorfer, Boston, MA: Kluwer Academic Publishers.