



OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Bridging the Digital Divide: Overcoming Regulatory and Organizational Challenges

November 22, 2011

**Sponsored by U.S. Postal Service Office of Inspector General
Risk Analysis Research Center
Report Number: RARC-WP-12-004**

Bridging the Digital Divide: Overcoming Regulatory and Organizational Challenges

Introduction

The Internet and the digital revolution are fundamentally changing the worlds of communications and commerce. In a rapidly growing digital economy, electronic substitution of traditional mail is accelerating as both consumers and businesses adopt electronic processes across multiple domains. Mail users are shifting from traditional hard copy distribution models to a variety of new digital communication, advertisement, and transaction methods. They are attracted to the greater convenience, faster service, and lower cost afforded by these options. The digital revolution has become a “disruptive innovation” to the traditional business of the U.S. Postal Service.

This revolution remains unsettled, with mobile devices moving beyond phone calls and e-mails and serving as hosts for a continual stream of new communications tools. Even the tools for the Internet are evolving, changing from Web sites to search engines to the latest in so called “curated” sites. Yet as the amount of information grows exponentially, even the curators are overwhelmed.

The Office of Inspector General, through its Risk Analysis Research Center (RARC), has embarked on a series of studies to inform the debate on this issue, providing market and strategic analysis for policymakers and other key stakeholders.

The first paper in the series, *The Postal Service Role in the Digital Age, Part 1: Facts and Trends*, analyzed developments and shifts from the physical to the digital in the changing communications and commercial landscape, while also identifying shortcomings of the ongoing digital revolution. A fundamental limitation in the present digital world is that the Internet, its functionality, and the economic benefits it provides are not universally available. Additionally, the paper noted that key communications and transaction standards (i.e., privacy, confidentiality, dependability, and security) and tools (e.g., digital currency and other financial instruments) are lacking, preventing the level of trust necessary for primary communications and commerce from being fully realized. These limitations offer the Postal Service, in its trusted role as an intermediary, an opportunity to bridge the divide between the digital and physical world.

The second paper, *The Postal Service Role in the Digital Age, Part 2: Expanding the Postal Platform*, focused on developing a strategic framework to aid the Postal Service as it redefines its mandated role of “binding the nation together” in the digital age. Three guiding principles were used in formulating the strategy: (1) does the strategy meet a “societal need” currently lacking or inadequate in the digital world; (2) does the strategy utilize the core competencies and assets of the Postal Service; and (3) is the

strategy considered a “proper” role for the Postal Service from a policy standpoint. Using these guidelines, the paper suggests a “postal platform,” a center for secure personal communications and commerce with the foundation of an eMailbox¹ that ties a person’s physical address to a digital one. In addition, the platform would enable the Postal Service to evolve its established role of providing a trusted communications infrastructure by encouraging entrepreneurial and collaborative development of postal, governmental, and commercial solutions available to all via platform-supported applications. The paper goes on to suggest a number of other initial applications that adhere to the three guiding principles, including eGovernment services, security and privacy tools for communications and commerce, and a prepaid card system that would provide low-cost access to digital currency.² This digital strategy would allow the Postal Service to “raise the floor,” bringing digital tools and services to the digital refugees of the American populace.

The U.S. Postal Service Office of Inspector General (OIG) contracted Joy Leong Consulting LLC to provide legal, policy and strategic analysis of issues (technical, regulatory, and institutional) involved in implementing the digital strategy proposed in the second paper. The following paper, *Bridging the Digital Divide: Overcoming Regulatory and Organizational Challenges*, is the product of this research effort.

This paper takes the digital strategy described above and goes a step further. It examines current postal regulations as well as the organization of the Postal Service. In reviewing the strategy, the paper emphasizes that the Postal Service has the assets and the infrastructure to operate as a platform bridging physical and digital communications. Additionally, an extensive analysis of the current regulatory environment is conducted and concludes that current regulations do provide a legal path for the Postal Service to operate a digital platform and offer a number of other digital services. Finally, the paper offers a number of action steps for the Postal Service to take on the road to implementing a digital strategy, including developing an infrastructure to foster innovation, reaching out to federal agencies to develop e-services, and working with the Postal Regulatory Commission and stakeholders to quickly develop market tests for a number of digital products.

Still, a digital strategy for the Postal Service cannot exist in a vacuum: it has to integrate with postal operations and strengths in the physical world. This means serving as a backbone to the nation’s infrastructure in times of emergency and providing a physical presence in large and small communities across the country, perhaps even expanding retail offerings. As a proven protector of personal information in its Address

¹ U.S. Postal Service Office of Inspector General, Risk Analysis Research Center, *The Postal Service Role in the Digital Age: Opportunities with eMailbox and eLockbox* (Working paper to be released in fiscal year 2012).

² U.S. Postal Service Office of Inspector General, Risk Analysis Research Center, *The Postal Service Role in the Digital Age: Opportunities in Digital Currency*, Report No. RARC-WP-12-001, October 3, 2012.

Management and National Change of Address systems, it could provide e-mail account confidentiality for consumers seeking private and secure electronic communication.

Implementing a strategy based solely on the analysis and action steps outlined in this paper will not resolve all of the Postal Service's structural problems. However, the reason for entering into the digital arena is to first and foremost serve the needs of the American people rather than for the Postal Service to survive or thrive. The paper does serve as an important guiding resource for postal executives and policymakers involved in building a bridge that connects all American citizens and businesses, whether in the physical or digital world.

Bridging the Digital Divide: Overcoming Regulatory and Organizational Challenges

Part III of The Postal Service Role in the Digital Age

Contents

I.	INTRODUCTION	4
II.	A LONG-TERM DIGITAL STRATEGY THAT CAPITALIZES ON THE POSTAL INFRASTRUCTURE.....	6
	A. The Inaction Option	6
	B. The “Major Internet Player” Option	7
	C. A Digital Strategy Should Capitalize on the Postal Infrastructure	10
	D. A Realistic Objective: Bridging the Physical and Digital Worlds.....	12
III.	LEGAL OBSTACLES TO IMPLEMENTING A DIGITAL STRATEGY ARE NOT INSURMOUNTABLE.	15
	A. The “Nonpostal Services” Restriction of PAEA.....	15
	1. <i>Policy Considerations</i>	16
	2. <i>Factors in Determining if a Product is a “Postal Service”</i>	18
	3. <i>Modifications of Grandfathered Nonpostal Services</i>	24
	4. <i>Pending Legislation to Modify the Nonpostal Services Restriction</i> 27	
	B. Activities that Are “Non-Services” Authorized by Section 411.....	28
	C. First Amendment Considerations.....	29
	D. Other Legal Issues.....	31
III.	RESTRUCTURING THE PRODUCT DEVELOPMENT PROCESS WOULD ENCOURAGE INNOVATIVE DIGITAL PRODUCTS.....	33
	A. Encouraging a Culture of Innovation.....	34
	B. Restructuring the Product Development Process	36
IV.	IMMEDIATE ACTION STEPS	40

BRIDGING THE DIGITAL DIVIDE: IMPLEMENTING A DIGITAL STRATEGY

EXECUTIVE SUMMARY

The U.S. Postal Service Office of Inspector General Risk Analysis Research Center (OIG) initiated a series of studies in 2011 on *The Postal Service Role in the Digital Age*. This paper, Part III in the series, addresses *how* the Postal Service can seize the unique opportunities the digital economy presents. It responds to four implementation questions:

1. What should be the Postal Service's overall objective in responding to the digital revolution?

While e-mail has displaced a great deal of hard-copy correspondence, the digital revolution has also created opportunities for the Postal Service. Building on the solid foundation of its national delivery infrastructure and its role as the guarantor of universal service, the Postal Service could become the interface between digital communication and physical delivery of letters and parcels. As the bridge between the physical and digital worlds, the Postal Service could enable its customers to move effortlessly between physical and digital communications and reap the benefits of both delivery formats. In addition, the Postal Service could strengthen its position as a key link in the e-commerce supply chain for mail and parcels. It could also provide digital postal products that address growing concerns related to security, privacy, and authentication in the Internet world. Examples include products that complement or are digital versions of current postal services, products that facilitate e-commerce, products that authenticate or validate electronic communications, and products that enable e-Government services.

2. What are the primary legal obstacles to the Postal Service offering innovative digital products?

By law, the Postal Service is restricted to offering "postal services" or specifically grandfathered "nonpostal services." Yet this restriction is not insurmountable and should not deter the Postal Service from moving forward to develop new digital products. Many new products that bridge the gap between the physical and digital worlds, such as those discussed in Part II of this Series, may be characterized as complements or digital versions of existing postal products. The Postal Regulatory Commission (PRC) could approve these products as either "postal services" or modifications of grandfathered "nonpostal services." The Postal Service is also authorized to enter into arrangements with executive agencies to provide e-Government

services.¹ At an early stage, the Postal Service can take into account the specific factors considered by the PRC in determining whether new products are allowable “postal services.” (A compilation of those factors may be found in Table 3.) Other legal issues that the Postal Service should consider in the product design stage are First Amendment implications, contracting guidelines and incentives for strategic partnerships, and protection of intellectual property.

3. What structural changes would encourage and expedite the development of innovative digital products?

The Postal Service is confronted with a disruptive technology which calls for something other than a business-as-usual approach with a limited arsenal of cost reductions and price adjustments. To encourage a “culture of innovation,” the Postal Service could establish an Innovation Department composed of independent innovation teams of cross-functional experts, who are freed from day-to-day operational responsibilities. Management could re-examine the risk tolerance levels and return-on-investment (ROI) standards applied to new digital products with an eye toward encouraging rational risk-taking. Instead of one large capital intensive project, many small forays into the digital market (which may be approved as market experiments under 39 USC. § 3641) would allow the Postal Service to gain knowledge and experience in the digital world without relying too heavily on any single initiative for success. The Postal Service could reach out to potential partners in private industry to explore a wider range of technological development. Most importantly, senior management and the Board of Governors should express and demonstrate their strong support for a culture of innovation.

4. What steps can be taken immediately to move the Postal Service toward increased relevance and long-term viability in the digital world?

First, the Postal Service could adopt an overall objective for its digital strategy such as the one suggested in this paper. It could restructure and streamline its product development process by creating an Innovation Department. That Department could start by acting on the backlog of digital products that have already been proposed, particularly those that are complements or digital versions of existing postal products. The Postal Service could expeditiously seek regulatory approval to conduct market tests of several new digital products. These tests would enable the Postal Service to gain expertise in the digital world, develop strategic partnerships, collect data to show these products are postal services, and demonstrate its competence to offer digital products on a larger scale. In addition, the Postal Service could aggressively pursue arrangements with other federal agencies to provide e-Government services and with strategic partners in private industry to expand use of the postal platform. The Postal Service must acknowledge that the digital transformation has changed its industry significantly. There is no turning back. To remain relevant in the 21st Century, the Postal Service must act now to respond to change.

¹ 39 USC § 411.

BRIDGING THE DIGITAL DIVIDE: IMPLEMENTING A DIGITAL STRATEGY

I. INTRODUCTION

The Internet and digital technology have revolutionized commerce in the new millennium. Over the past decade, the U.S. Postal Service has witnessed the devastating effects of this “disruptive innovation”² on mail volume, as mailers have abandoned traditional mail for electronic mail. In 2011, the U.S. Postal Service Office of Inspector General Risk Analysis Research Center (RARC) began a study on the impact of digital changes on the American postal system, issuing Part I on the trends and effects of the digital revolution on communications³ and Part II on expanding the postal platform. Part II proposed specific digital products in three areas: (a) services related to physical delivery of mail; (b) services addressing the risks and inherent fragility of the digital world; and (c) services facilitating the delivery of government services.⁴ Two proposed products were an “e-Mailbox,” linking an electronic address to each physical address, which would serve as a digital counterpart to the physical mailbox; and a “secure digital postal platform, accessible to all citizens through a website,” for developing effective postal and governmental applications.⁵

This paper comprises Part III of the series. It addresses the implementation question: *How can the Postal Service seize the unique opportunities presented by the digital economy?* Specifically:

1. What should be the Postal Service’s overall objective in responding to the digital revolution? (Section II)
2. What are the primary legal obstacles to the Postal Service offering innovative digital products? (Section III)

² Clayton M. Christensen, *The Innovator’s Dilemma: When New Technologies Cause Great Firms to Fail* (Boston, Massachusetts: Harvard Business School Press, 1997) (Christensen).

³ U.S. Postal Service Office of Inspector General, *The Postal Service Role in the Digital Age, Part I: Facts and Trends*, Report Number RARC-WP-11-002, February 24, 2011 (http://www.uspsoig.gov/foia_files/RARC-WP-11-002.pdf).

⁴ U.S. Postal Service Office of Inspector General, *The Postal Service Role in the Digital Age, Part II: Expanding the Postal Platform*, Report Number RARC-WP-11-003, April 19, 2011, at 12 (http://www.uspsoig.gov/foia_files/RARC-WP-11-003.pdf).

⁵ *Id.* at iii-iv.

3. What structural changes would encourage and expedite the development of innovative digital products? (Section IV)
4. What actions can the Postal Service immediately take to move toward increased relevance and long-term viability in the digital world? (Section V)

While the digital revolution has substantially displaced personal correspondence, the Postal Service – with its national delivery infrastructure – is uniquely positioned to capitalize on new opportunities. As mail volume declines, the Postal Service can do much more than reduce costs by downsizing – it can grow revenues by using its strengths, brand, and physical network to offer complementary products that enable customers to move effortlessly between digital communication and physical delivery.⁶ Nor are legal restrictions so onerous that these types of innovative digital products would be prohibited. Even without a huge influx of capital, the Postal Service can begin immediately to implement an incremental digital strategy and embrace a culture of innovation.⁷

⁶ For example, the Postal Service could leverage its current position as owner of one of the top 75 most visited websites in the nation, with 1.3 million visitors each day. <http://about.usps.com/who-we-are/postal-facts/welcome.htm#H1>. See also <http://www.alexa.com/siteinfo/usps.com#>.

⁷ Specific operational and financial feasibility analyses, which are essential steps to bringing new products to market, are recommended for individual products. See Section IV.

II. A LONG-TERM DIGITAL STRATEGY THAT CAPITALIZES ON THE POSTAL INFRASTRUCTURE

Strategic management experts offer many approaches for setting business strategies. One of the most intuitive is “See—Think—Draw.”⁸

Table 1 – Steps in Analysis	
Step in Process	Analysis
See – Evaluate the current situation	Parts I and II presented an evaluation of the current situation resulting from the disruptive technology of the Internet and digital services. ⁹
Think – Define goals/objectives	Section II of this Part III
Draw – Map a route to those objectives, surveying obstacles and opportunities	Sections III, IV, and V of this Part III.

Starting at the “Think” step, we need to determine the desired level of Postal Service involvement in the digital arena to define a realistic objective. We begin by examining the ends of the spectrum and then discuss a middle ground approach.

A. The Inaction Option

One response to disruptive innovation is inaction. Inaction can be a matter of choice or of circumstances. Some management teams deliberately choose to delay changes until a disruptive technology has been tested and is more widely adopted. “[F]or those [incumbents] with significant legacy assets, innovative technologies and services could be very disruptive if the incumbents do not remain competitive and continue to innovate. [CEOs] may be forced to choose between competing with their own businesses and having another company doing it. The threat of innovation may also cause some strong incumbents to adopt delaying tactics.”¹⁰ But management’s initial fear of “cannibalizing” its own products eventually gives way to the realization that, without change, the

⁸ This paper eschews business management terminology and adopts the intuitive three-part approach above. In addition, while we do not perform a complete SWOT (strengths, weaknesses, opportunities and threats) analysis, elements of that test are discussed throughout this Series: Strengths (Part II at 5-6), Weaknesses (Section III of Part III), Opportunities (Part II at 3-5, 12-20), and Threats (Sections III and IV of Part III).

⁹ In addition, a Boston Consulting Group Study in March 2010 offered an estimate of the future effects of electronic diversion on postal volume. See The Boston Consulting Group, Inc., *Projecting US Mail Volumes to 2020*, March 2, 2010, (<http://about.usps.com/future-postal-service/qcg-narrative.pdf>).

¹⁰ International Telecommunications Union, *ICT Regulation Toolkit*, at Section 1.4 (<http://www.ictregulationtoolkit.org/en/Section.3101.html>) (ICT Study).

company's products will become irrelevant in the changing market.¹¹ By now, the disruptive innovation facing the Postal Service — digital mail (e.g., e-mail and, increasingly, texting) — has become an integral part of the nation's communications and commerce; few dispute that the decline in First-Class Mail will continue. A conscious decision to delay adoption and implementation of a digital strategy can no longer be justified.

But inaction may not be the result of management's conscious decision. It may instead be caused by delay, indecision, bureaucracy, legal obstacles, or a risk-adverse culture. While the Internet advances with lightning speed, the Postal Service changes slowly. For example, the Postal Service's Intelligent Mail Barcode, a heavily marketed sustaining innovation, was announced to the public in 2003, first rolled out in 2009, and, as of today, has not yet been fully deployed.¹² In comparison, Apple began development of the iPhone in 2005, released the first one in 2007, and has since sold over 100 million units. A fifth generation model became available in October 2011, and over 425,000 applications are now marketed for the iPhone.¹³

Whatever the causes of inaction, digital communications and commerce have reached the point that Postal Service management has recognized it must respond with a strategy, even if it is only defensive or transitional.¹⁴ Ignoring the digital world is not an option.

B. The “Major Internet Player” Option

At the other extreme is the goal of becoming an Internet heavyweight such as Google. While implausible to some, statistics indicate that size is not a barrier: The Postal Service has revenues of \$67 billion and is the second largest employer in the nation with 574,000 employees;¹⁵ Internet “giant” Google has revenues of \$29 billion and

¹¹ “[W]hen established firms wait until a new technology has become commercially mature in its new applications and launch their own version of the technology only in response to an attack on their home markets, the fear of cannibalization can become a self-fulfilling prophecy.” Christensen, at 23, 152-153 (emphasis added).

¹² https://ribbs.usps.gov/intelligentmail_latestnews/documents/tech_guides/IMVision.pdf.

¹³ <http://en.wikipedia.org/wiki/IPhone>.

¹⁴ <http://postandparcel.info/38869/news/us-postal-service-digital-strategy-%E2%80%9Cnot-ready-for-prime-time/>.

¹⁵ U.S. Postal Service, *2010 Annual Report* (<http://about.usps.com/who-we-are/financials/annual-reports/fy2010.pdf>).

44,400 employees.¹⁶ It is worth taking time to consider whether such an ambitious goal is desirable.

First, a strong argument could be made that the failure of private enterprise to remedy Internet abuses justifies the government stepping in to protect its citizens. The Internet may have accelerated the speed and scope of communications and commerce, but it has also generated serious problems:

- Inadequate protections for privacy, confidentiality, and security – The interests of consumers in privacy, confidentiality, and security for digital communications and transactions do not always coincide with the profit-driven interests of private companies, creating the potential for problems, such as unauthorized secondary uses of private information.
- Threats to equal access to the Internet – Individuals and businesses have no guarantee that privately-owned platforms will continue to provide them equal access and nondiscriminatory treatment.
- Online scams – “A wide variety of scams operate in the online environment, ranging from fraudulent lottery schemes, travel and credit-related ploys, modem and web page hijacking, and identity theft [T]he Internet has given criminals access to a worldwide base of consumer targets as well as more opportunities to elude enforcement as they need not be in the same country, or even in the same hemisphere, as their victims.”¹⁷
- Digital infrastructure limitations – Connectivity and bandwidth may be inconsistent or may depend on private companies that could fail, effectively stranding their customers.
- Digital refugees – Many people do not have access to reliable high-speed Internet or have chosen not to use the Internet. As companies push consumers into digital-only communications, these “digital refugees” face the likelihood that their preferred delivery format will become unavailable.
- Need for affordable digital currency – Consumers who do not have bank accounts or credit/debit cards are hindered in participating in e-commerce transactions.

Initiatives to address these problems in a coordinated way may not fulfill the traditional profit-seeking motives of private enterprises. Theoretically, a government entity acting in the public interest could protect citizens, ensure equal access to the Internet, safeguard

¹⁶ <http://en.wikipedia.org/wiki/Google>.

¹⁷ ICT Study at Section 3.18 (www.ictregulationtoolkit.org/en/Section.3118.html).

personal privacy, and guarantee secure financial transactions.¹⁸ If the government determined that it had a compelling interest in ensuring a safe and accessible digital infrastructure, it could designate the Postal Service, with its vast experience in providing daily nationwide communications, to be the provider of those safeguards. Postal Service strengths that could enable it to provide a solution to some of the problems listed above include:

- history as a trusted intermediary and the most trusted federal entity;
- position of legal standing for postal communications;
- experience in developing and maintaining a national address management system that can update every address in the country;
- largest customer base in the nation;
- position as one of the top 75 most visited websites in the nation;¹⁹
- experience in facilitating communications and delivery in the first and last mile;
- last resort provider at an affordable rate since the founding of the nation;
- experience with currency transactions, including domestic and international money orders; and
- experience in performing government enforcement functions, including investigations of internal misconduct by the Office of Inspector General and of external mail fraud and Internet scams by the Postal Inspection Service.²⁰

But even if the Postal Service could leverage these strengths, it would face an even greater obstacle: Any Postal Service effort to take on greater responsibilities with respect to Internet security and access could be perceived as a major *government* presence intruding into the Internet. The Postal Service would become a lightning rod for protests against government interference with the Internet unless its services were carefully designed and essential. Currently, debates rage over net neutrality, Internet censorship, and the appropriate role of the government in the Internet. These

¹⁸ Justification for the exercise of government power to address these concerns could rest on the doctrines of police power (protecting the safety, health, and welfare of its citizens) and *parens patriae* (taking care of less capable citizens, such as the elderly or poor), as well as facilitating interstate commerce over the Internet.

¹⁹ <http://www.alex.com/siteinfo/usps.com#>.

²⁰ U.S. Postal Inspection Service, *2010 Annual Report*, at 66-67 (<http://www.postalinspectorsvideo.com/uspis/AnnualReport2010.pdf>).

controversies will not be resolved in the near future. Other government entities, such as the Federal Communications Commission, have taken the lead in addressing the Internet and will claim greater expertise than the Postal Service. The federal government's financial state also makes it unlikely that the Postal Service would receive adequate funds to assume major Internet responsibilities. As a legal matter, existing statutes do not authorize the Postal Service to play a major role in the Internet, and new legislation would face fierce opposition and likely take years to pass.²¹ For this reason alone – aside from the Postal Service's capability to transform itself into a high tech company – we do not believe that becoming a major Internet player is a viable goal for the Postal Service.

In sum, neither inaction nor over-ambition is realistic. We turn now to a middle ground strategy based upon the Postal Service's key asset – the postal infrastructure.

C. A Digital Strategy Should Capitalize on the Postal Infrastructure

Capitalizing on the distinct value of the existing postal infrastructure is the starting point for determining a realistic objective for digital services. The postal infrastructure consists of a nationwide network of 31,800 postal-managed retail locations, over 500 processing facilities,²² and a fleet of 215,000 vehicles; it is designed to reach 150 million addresses – every business and household – six days a week.²³ It consists of sorting centers,

²¹ First Amendment challenges could also be asserted. Postal Service activities in the communications field could violate First Amendment protections unless carefully designed. See Section III.

²² These include Processing and Distribution Centers, Customer Service Facilities, Network Distribution Centers, Logistics and Distribution Centers, Annexes, Surface Transfer Centers, Remote Encoding Centers, and International Service Centers.

²³ The Postal Service network accounts for the largest portion of the U.S. Postal and Shipping Sector. The U.S. Department of Homeland Security (DHS) has described the Sector as:

[A]n integral component of the U.S. economy, employing more than 1.8 million people and earning direct revenues of more than \$213 billion per year. The Postal and Shipping Sector moves over 720 million messages, products, and financial transactions each day. Postal and shipping activity is differentiated from general cargo operations by its focus on letter and flat mail, publications, and small- and medium-size packages and by service from millions of senders to nearly 150 million destinations. The sector is highly concentrated, with a handful of providers holding roughly 94 percent of the market share. Sector-specific assets include: over 400 high-volume automated processing facilities; over 40 thousand local delivery units; many and varied collection, acceptance, and retail operations; over 50 thousand transport vehicles including vans, trucks, tractor trailers and aircraft; and information and communications networks. Every sector of the economy depends on the service providers in the Postal and Shipping Sector to deliver time-sensitive letters, packages and other shipments. These time-sensitive delivery needs are critical to the Banking and Finance, Government Facilities, Commercial Facilities, and Healthcare and Public Health Sectors, who all rely heavily on the Postal and Shipping Sector for the shipment and delivery of critical documents and packages.

Postal Service-owned Post Offices™, a trained workforce, advanced mail processing systems, and a comprehensive address management service. In addition, the Postal Service has extensive intellectual property, including software for intelligent mail and change-of-address processing. The Postal Service is consistently voted the most trusted federal agency.²⁴

The Department of Homeland Security (DHS) has designated the postal network a *critical infrastructure*, “so vital to the United States that [its] incapacitation or destruction would have debilitating effect on security, national economic security, public health or safety, and any combination thereof.”²⁵ DHS has recognized that this extensive infrastructure is a unique federal asset that can be called upon during a major disaster or terrorist attack when power and phone lines are not functional.²⁶

The postal infrastructure currently plays a major role in the supply chain for e-commerce. The supply chain is the mechanism for ordering, transport, delivery, and payment of physical supplies from seller to buyer, in both business-to-consumer and business-to-business transactions. While certain stages of the modern supply chain use digital communications, products must be delivered to the purchaser through a physical delivery network. The postal network has a role in the marketing stage (Standard Mail flats and letters, newspaper advertisements, etc.), the ordering process (mail order or business reply mail), the payment stage (invoices, checks, money orders, and gift cards), the fulfillment process (delivery), the return stage (including residential pick-ups), and even the end-of-life stage of recycling.

The postal infrastructure also undergirds the Postal Service’s universal service obligation. As the affordable provider of last resort, the Postal Service is the entity that Internet and retail marketers rely on to reach *all* consumers, including those offline. Even private couriers, such as FedEx and UPS, use the postal network for last-mile delivery in many rural or high-cost areas. And “digital refugees,” consumers who have

http://www.dhs.gov/files/programs/gc_1188412546210.shtm. See also http://www.dhs.gov/xlibrary/assets/nipp_snapshot_postal.pdf.

²⁴ See <http://about.usps.com/who-we-are/postal-facts/welcome.htm>. Today, the Postal Service delivers over 170 billion pieces a year six days a week. The size and scope of the Postal Service “show the vital role that mail plays in the social and economic fabric of our society.” U.S. Postal Service, Comments of Governor Carolyn Gallagher at Board of Governors Meeting (November 12, 2010).

²⁵ http://www.dhs.gov/files/programs/gc_1189168948944.shtm.

²⁶ A vivid illustration is the Postal Service's contribution to the Katrina recovery efforts in 2005, when it moved quickly to reestablish communications; reopen lines of commerce; and deliver government information, relief checks, and medicine to hurricane victims living in makeshift shelters. Its extensive address database enabled it to locate hundreds of thousands of displaced persons so that they could be reunited with their families. The nation benefited from having a functioning, comprehensive delivery, retail, and address management infrastructure in place at the time of Katrina's landfall. See Postal Regulatory Commission, *Contribution of the Postal Service in National Emergencies*, August 31, 2011 (http://www.prc.gov/prc-docs/home/whatsnew/Emergency_Prep_Report.pdf).

no Internet access and must use, or who prefer to use,²⁷ the physical format, depend almost daily upon the postal network. As long as a significant portion of consumers continue to demand physical delivery (or a combination of physical and digital formats), it is unlikely that the postal infrastructure would be totally dismantled.²⁸

Digital refugees are beginning to encounter increasing pressure to interface with the digital economy.²⁹ For example, a company may provide free digital statements and impose a surcharge for hard copy statements. Or a customer who wants to purchase a product over the Internet may need to first obtain an acceptable form of digital currency, such as a prepaid, debit, or credit card. Because the Postal Service already operates the delivery infrastructure for mailpieces, a logical extension would be to enable its customers to send mailpieces converted to e-mails or to receive mailpieces that were originally sent as e-mails. The Postal Service is well-positioned to offer products that enable customers to move easily between the physical and digital formats.

D. A Realistic Objective: Bridging the Physical and Digital Worlds

The Postal Service is ideally suited to provide the interface between digital communication and physical delivery of letters and parcels, thereby becoming the bridge between the physical and digital worlds. It can enable customers to move effortlessly between physical and digital communications by offering products that facilitate e-commerce and allow customers to reap the benefits of both digital and physical delivery formats.

For example, customers of hybrid mail could choose between having their mailpieces delivered physically or electronically on a daily basis. Or businesses using a Postal Service product that pairs a physical address with an e-mail address would have the flexibility to send direct marketing mail to prospects or e-mails to customers, or any combination of the two. A consumer with a physical address paired to a personal e-mail address would no longer have to provide delivery information at individual websites each time he or she makes an Internet purchase. Table 2 shows other digital products, such as those identified in Part II of this Study, which would further this objective.

²⁷ In this paper, the term “digital refugees” includes those people who do not want to use the Internet for security, privacy, or personal reasons, as well as those people who do not have physical access to broadband.

²⁸ Of course, the postal infrastructure should be streamlined to reflect decreasing mail volumes, and unnecessary costs should be removed from the system, including excessive pension and retiree health care prefunding obligations.

²⁹ See, e.g., <http://www.nytimes.com/2009/08/29/business/29postal.html>.

Table 2 – Proposed Digital Products	
Proposed Product	How it furthers the overall objective
Coupled Physical and E-mail Address	Allows recipient to move freely between electronic and physical addresses and creates delivery options for sender.
Hybrid mail	Allows recipient flexibility to choose electronic or physical delivery on a daily basis.
Enabling e-commerce	Merges physical delivery with digital communication in supply chain through track and trace.
Digital currency exchange	Enables those without a bank account and credit card to order over the Internet.
Authentication tools	In-person identification at postal facilities (similar to passport application procedures) increases security in Internet transactions.
e-Government	Through kiosks in Post Offices, citizens without Internet access can interact with government agencies. Government agencies have the option of reaching citizens using electronic or physical formats.

The Postal Service could explore four categories of products which meet this “bridging” objective and which could be implemented in the short term:³⁰

1. Digital complements of existing services: Under its "bind the nation together" mandate, the Postal Service could offer hybrid electronic/physical postal services, in effect offering a digital *complement* of an existing product to facilitate interaction with the digital world.
2. Digital versions of existing mail products: This would include a wide range of secure digital products, including provision of an electronic address for every physical address, expanded Electronic Postmark[®] services, and electronic money orders (including electronic transfers via prepaid cards). Successful market tests of new products would lay the foundation for final regulatory approval of products on a larger scale and would demonstrate the Postal Service's Internet capabilities.
3. E-commerce services: Closely tied to the marketing and delivery roles that the postal infrastructure already performs, these services could include Walmart/UPS-type package pickups at Post Offices, using Post Offices as showrooms for ordering e-commerce products, online ordering, digital currency, online shipping and tracking, parcel lockers, and online logistics services.

³⁰ See Section III for a discussion of the Postal Service's legal authority to offer these types of services.

4. E-Government services: The Postal Service could provide electronic access to government agencies through kiosks in Post Offices, reloadable prepaid cards for government benefits, and in-person identification services.

In its current financial state, the Postal Service does not have the funds to acquire Internet companies, and, without specific expertise, plunging into the fast-changing Internet world would be risky. Instead, by adopting an incremental approach, the Postal Service could leverage its current delivery expertise, infrastructure, and customer base to develop products that are digital versions or complements of existing mail services. Because they would be related to existing products, funding could be handled in the same way as other product improvement initiatives. Some complementary digital products, such as parcel lockers, could even reduce postal costs. In addition, the Postal Service could cultivate strategic partnerships in the digital world, and joint ventures with digital companies could become an additional source of funding.

Many small forays in the digital market are preferable to one large capital intensive project. “[I]n many instances, the information required to make large and decisive investments in the face of disruptive technology, simply does not exist. It needs to be created through fast, inexpensive, and flexible forays into the market and the product. The risk is very high that any particular idea about the product attributes or market applications of a disruptive technology may not prove to be viable. Failure and iterative learning are, therefore, intrinsic to the search for success with a disruptive technology.”³¹ Engaging in many small scale market tests for new postal products would minimize risks and provide an opportunity for the Postal Service to acquire expertise, grow strategic partnerships, and build a positive track record for digital services. The market tests would allow the Postal Service to diversify its portfolio by taking on a few riskier projects. In addition, the Postal Regulatory Commission has expressed a policy of encouraging the Postal Service to undertake more market tests.³²

Rather than being paralyzed by the specter of cannibalization – concern that digital products would take away from existing mail volume – the Postal Service could use hard data from its market tests to determine whether a particular digital product diverts revenues from other products and whether the new revenue will outweigh the lost revenue in the long run. In any event, the Postal Service may find it has little choice as the window of opportunity to join the digital revolution closes – it must enter the digital market to keep in step with the rest of the digitized commercial world.³³

³¹ Christensen, at 259-60.

³² See Section III.A.1.

³³ Several foreign posts have begun to offer digital services to counter the disruptive effects of digital changes on physical mail. Examples are e-Boks, a company founded jointly by Post Denmark and a private company (Nets), which provides a secure electronic mailbox and archiving solutions through partnership with the banking industry; Israel Post’s iPost, which provides e-Mailbox and archiving services with the capability to conduct online bill payment, hybrid mailings, and, potentially, links of electronic and

III. LEGAL OBSTACLES TO IMPLEMENTING A DIGITAL STRATEGY ARE NOT INSURMOUNTABLE.

The Postal Service has asserted that its efforts at innovation are often stifled by legal restrictions,³⁴ particularly the prohibition of “nonpostal services” in the 2006 Postal Accountability and Enhancement Act (PAEA).³⁵ But the Postal Service should not be deterred from moving forward to develop new products that bridge the gap between digital communication and physical delivery; for many of these products, the legal obstacles are not insurmountable. Digital products that complement or are digital versions of existing postal services would have a greater chance of being approved as postal services. This section examines what factors have been used to determine whether a product is a “postal service” and how those factors could apply to digital products.³⁶ We also point out other legal issues that digital products may present.

A. The “Nonpostal Services” Restriction of PAEA

Section 101(a) of Title 39 provides, “The Postal Service shall have as its basic function the obligation to provide postal services to bind the nation together” Section 403(a) states, “The Postal Service shall receive, transmit, and deliver throughout the United States [and] the world, written and printed matter, parcels, and like materials and provide such other services incidental thereto as it finds appropriate to its functions and in the public service.”

The PAEA added the restriction that the Postal Service may offer only “postal services” or those “nonpostal services” that were already in effect at the time PAEA was enacted in 2006.³⁷ Section 404(e) directs the PRC to review each nonpostal service offered by the Postal Service on December 20, 2006, to determine whether a nonpostal service should continue, taking into account the public need for the service and the ability of the private sector to meet that public need.³⁸ The Postal Service was required to terminate any nonpostal service the PRC concluded should not continue.³⁹ Services that the PRC

physical addresses; and Canada Post’s digital services, which include ePost, an electronic mailbox, PosteCS, a secure Internet-based document delivery service, and Borderfree, an e-commerce and cross-border delivery platform to streamline international online purchases.

³⁴ See discussion at 35 & n.111.

³⁵ Pub.L.109-435, 120 Stat. 3198.

³⁶ Of course, the precise application of current regulations will depend on the specific design of each proposed product.

³⁷ 39 U.S.C. § 404(e)(2).

³⁸ *Id.* § 404(e)(3).

³⁹ *Id.* § 404(e)(4).

allowed to continue are regulated under Title 39 as market dominant, competitive, or experimental products.⁴⁰ From 2008 to 2009, the PRC conducted a two-phase review in Docket No. MC2008-1, culminating in Order No. 154, issued December 19, 2008,⁴¹ and Order No. 392, issued January 14, 2010.⁴²

Section 102(5) defines “postal services” as “the delivery of letters, printed matter, or mailable packages, including acceptance, collection, sorting, transportation, or other functions ancillary thereto.” If a service relates to the carriage of mail or if it serves “other functions ancillary” to the carriage of mail, it may be classified as a postal service.⁴³ The term “nonpostal service” means any service that does not meet the terms of this definition.

The question then is whether a particular digital product may be classified as a “postal service.” If not, since grandfathering is no longer available, the product is allowable only if it is a modification of a previously grandfathered service or if it has independent statutory authorization (e.g., under arrangements with other government agencies as allowed under 39 U.S.C. § 411).

1. Policy Considerations

Before reviewing the case law, we examine three policy imperatives that would come into play in the PRC’s review of a new digital product. The first is the Universal Service Obligation (USO) of the Postal Service, generally defined as the obligation to provide adequate service to all parts of the country at an affordable price. In its December 2008 *Report on Universal Service and the Postal Monopoly*,⁴⁴ the PRC found that “[t]he current obligation to provide service to all persons in all parts of the Nation, its

⁴⁰ *Id.* § 404(e)(5).

⁴¹ Order No. 154, Postal Regulatory Commission Docket No. MC2008-1, *Phase I Review of Nonpostal Services under the Postal Accountability and Enhancement Act*, December 19, 2008, *aff’d*, *United States Postal Service v. Postal Regulatory Commission*, 599 F.3d 705 (D.C. Cir. 2010) (Order No. 154).

⁴² Order No. 392, Postal Regulatory Commission Docket No. MC2008-1, *Phase II Review of Nonpostal Services under the Postal Accountability and Enhancement Act*, January 14, 2010 (Order No. 392), *rev’d*, *LePage’s 2000 v. Postal Regulatory Commission*, Case No. 10-1031 (D.C. Cir. June 7, 2011) ([http://www.cadc.uscourts.gov/Internet/opinions.nsf/66ED748E95B9C59D852578A8004E1021/\\$file/10-1031-1311837.pdf](http://www.cadc.uscourts.gov/Internet/opinions.nsf/66ED748E95B9C59D852578A8004E1021/$file/10-1031-1311837.pdf)) (*LePages*).

⁴³ Order No. 154 at 30.

⁴⁴ The Report set forth seven attributes of the universal service obligation: (1) geographic reach; (2) range of products; (3) access to postal facilities; (4) delivery frequency; (5) prices/affordability; (6) quality of service; and (7) users’ rights. “The USO is not specific,” and thus the PRC agreed that the Postal Service should have continued flexibility in balancing the needs and expectations of the nation against budgetary constraints. <http://www.prc.gov/Docs/61/61628/USO%20Report.pdf>.

territories, and possessions, is paramount, and should not be altered.”⁴⁵ Postal products that make access to commerce possible, convenient, or secure would further the goal of binding the nation together by ensuring that digital refugees are not left behind. For example, a digital product that converts an e-mail to a physical mailpiece would benefit citizens who do not have access to broadband and thus would fall squarely within the USO.

The second policy consideration, embodied in the PAEA, is that the Postal Service cannot use its postal monopoly to compete unfairly in the provision of new competitive products. Title 39, section 3633 directs the PRC to promulgate regulations to “prohibit the subsidization of competitive products by market-dominant products . . . and ensure that each competitive product covers its costs attributable.”⁴⁶ Most new digital products would likely be classified as “competitive products,” but this factor alone would not prohibit their development, only their unlawful subsidization. While separate accounting for digital products may complicate the process of bringing them to market, it is not an insurmountable hurdle, as the Postal Service has demonstrated with other competitive products.⁴⁷

The third consideration is the Commission’s policy of encouraging market experimentation by the Postal Service. Under Section 3641 of the PAEA, the Postal Service may conduct a two-year market test of an experimental product, if the product is significantly different from those offered within the preceding two years, does not create an unfair competitive advantage for the Postal Service or any mailer, and is correctly classified as market-dominant or competitive. Total revenues may not exceed \$10 million in any one year, unless the PRC grants an exemption, and even then revenues may not exceed \$50 million in any one year. In addition, as the PRC recently ruled, the Postal Service must show that the proposed product falls within the definition of “postal services,” at least on a preliminary basis.⁴⁸

⁴⁵ *Id.* at 4.

⁴⁶ See 39 U.S.C. §§ 404a and 3633.

⁴⁷ This analysis focuses on policy and legal concerns. Political considerations could also play a role. Even if the Postal Service provides separate accounting for digital products and demonstrates that it is not unlawfully subsidizing them, businesses may argue — as some have in the past — that, in general, the Postal Service should refrain from competing in new sectors where private operators exist. Therefore, in selecting the digital products it pursues, the Postal Service should factor in not only its ability to meet subsidization and other legal standards, but also political and commercial factors. In some instances, it may prefer to pursue digital initiatives through partnership agreements with the private sector.

⁴⁸ In the Postal Service’s first request to conduct a market test, Docket No. MT2009-1, the question of whether the proposed product was a postal service was not raised by the parties or addressed by the PRC. The proposed product involved an arrangement with Collaborative Logistics to sell excess space on postal trucks. Arguably, this product was an offering that is ancillary to the transportation function of the Postal Service. The issue is moot, however, because the Postal Service indicated that it is terminating the market test as of September 1, 2011. Notice of the United States Postal Service of Termination of Market Test, Docket No. MT2009-1, August 19, 2011.

In Order No. 721 in Docket MT2011-2, a majority of the PRC ruled:

The PAEA affords the Postal Service considerable flexibility to conduct market tests. Such tests, however, are limited to postal services. The Postal Service and commenters have made a sufficient showing. . . to justify permitting the market test to proceedThe Commission cautions that this ruling is limited to the market test itself. It is imperative that the Postal Service collect data on the sale of gift cards to demonstrate the portion of gift cards mailed (or likely to be mailed). The Postal Service cannot be expected to have this information absent the market test. Thus, the market test provides a means to obtain corroborating information, to support gift cards' favorable comparison to money orders and greeting cards.⁴⁹

The referenced footnote is instructive: "To be clear, if the market test proves to be a success and the Postal Service requests to add gift cards to the competitive product list, it must submit information demonstrating that gift cards are (or are likely to be) mailed." In effect, in order to encourage experimentation of new products, the PRC granted the Postal Service permission to conduct a limited market test; customer usage patterns derived from that market test would then buttress the PRC's *preliminary* finding that the product was a postal service. Under this reasoning, the PRC would be inclined to allow the market test of a digital product on the basis of a credible assertion that it is a "postal service" and a Postal Service plan to collect data to support the preliminary determination.

2. *Factors in Determining if a Product is a "Postal Service"*

As explained above, Section 102(5) defines "postal services" as "the delivery of letters, printed matter, or mailable packages, including acceptance, collection, sorting, transportation, or other functions ancillary thereto." The PRC's definition of "service" in Order No. 154, upheld by the D.C. Circuit Court of Appeals, is "any ongoing commercial activity offered to the public for the purpose of financial gain." Under this definition, arrangements between the Postal Service and other government agencies would not be considered the provision of "services". Digital products offered to the public would likely be considered "services".

As services, the proposed products must either be related to acceptance, collection, sorting, or transportation, "broadly, the carriage of mail" or serve "other functions ancillary" to the carriage of mail.⁵⁰ The question presented is whether a digital product that bridges the gap between physical and digital communications falls under the

⁴⁹ Order No. 721, Postal Regulatory Commission Docket No. MT2011-2, *Market Test of Experimental Product—Gift Cards*, April 28, 2011 (Order No. 721).

⁵⁰ Order No. 154 at 30.

phrase “other functions ancillary thereto.”⁵¹ The case law interpreting these four words, however, is in flux.

Order No. 154 defines “ancillary” as “auxiliary, subordinate, or subsidiary.” It reaffirms the finding in Docket No. R76-1, in the context of special postal services, that:

Special postal services – that is, those which fall within the ambit of § 3622 – are services other than the actual carriage of mail but supportive or auxiliary thereto. They enhance the value of service rendered under one of the substantive classes by providing such features as added security, added convenience or speed, indemnity against loss, correct information as to the current address of the recipient, etc.⁵²

Order No. 154 explained that since “carriage of mail encompasses collection, transmission, and delivery,” a special postal service would be a service that is “ancillary to one or more of these steps.”⁵³

The PRC also quoted *Associated Third Class Mail Users v. U.S. Postal Service*:

It is clear that nearly all of these other services are very closely related to the delivery of mail. The single possible exception is the selling of money orders, since they can be used equally as well without being delivered by mail. But it does seem that the *vast majority of money orders sold at post offices are actually sent by mail*. Therefore, it appears safe to say that all of these services would be considered “postal services” in ordinary parlance.⁵⁴

Other than these pronouncements, however, the PRC’s interpretation of the phrase “other functions ancillary thereto” must be gleaned from the types of products that the Commission has decided meet this description. In Docket No. MC2008-1, five products were deemed “ancillary” and allowed to continue as “postal services.” A sixth product has since been deemed to meet the “ancillary” test, at least on a preliminary basis. We examine below the factors the PRC considered in evaluating each of these products:

⁵¹ One could argue that the words “letters” and “printed matter” encompass both physical and electronic letters and printed matter, and that the transmission (or “transportation”) of electronic versions falls under the first part of the definition of postal services.

⁵² PRC Op. R76-1, Vol. I, at 266-267 (footnote omitted).

⁵³ Order No. 154 at 30 n. 68.

⁵⁴ *Associated Third Class Mail Users v. U.S. Postal Service*, 405 F.Supp.1109, 1115 (D.D.C. 1975) *aff’d* *NAGCP v. U.S. Postal Service*, 569 F.2d 570, 596 (D.C. Cir. 1976), *vacated in part on other grounds*, 434 U.S. 884 (1977) (*ATCMU*) (emphasis added).

Address management services: Address quality and support services associated with undeliverable as addressed (UAA) mail and the Move Update program “enable mailers to improve the quality of addresses on their mailpieces, and in some instances to qualify for postage discounts.”⁵⁵ The PRC found that “*Like an existing special service, address correction service, Address Management Services are ancillary to the carriage of mail, enhancing both the delivery and sortation of mail.*”⁵⁶

ReadyPost®: The sale of shipping supplies at postal retail locations was deemed “ancillary to the carriage of mail” despite a previous decision under the 1970 Postal Reorganization Act (PRA) that the sale of packaging materials was not a postal service.⁵⁷ The PRC approved ReadyPost® because:

- It is likely that most ReadyPost® products are mailed.
- ReadyPost® product lines are available in Post Offices and are designed to meet customers’ mailing needs.
- Customers are assured that such products meet the packaging and labeling requirements of the Postal Service and use of approved packaging and labels lowers the Postal Service’s handling and transportation costs.
- “Making these postal-related products available at retail outlets offers convenience to the customer and makes access to the mailstream easier.”⁵⁸

Greeting cards: The Postal Service sells note cards, greeting cards, and other stationery items in Post Offices and features stamp designs and other postal intellectual property on some, but not all, cards.⁵⁹ The PRC considered the following factors in finding these products were “ancillary”:

- “A majority of these products are mailed.”
- They “are designed to foster the use of the mails.”
- Greeting cards are “a particularly valued form of personal communications [and] serve to bind the Nation together through personal correspondence, a basic function of the Postal Service.”

⁵⁵ Order No. 154 at 33.

⁵⁶ *Id.* (emphasis added).

⁵⁷ PRC Op. R76-1, Vol. II, App. F, at 2021.

⁵⁸ Order No. 154 at 33.

⁵⁹ *Id.* at 34 n.73.

- They offer benefits of “customer convenience and assurance that such products satisfy the Postal Service’s processing requirements.”
- No party objects to classifying greeting cards as a postal service.⁶⁰

Customized postage: Customers of customized postage vendors obtain Postal Service-authorized postage consisting of customer-specific, customer-supplied images aligned with Postal Service-approved indicia of postage payment. The PRC determined that customized postage is “a form of postage prepayment, *a core function of the Postal Service* It is indistinguishable from the prepayment of postage via postage meters, *a long-recognized special postal service*. The payment of postage is a prerequisite to the carriage of mail.”⁶¹

International Money Transfer Service (IMTS): The PRC found that payments or fund transfers to individuals or firms in foreign destinations were postal services, because hard copy international money orders were the counterpart of domestic money orders.

Domestic money orders *have long been classified as a postal service* On balance, given the Postal Service’s *extensive history* in providing remittances to customers, the *unique role that postal administration may serve in this area*, and that IMTS offered through postal networks is ancillary to hardcopy postal services, the Commission is persuaded that IMTS should be classified as a postal service.⁶²

The PRC specifically addressed whether a distinction should be drawn between electronic and hard-copy money transfers:

IMTS uses modern technology to extend and enhance the service that has been provided for many years. *It would seem needlessly short-sighted to restrict the service solely to hardcopy form, one long recognized as a postal service, when the electronic alternative has long been provided and serves the same function.*⁶³

⁶⁰ The PRC also noted that selling a Frank Sinatra CD to promote the Sinatra stamp and greeting card was appropriate but that the Postal Service website “appears to be selling a number of popular music CDs that are not obviously related to any stamp. Sales of CDs do not appear likely to be a postal service, and are not authorized as ‘greeting cards.’” *Id.* at 35.

⁶¹ *Id.* at 36.

⁶² Order No. 154 at 37-38 (emphasis added).

⁶³ *Id.* (emphasis added).

On the basis of Order No. 154, there is no reason to bar domestic and international money transfer services in both the hard copy and electronic formats.⁶⁴ It would also be logical to allow the Postal Service to offer electronic bill payment,⁶⁵ a form of money transfer similar to an electronic money order.⁶⁶

These five services were the only products out of 47 revenue-generating activities that the Postal Service presented to the PRC as “postal services.” The Postal Service took the position that 15 additional “activities” were “nonpostal services” but argued that they should be grandfathered under Section 404(e).⁶⁷ In refusing to grandfather one of those nonpostal activities, Stored Value Cards (SVCs), the PRC specifically left open the question whether SVCs could be classified as a postal service.⁶⁸ That question was later addressed in Docket No. MT2011-2 when the Postal Service requested a market test to sell gift cards.

Gift cards: Recently, the Postal Service proposed a market test to offer a gift card loaded with a specified sum of money which could be sent through the mail. Despite the opposition of several parties, a majority of Commissioners in Order No. 721 found that “the Postal Service has satisfactorily demonstrated, *at least preliminarily*, that the experimental product is a postal service. Thus, the market test may proceed.”⁶⁹ Factors the PRC considered were:

⁶⁴ The Order decided that international money orders are postal services, whether they are sent by hard copy or electronically. There is no logical reason to treat domestic money orders differently. Domestic money orders should thus continue to be classified as postal services, whether they are sent by hard copy or electronically.

⁶⁵ In Docket No. MC2008-1, postal officials indicated that many money orders are sent to billers for payment of accounts, which then deposit the money orders into the customer accounts. There is little functional difference between a hard-copy money order sent to a utility company and a money order sent electronically to pay a utility bill, in effect, a bill payment service.

⁶⁶ As alluded to in footnote 47, businesses that currently offer electronic bill payment may oppose Postal Service entry into this line of business. In developing an e-billing product, the Postal Service may wish to explore a partnership arrangement.

⁶⁷ The PRC found that 26 of the 47 revenue-generating activities identified by the Postal Service were not services and not subject to review under 39 U.S.C. § 404(e); five of the revenue-generating activities met the definition of postal services; and fifteen of the revenue-generating activities met the definition of nonpostal services. Of those fifteen, one (Stored Value Cards) was not offered on January 1, 2006, and thus was not allowed to continue. For those authorized nonpostal services, the PRC initiated a rulemaking proceeding to determine the scope and extent of regulation of those services. Due to the lack of sufficient record evidence, the PRC deferred its decision in two areas, Licensing of Mailing & Shipping services and the Warranty Repairs Program, until completion of Phase II of the proceeding, discussed *infra*.

⁶⁸ Order No. 154 at 48 n. 90.

⁶⁹ Order No. 721 at 8.

- “An important consideration in this decision is the requirement that the Postal Service collect data to support its supposition that the gift cards will be mailed.”
- Gift cards may reasonably be compared with two existing postal services, money orders and greeting cards.
- Gift cards are often transmitted in greeting cards. In fact, the greeting card industry has a product line designed to hold such cards.
- “The experimental product at issue in this proceeding has features similar to two existing postal services. *Given that link, the fact that it is not on all fours with those products is not disqualifying since the market test will provide, among other things, evidence of the nexus.*”⁷⁰

The majority relied heavily on the fact that its determination was made in the context of a market test and was thus preliminary: “The Postal Service and commenters have made a sufficient showing . . . to justify permitting the market test to proceed on the theory that gift cards sold in retail postal facilities *are likely to be mailed*. The PRC cautions that this ruling is limited to the market test itself.”⁷¹

The PRC specifically noted that the Court’s finding in *ATCMU* that money orders were a postal service was tied to the likelihood that they would be mailed.⁷² Moreover, the availability of gift cards in retail postal facilities will “increase customer convenience, *complement* two existing postal products, stimulate demand for postal services, and, if the market test is successful, enhance Postal Service revenue by encouraging the use of the mail.”⁷³

Table 3 summarizes the factors that have been articulated by the PRC⁷⁴ and provides examples of how these factors would apply to specific digital products. Any proposed digital product should be designed with these factors in mind.

⁷⁰ *Id.* at 8-10.

⁷¹ *Id.* at 11.

⁷² See *ATCMU* at 1115.

⁷³ Order No. 721 at 9 (emphasis added).

⁷⁴ Several of these factors were quoted in the D.C. Circuit Court’s review of the PRC’s analysis in the appeal of MC2008-1. See *LePages* at 6.

Table 3 – Factors in “Postal Service” Determination

Factor	Twin Prepaid Card	Hybrid Mail	Pairing digital and physical mail addresses	Enabling e-Commerce
Will likely be mailed	Yes	Involves physical mail	Possibly	Results in packages mailed
Enhances customer convenience or meets customer needs	Yes	Yes	Yes	Yes
Complements existing postal products	Yes, like money orders and IMTS	Yes	Yes	Yes
Stimulates demand, fosters use of the mail	Yes	Yes, physical mail is more flexible	Yes	Yes
Like an existing postal product, historically offered	Like money orders and greeting cards	Like snowbird forwarding	Yes	
Makes access to mailstream easier		Yes	Yes	Yes
Satisfies processing requirements			Possibly	Possibly
Valued form of communication or core function	Yes		Possibly	
Enhances delivery and sortation		Yes	Yes	Possibly
Lowers USPS' operational costs		Yes		Possibly
Enhances USPS revenue	Yes	Yes	Yes	Yes
Third party objections	Unknown	Unknown	Unknown	Unknown

3. *Modifications of Grandfathered Nonpostal Services*

A digital product that fails to meet the ancillary test may still be allowed if the Postal Service can show that the product is a modification of an existing product that received grandfathering treatment in Docket No. MC2008-1. Although the PRC has not explicitly ruled on this issue, this conclusion is implicit in the language of Order No. 154 on the Electronic Postmark and web-based linking agreements and in its handling of the Postal Service’s licensing program.

Electronic Postmark® (EPM): In grandfathering EPM, the PRC recognized that there was a public need for the service of authenticating electronic files⁷⁵ and that the Postal Service was uniquely positioned to fulfill that need:

- “EPM provides the Postal Service’s imprimatur of trust to electronic files.”
- “Postal operators may have a unique role to play in authenticating electronic files.”⁷⁶
- “*EPM provides a technological platform that may serve as a foundation for digital applications offering the trust of the Postal Service, which may provide additional benefits to the public.*”⁷⁷

The phrase “*a technological platform that may serve as a foundation for digital applications offering the trust of the Postal Service*” implies that future digital applications built on the EPM foundation would be permitted. The Postal Service could reasonably argue that enhancements to EPM, such as digital applications for identity validation, privacy protection, or secure storage for electronic documents, fall under EPM’s grandfathering umbrella.⁷⁸

Web-based linking service: The PRC grandfathered the Postal Service’s “affiliate website linking service,”⁷⁹ agreeing with the Postal Service’s characterization of web-based linking agreements as leases of “virtual real estate”:

The service provides very convenient means for customers to access information about mail-related products to assist them in the preparation and handling of their mail. This service may also lead to an increase in the

⁷⁵ EPM is “an auditable time-and-date service offered by authorized service providers that enables users to detect whether documents stamped with an EPM have been altered or modified. Once applied to a document or file, an EPM seal may be used to verify the authenticity (content) of a document or file sent electronically as of a specific point in time. EPMs . . . are stored in . . . repositories and available for verification The Postal Service serves as the backup verifier for all EPMs.” Order No. 154 at 50.

⁷⁶ Referencing Microsoft Corporation’s comments, the PRC explained, “postal operators are uniquely positioned to employ the trust they have earned in the physical world to use in the digital world. [Microsoft] argues that EPM satisfies ‘the public need for trusted electronic communication in a way no private sector organization could rival.’” *Id.* at 53.

⁷⁷ *Id.* at 53-54.

⁷⁸ The Postal Service would need to show that the enhanced offering is not an entirely new “product,” an issue that has been raised in other contexts.

⁷⁹ The six agreements involved links to a provider of mailing labels, a seller of maps for targeting direct mail campaigns, an operator of an online, interactive directory, Click2 Mail which allowed customers to create and send mail, including letters, brochures, postcards, and certified mail, and two providers that offered services for creating and sending high-gloss postcards, and/or gift cards. *Id.* at 77-78.

mail volumes or use of related services. Overall, this affiliate website-linking service encourages not only the use of the mails, but by increasing product knowledge for all customers visiting the sites, it can have a positive impact on the mailing industry and the economy.⁸⁰

The PRC specifically noted that “given that these lease agreements provide ‘access to these mailing resources through the Internet,’ it may be that . . . one or more of these linking arrangements would be more properly classified as a postal service.”⁸¹ Although not entirely clear,⁸² the Order appears to have grandfathered the broader service of “[l]easing (virtual) space for links to vendors” rather than each of the six separate affiliate linking agreements, and thus, the Postal Service could enter into additional linking agreements as part of the overall grandfathered service. The Postal Service could also argue, as the PRC suggested, that a link to a website offering mail-related products should be classified as a postal service.

Licensing: The Postal Service might also consider licensing its brand to vendors of digital products or Internet applications rather than offering the digital products itself. In Phase I of the PRC’s hearing on nonpostal services (Docket No. MC2008-1), the PRC distinguished between licensing postal-themed products (the “Bears and Scales program”) and licensing products “that related to the Service’s core business of delivery of the mail.”⁸³ In Phase II of the proceeding, the PRC refused to grandfather the second type of licensing program, as it applied to the Bubblewrap arrangement, finding an insufficient showing of public need. The D.C. Circuit Court of Appeals overturned this distinction, holding that the Phase II decision contradicted the Phase I decision: In Phase I, the PRC found a public need for the service “offered by” the Postal Service – *licensing of the Postal Service brand* – but, in Phase II, it inexplicably switched the test to the public need for the “*sale of the Bubblewrap product*,” by the vendor LePage’s 2000.⁸⁴ “Yet the service offered by the Postal Service in the Bubblewrap program is, of course, the licensing of intellectual property. The PRC’s focus on the economic effect of the *products* that result from licensing, then, would seem to depart from the Act’s plain

⁸⁰ Order No. 154 at 78-79.

⁸¹ *Id.*

⁸² Some uncertainty is created by the PRC’s separate statements that “the affiliate website-link program should be authorized to continue as a nonpostal service” and “[u]nless otherwise demonstrated, each of the ongoing affiliate linking arrangements represents a separate product.” *Id.* at 79.

⁸³ *Id.* at 74.

⁸⁴ *LePages, supra*. The Court had some unusually harsh words for the PRC: “The Commission’s order is rife with anomalies, any one of which is sufficient to justify a remand, and all of which, when considered together, demonstrate the Commission was proceeding in a slapdash manner.” *Id.* at 11.

language.”⁸⁵ The D.C. Circuit vacated the order and remanded the case to the PRC. The PRC has not yet commenced remand proceedings.

It may turn out that licensing the Postal Service brand to Internet applications or digital products provided by third parties is promising area of opportunity. We recommend that the Postal Service move forward with other digital initiatives while awaiting further guidelines and clarification for licensing digital products.

4. *Pending Legislation to Modify the Nonpostal Services Restriction*

Several bills pending in Congress propose modifying the nonpostal services restriction. For example, H.R. 1262, introduced by Rep. Gerry Connolly of Virginia, on March 30, 2011, would allow the Postal Service:

to provide services other than postal services, but only after determining that the provision of those other services would use the processing, transportation, delivery, retail network, and technology of the Postal Service (whichever apply) in a manner that is consistent with the public interest.⁸⁶

Senate Bill 1789, The 21st Century Postal Service Act of 2011, as introduced by Senator Joseph Lieberman⁸⁷, on November 2, 2011, would amend Section 404 to allow the Postal Service to provide other services that are not postal services, after the Postal Regulatory Commission--

(A) makes a determination that the provision of such services--

(i) uses the processing, transportation, delivery, retail network, or technology of the Postal Service;

(ii) is consistent with the public interest and a demonstrated or potential public demand for--

(I) the Postal Service to provide the services instead of another entity providing the services; or

(II) the Postal Service to provide the services in addition to another entity providing the services;

(iii) would not create unfair competition with the private sector; and

⁸⁵ *Id.* at 13-15.

⁸⁶ <http://thomas.loc.gov/cgi-bin/bdquery/D?d112:1:./temp/~bdo9OT:@@D&summ2=m&/home/LegislativeData.php>

⁸⁷ Other co-sponsors include Senators Scott Brown, Thomas Carper, and Susan Collins.

(iv) has the potential to improve the net financial position of the Postal Service, based on a market analysis provided to the Postal Regulatory Commission by the Postal Service; and

(B) for services that the Postal Regulatory Commission determines meet the criteria under subparagraph (A), classifies each such service as a market-dominant product, competitive product, experimental product, or new product, as required under chapter 36 of title 39, United States Code⁸⁸

In effect, this legislation would allow the Postal Service to provide any service that utilizes the postal infrastructure, as long as the PRC finds that the service is in the public interest, does not create unfair competition, and is justified through Postal Service market analysis to potentially improve the financial position of the organization.

In addition, H.R. 2309, introduced by Rep. Darrell Issa of California on June 23, 2011, contains provisions on nonpostal services that would expand the Postal Service's advertising program and programs for state government services.⁸⁹

These legislative proposals offer the possibility that the Postal Service's legal authority to pursue digital products may be expanded in the future. However, controversy surrounding the Postal Service's current financial crisis may prevent any postal legislation from moving forward this year. Nonetheless, as demonstrated above, the Postal Service already possesses the legal wherewithal to initiate several digital activities. Section IV of this Paper outlines a path forward to develop and implement digital initiatives under existing authority.

B. Activities that Are "Non-Services" Authorized by Section 411

Enacted in 1970, section 411 of Title 39 states, "Executive agencies . . . are authorized to furnish property, both real and personal, and personal and nonpersonal services to the Postal Service, and the Postal Service is authorized to furnish property and services to them." The restrictions on nonpostal services later added by PAEA in 2006 were not intended to apply to activities that are not "commercial."⁹⁰ The PRC acknowledged, "Plainly, the activities undertaken by the Postal Service pursuant to 39 U.S.C. § 411 are neither commercial in nature nor offered to the public for purposes of financial gain. Thus, notwithstanding their characterization under the PRA [as nonpostal services], they are not deemed to be services for purposes of review under 39 U.S.C. § 404(e)."⁹¹ The U.S. Court of Appeals for the D.C. Circuit has agreed: "several revenue-generating

⁸⁸ <http://thomas.loc.gov/cgi-bin/query/z?c112:S.1789>.

⁸⁹ See H.R. 2309 at Section 407 (<http://thomas.loc.gov/cgi-bin/bdquery/z?d112:HR02309:@@X>).

⁹⁰ Order 154 at 21.

⁹¹ *Id.* at 59.

activities—including . . . services provided to government agencies—did not qualify as ‘services’ under the PRC’s definition and, therefore, were not subject to the PRC’s review.”⁹²

Services to executive agencies under Section 411 can be implemented without PRC approval as soon as the Postal Service reaches an agreement with the federal agency on “terms and conditions, including reimbursability.” Government services could include issuance of a Postal Service Stored Value Card (SVC) loaded with IRS tax refunds or government benefits, such as monthly Social Security, Black Lung Disability, Veteran’s Retirement, or Railroad Retirement payments. The Postal Service could cash government checks or SVCs; handle transfers of funds received from government payments; provide identification services; or load government SVCs at Post Offices, Automated Postal Centers, or through letter carriers. Many recipients of these government services may be members of the unbanked population, and providing convenient and safe access to government services at local Post Offices would be an added benefit to society.

In a similar vein, the Postal Service could establish kiosks in some Post Offices to provide convenient citizen access to government services and agencies via the Post Office’s Internet connection. This could be particularly beneficial to individuals who lack reliable access to the digital world. In addition, through outreach to executive agencies, the Postal Service could explore additional collaborative digital initiatives. By providing Internet-related services to executive agencies under Section 411, the Postal Service could gain operational expertise and develop strategic partnerships in the digital world without having to wait for Congressional or regulatory approval.⁹³

C. First Amendment Considerations

While Section 404(e)’s nonpostal services prohibition is the primary legal hurdle facing a new postal product, a digital product that allows consumers to filter e-mails or authorize digital scans of certain types of physical mail could raise First Amendment issues. Since courts generally equate the Postal Service with the government, any postal product that involves restricting speech or reviewing content necessarily implicates the First Amendment.

Reviewing courts have invalidated regulations that sought to ban or restrict unwanted or presumptively offensive mail as violating the First Amendment. For example, in *Consolidated Edison Co. v. Public Service Commission of New York*, 447 U.S. 530 (1980), the Supreme Court struck down a state restriction on including in utility bill

⁹² *U.S. Postal Serv. v. Postal Regulatory Comm’n*, 599 F.3d 705 (D.C. Cir. 2010) (<http://pacer.cadc.uscourts.gov/common/opinions/201003/09-1032-1237256.pdf> at 6).

⁹³ Section 411 refers to “executive agencies” only. The Postal Services might be able to provide services to state and local governments by working through a federal agency.

inserts that addressed controversial issues of public policy. It found that even though “the inserts may offend the sensibilities of some consumers, the ability of government to shut off discourse solely to protect others from hearing it [is] dependent upon a showing that substantial privacy interests are being invaded in an essentially intolerable manner.”⁹⁴ The basic constitutional principle is that the speaker and the audience, not the government, must assess the value of the information presented.⁹⁵

The leading case on blocking unwanted mail is *Rowan v. U.S. Post Office Dept.*⁹⁶ *Rowan* involved a challenge under the First Amendment to what is now section 3008 of Title 39, the prohibition against pandering advertisements. Under postal regulations, the addressee could submit a written request to have the Postmaster General issue an order blocking “any pandering advertisement which offers to sale matter which the addressee in his sole discretion believes to be erotically arousing or sexually provocative.” Upon receipt of such an order, the offending sender was required to delete the addressee’s name from its mailing list. The Supreme Court upheld the law because the blocking order “only effectuated individualized preferences.”⁹⁷

In operative effect, the power of the householder under the statute is unlimited; he may prohibit the mailing of a dry goods catalog because he objects to the contents or indeed the text of the language touting the merchandise Congress provided this sweeping power not only to protect privacy but to avoid possible constitutional questions that might arise from vesting the power to make any discretionary evaluation of the material in a governmental official [the Postmaster General].⁹⁸

⁹⁴ *Consolidated Edison Co. v. Public Serv. Comm’n*, 447 U.S. 530, 541 (1980) (quoting *Cohen v. California*, 403 U.S. 15, 21 (1971)).

⁹⁵ *Edenfield v. Fane*, 507 U.S. 761, 767 (1993). See also *Ward v. Rock Against Racism*, 491 U.S. 781, 795 (1989) (regulation of sound amplification to protect nearby residents denies government ability to vary the volume based on the message being delivered); *Cincinnati v. Discovery Network*, 507 U.S. 410, 428 (prohibition against the use of sound trucks emitting loud and raucous noise in residential neighborhoods is permissible if it applies equally to music, political speech and advertising).

⁹⁶ 397 U.S. 728 (1970).

⁹⁷ *Id.* at 730, 737.

⁹⁸ *Id.* at 737. Restrictions on mail or e-mail may be distinguished from Do Not Call regulations, which have passed constitutional muster. In *Mainstream Marketing v. FTC*, 358 F.3d 1228 (10th Cir. 2004), the 10th Circuit upheld Do Not Call regulations after evaluating rulemaking proceedings that determined the intrusiveness of unwanted calls necessitated a stronger regulatory approach than had been used in the past. “Mail, on the other hand, is silent, and does not affect the tranquility of the home in the same way as a ringing telephone.” The Court noted that “[t]he challenged regulations do not hinder any business ability to contact consumers by other means, such as through direct mailings or other forms of advertising. *Id.* at 1233,1243. In *Bolger v. Young’s Drug Products Corp.*, 463 U.S. 60 (1983), the Supreme Court explained that “we have never held that the government itself can shut off the flow of mailings to protect those recipients who might potentially be offended. The First Amendment does not permit the government to prohibit speech as intrusive unless the captive audience cannot avoid

In light of the extensive case law, the Postal Service must tread carefully in developing digital products to screen unwanted e-mails. In particular, the Postal Service (considered part of the government) may not exercise any discretion in deciding which e-mails to deliver and which e-mails to block. The Postal Service may only carry out a specific directive of the recipient.

Thus, if the Postal Service were to offer such a product, the consumer would have complete control of the digital communication he or she receives. For example, the Postal Service could honor a request to block “all communications from Store ABC,” but it could not block “all promotional communications” (it would require the exercise of discretion to decide what is “promotional”) or even “all promotional communications for women’s apparel” (it would require the exercise of discretion to decide whether to block catalogs that include both men’s and women’s apparel and to determine what is “apparel”). Given these potential challenges, we recommend that the Postal Service obtain legal advice and carefully design any digital products that involve blocking or filtering mail or e-mail.

D. Other Legal Issues

The Postal Service has successfully partnered with private companies such as Imagitas, Stamps.com, and Click2Mail to develop and provide innovative products that utilize the postal platform. In offering digital products, the Postal Service may wish to expand its strategic partnerships to private entities with specific expertise in the Internet world, such as Google, PayPal, or Amazon.⁹⁹ Competitive bidding processes and careful adherence to Postal Service contractual guidelines are essential, even if they require extra time. Regulatory restraints should be considered early on, particularly with respect to the level of Postal Service involvement and to the structuring of licensing arrangements. The PRC’s decision in Phase II of Docket No. MC2008-1, which distinguished licensing of mail-related products from licensing of non-mail-related products, was reversed and remanded by the Court of Appeals. On remand, the PRC

objectionable speech. 463 U.S. at 70. Despite the annoyance that may be associated with unsolicited junk mail, the First Amendment has been construed to require that the short, though regular, journey from mail box to trash can . . . is an acceptable burden, at least so far as the Constitution is concerned.” *Id.* at 72 (quoting *Lamont v. Commissioner of Motor Vehicles*, 269 F.Supp. 880, 883 (SDNY 1967), *aff’d*, 386 F.2d 449 (2d Cir. 1967), *cert. denied*, 391 U.S. 915 (1968)). E-mails, which are much less intrusive than phone calls, would likely be treated like physical mail.

⁹⁹ We do not address here the legality of Postal Service purchase of an Internet company since, as a practical matter, this is not a current option given its current financial state. Nor do we address creation of a subsidiary of the Postal Service, which has been proposed in the past. Prior to passage of the PAEA, Rep. John McHugh offered legislation to establish an arm’s length corporate subsidiary of the Postal Service to provide nonpostal products, which was later dropped from the bill.

should clarify licensing issues, and, until that time, the Postal Service should not make licensing the main focus of its digital strategy.¹⁰⁰

Intellectual property that forms the basis for new digital products will require patent and trademark protections. The Office of Inspector General has issued two reports on the management of patents by the Postal Service Legal Department.¹⁰¹ The OIG recommended that the Postal Service “[d]evelop a comprehensive strategy for developing patent intellectual property that enhances Postal Service products and services and its competitive position in the global marketplace and is a source of income.”¹⁰² That strategy could include a clear, streamlined process for handling patents for digital products and software.¹⁰³ Because the legal issues raised will depend on specific facts and product design, we recommend conducting a detailed legal analysis early in the product development process so that the digital product and the strategic partnership can be fashioned to avoid possible legal pitfalls.

¹⁰⁰ The Postal Service process for licensing is currently handled by the Licensing Group in Public Affairs and Communications. Its criteria for granting licenses are:

- strategic fit with the goals and objectives of the Postal Service and its Licensing Program;
- ability to maintain and enhance the Postal Service’s image and brands;
- prospective licensee’s business capability and financial stability;
- ability to produce quality products;
- distribution capabilities in mass market retail channels; and
- cogent business and/or marketing plan.

<http://about.usps.com/licensing/commercial-program/application.pdf>.

¹⁰¹ U.S. Postal Service Office of Inspector General, *Management Advisory – Postal Service Patent Management*, Report Number DA-MA-10-004, August 31, 2010 (http://www.uspsoig.gov/foia_files/DA-MA-10-004.pdf); U.S. Postal Service Office of Inspector General, *Management Advisory – Postal Service Patent Management Continuation*, Report Number DA-MA-11-002, April 11, 2011 (http://www.uspsoig.gov/foia_files/DA-MA-11-002.pdf).

¹⁰² U.S. Postal Service Office of Inspector General, *Management Advisory – Postal Service Patent Management Continuation*, Report Number DA-MA-11-002, April 11, 2011, at 4 (http://www.uspsoig.gov/foia_files/DA-MA-11-002.pdf).

¹⁰³ Section 602.1 of the Code of Federal Regulations applies to Postal Service intellectual property other than patents. These non-patent properties are managed by the Office of Licensing, Philatelic and Retail Services Department, which manages intellectual property rights to promote the economic, operational, and competitive well-being of the Postal Service, to limit restrictions on the use of Postal Service intellectual property to a minimum consistent with its statutory obligations, and to and assure that all potential users are treated fairly. 39 C.F.R. §§ 602.1 and 602.2.

III. RESTRUCTURING THE PRODUCT DEVELOPMENT PROCESS WOULD ENCOURAGE INNOVATIVE DIGITAL PRODUCTS

“[H]ow one manages in an era of disruptive technology is totally different from how one manages in a time of sustaining technologies.”¹⁰⁴ Clayton Christensen, in his classic work *The Innovator's Dilemma*, studied how companies faced disruptive technologies and concluded that managers with “great track record[s] in understanding customers' future needs, identifying which [sustaining] technologies could best address those needs, and in investing to develop and implement them,” often were the ones that failed when confronted with disruptive innovation – because those managers “played the game the way it was supposed to be played.”¹⁰⁵ Examples abound: Borders, the nation’s second largest book chain, failed to adapt quickly enough to the advent of e-books and e-commerce and ended up in bankruptcy.¹⁰⁶ In contrast, leading DVD mailer Netflix moved forward to develop original content and to offer streaming video even

¹⁰⁴ A sustaining technology, such as the Flats Sequencing System, “improves the performance that mainstream customers in major markets have historically valued.” In contrast, a disruptive technology is an innovation that “results in worse product performance, at least in the near term [and] brings to market a very different value proposition than had been available previously.” Christensen, at xviii. As the author of this paper has previously stated:

Disruptive technologies have often precipitated the failure of leading firms. But some companies have survived, and even flourished. So what can we learn from those survivors' experiences? Something more is needed – a long term vision of success and the courage to take risks to achieve that vision. Postal Service managers are often perceived as the proverbial government employees – managing to avoid failure. No one likes failure, but, in confronting a disruptive technology, someone has to have the courage to make radical changes and take some rational risks. And if risks are taken, Congress and regulators have to expect and allow for some failure.

Leong, Mailing Systems Technology, *Confronting a Disruptive Technology*, June 2009

(<http://www.mailingsystemstechnology.com/ME2/dirmod.asp?sid=E8941DB3E6A4499196334DC6734E5945&nm=Contact+Us&type=Publishing&mod=Publications::Article&mid=8F3A7027421841978F18BE895F87F791&tier=4&id=5038C9B68FAA4F2F89631A3AFC8D6670>).

¹⁰⁵ Christensen, at xvi.

¹⁰⁶ See <http://www.freep.com/article/20110717/COL01/107170485/> Mitch-Albom-Borders-fades-does-bookstore-magic; <http://www.theatlantic.com/business/archive/2011/07/the-end-of-borders-and-the-future-of-the-printed-word/242545/>.

before the technology was fully available, and as a result, outlasted its slower competitor Blockbuster.¹⁰⁷

Christensen argues that good firms may be well aware of the disruptive innovation, but their business environment does not allow them to respond when the innovations first arise because the new technologies are not initially profitable enough and because developing disruptive technologies can take scarce resources away from sustaining technologies (which are needed for current competition). In Christensen's terms:

[A] firm's existing *value networks* place insufficient value on the disruptive innovation to allow its pursuit by that firm. Meanwhile, upstart firms inhabit different value networks, at least until the day that their disruptive innovation is able to invade the older value network. At that time, the established firm in that network can at best only fend off the market share attack with a me-too entry, for which survival (not thriving) is the only reward.¹⁰⁸

A. Encouraging a Culture of Innovation

A 2011 Office of Inspector General Report on the Postal Service's Innovation Process¹⁰⁹ (OIG Innovation Report) concluded that the Postal Service:

¹⁰⁷ See http://www.economist.com/node/4149765?story_id=4149765. Netflix also illustrates the transitory nature of success in the digital age. After reigning as a titan of the digital world, its recent decision to separate its mail and streaming services into separate businesses proved disastrous. The move was intended to keep Netflix on the cutting edge of trending consumer usage by allowing it to focus on online video-streaming. However, the change was apparently too far ahead of consumer preference, and provoked major customer and investor backlash. Within three weeks, Netflix was forced to revamp its approach, announcing it would not split its online and mail services. It is not yet clear whether the negative fallout will have a lasting impact on Netflix's business. http://www.nytimes.com/2011/10/25/technology/netflix-lost-800000-members-with-price-rise-and-split-plan.html?_r=2&emc=eta1.

¹⁰⁸ Christensen, at 46-48. An example of this counterintuitive approach is the good manager's attention to the needs of current customers. Whether an incumbent facing a disruptive technology should continue to focus on satisfying the expressed needs of its customers is a matter of some controversy. Christensen argues that disruptive technology is one instance when the common business-world advice to "stay close to the customer", "listen to the customer" is strategically counterproductive. Christensen, at xv. Critics have disagreed with his conclusion that incumbents fail because they "listened too closely to their customers." See, e.g., http://tourism.wu.wien.ac.at/lehrv/lven/05ws/lv4/danneels_disruptive.pdf (Management should be "visionary in formulating customer strategy, and should do so by thinking about market environment shifts, how these could impact customer sets, and whether those customer sets are the ones the company wishes to serve").

¹⁰⁹ U.S. Postal Service Office of Inspector General, *Audit Report – Postal Service's Innovation Process for Competitive and Market-Dominant Products*, Report Number MS-AR-11-004, June 9, 2011 (http://www.uspsoidg.gov/foia_files/MS-AR-11-004.pdf) (OIG Innovation Report).

- does not have a comprehensive innovation strategy,
- does not have a consolidated approach to product development,
- does not have independent innovation teams with “defined, separate budgets, teams and decision-making processes in place,”
- does not effectively manage ideas from external stakeholders. (“[S]takeholders described a Postal Service culture resistant to change and unresponsive to customers’ needs.”)

The OIG Innovation Report stated:

While the Postal Service is making an effort to engage a culture of innovation, the lack of a comprehensive strategy, including systemic tracking and management of innovative ideas has the effect of both limiting strategic vision and creating an organization that responds slowly to a rapidly changing business and technological environment. To overcome the challenges it faces, the Postal Service must reach beyond its current vision and *embrace a culture of innovation that begins with the most senior levels of management . . .* and commit to an organizational structure that allows innovation teams to work free from the constraints of day-to day operations.¹¹⁰

The Postal Service’s response to the OIG Innovation Report noted that “management does not believe that investments in additional innovation teams are appropriate at this time given the legal constraints around the types of products and services we can bring to market,¹¹¹ and the competitive constraints that any business must be cognizant of when developing new products.”¹¹²

To encourage the development of digital products, the Postal Service needs to adopt a “culture of innovation.” We recommend taking these specific steps to move in that direction and to remove obstacles that squelch innovative thinking:

¹¹⁰ *Id.* at 6-7 (emphasis added).

¹¹¹ As discussed in Section III, the legal constraints of PAEA on “nonpostal services” leave room for the Postal Service to propose many new products to provide an interface between physical and digital communications.

¹¹² Letter of Paul Vogel, USPS, *et al.* to Lucine Willis, USPS OIG, dated May 27, 2011, appended to OIG Innovation Report at 30.

1. Senior management's active support and promotion of a culture of innovation; demonstrated interest of the Board of Governors in the development of digital products; and tangible rewards to employees for successful innovative ideas.
2. Establishment of an Innovation Department with a Vice President for Innovation, who reports to the Postmaster General and briefs the Board of Governors.
3. Independent innovation teams of cross-functional experts who are freed from day-to-day operational responsibilities to focus on product development.
4. Tracking innovative ideas from internal and external sources.
5. Actively and openly soliciting relationships with established digital businesses and innovative entrepreneurs for strategic partnerships.
6. Gaining experience through many small-scale forays into the digital market with products that can be increased in scale.
7. Reexamining traditional risk levels and return on investment for new products to encourage rational risk-taking.
8. Designating a liaison to other government agencies to develop e-Government postal products.

In the next section, we outline a product development process that would incorporate many of these changes.

B. Restructuring the Product Development Process

Business experts Vijay Govindarajan and Chris Trimble of Dartmouth College¹¹³ posit: "Every innovation initiative needs a special kind of team and plan One of the most

¹¹³ Vijay Govindarajan and Chris Trimble, *The Other Side of Innovation: Solving the Execution Challenge*, (Boston, Massachusetts: Harvard Business Review, 2010), ISBN 978-1-42221-6696-3. The Wall St. Journal recently quoted Dr. Govindarajan:

"Apple's success doesn't have to be a mystery to us," says Vijay Govindarajan, a professor of global business at the Tuck School of Business at Dartmouth and former chief innovation consultant at General Electric Co. "It can be replicated". . . . Executing ideas is often tougher than generating them. Developing new ideas involves a certain amount of experimentation and failure, as well as prioritizing of the most promising ideas. The key, says Dr. Govindarajan of Dartmouth, is to keep development costs low and test assumptions quickly so that companies can afford to experiment.

The Wall Street Journal, *How to Be Like Apple*, August 29, 2011 (<http://online.wsj.com/article/SB10001424053111904009304576532842667854706.html>).

common reasons that established companies struggle to execute innovation initiatives is that they fail to appreciate just how differently they must treat them. The group working on an innovation initiative cannot just be a home to a more creative culture The innovation team must be distinct from [operations].”¹¹⁴ We describe below one process for product development that has been adopted by large companies to encourage innovation, but many variations are possible. “[W]hat matters is not the exact organizational structure, but that those tasked with innovation are free to focus on innovation.”¹¹⁵

A new Innovation Department would be tasked to conceptualize innovative ideas, conduct research to determine which products should be brought to market, and track and coordinate the approval and deployment process. The Innovation Department, headed by a Vice President for Innovation, would employ a four-step process:

- Concept Review
- Research and Evaluation
- Innovation Committee Review
- “Go-to-Market” Coordination

An external stakeholder, entrepreneur, or employee (perhaps using the Postal Service’s eIDEAS website) could introduce a concept for a new product to any Innovation group manager. That manager would present the concept to the Concept Team, which would be composed of cross-functional experts. The Concept Team would determine, on a preliminary basis, (1) whether the concept fit into the long term strategy; (2) whether the concept capitalized on Postal Service’s strengths and distinctiveness (*e.g.*, last mile delivery, trusted brand); and (3) whether customer response would likely be positive.

¹¹⁴ Govindarajan and Trimble, *supra*. See also OIG Innovation Report at 5. Procter & Gamble (P&G), Nokia, and 3M are examples of companies that have created business units specifically designed to foster innovation, unencumbered by the demands of day-to-day operations. The OIG Innovation Report states:

P&G created the position of vice president for innovation and knowledge and transformed its traditional in-house research and development process into an open-source innovation strategy. Nokia has a research center dedicated to open innovation through collaboration with world-leading institutions, and 3M uses teams of four to six individuals from both technical and marketing functions to explore areas where existing company knowledge is slim, because those areas represent prime areas for generating new products and concepts.

¹¹⁵ *Id.* at 5.

The Concept Team could reject the concept or call for further evaluation; if the latter, the team would also decide whether to place the project on a regular track or a fast track.¹¹⁶

The project would then be forwarded to the Evaluation Team, which would assign a manager to track and coordinate the process until the idea is rejected or designated “go to market.” The Evaluation Team would conduct research and prepare a report covering:

- business analyses, including funding, return on investment, costs, profit and loss, volume and revenue potential, and market share changes;
- contribution that this product would make to organization’s strategic goals;
- operational and technology issues;
- market assessment (competition, customers);
- impact on brand and on other strategies and products;
- policy implications (Congress, workforce);
- legal/regulatory issues;
- strategic partners; and
- special strengths, weaknesses, opportunities, and threats.

The Evaluation Team’s report, together with recommendations, implementation guidelines and a suggested timetable, would be reviewed by the Innovation Committee (IC). The IC would include the Postmaster General, Vice President of Innovations, President, Chief Operating Officer, General Counsel, and Chief Financial Officer. It would meet on a regular basis to decide whether projects should (a) “go to market”; (b) be placed on hold; or (c) be rejected. It would also set the process and timetable for “go-to-market” projects. The Executive Committee would review the IC’s decision.

For products that are designated “go to market,” the Vice President for Innovation would appoint a Senior Manager to coordinate the implementation process and make sure the timetable set by the Innovation Committee is met. The Senior Manager would build a “go-to-market” team using Special Assignment Managers from the appropriate operational areas with experience in implementing new products. While the operational departments would necessarily handle execution and deployment of the new product, the Senior Manager would be responsible for ensuring that deadlines are met and for

¹¹⁶ The fast track would complete the approval process in three months; digital products in particular may benefit from expedited processing.

day-to-day coordination among the Special Assignment Managers, strategic partners and stakeholders, and senior management. He or she would shepherd the new product through the internal operations, marketing, finance, and legal departments, and through the regulatory approval process, and would report directly to the Vice President for Innovation, who would in turn brief the Postmaster General and the Governors regularly on the progress of innovative products in the pipeline. If necessary, a high level executive would be assigned as the “champion” for the new product. The entire process – from concept to market – would take 6 months to one year.¹¹⁷

There are several benefits to this approach. First, after setting overall objectives, the Executive Committee would not need to be involved in every concept review, only those concepts that have been thoroughly researched by the Innovation Department and approved by the IC. Second, independent innovation teams, relieved of the burden of meeting operational goals, can focus on developing creative solutions while product managers can focus on marketing existing products. Third, a separate Innovation Department with cross-functional experts is better equipped to decide the significance of new concepts and how they fit into the Postal Service’s overall strategy, rather than product managers who tend to consider each innovation as an isolated product. Fourth, dedicated cross-functional teams to evaluate and implement concepts will become increasingly efficient as their members gain experience with the innovation process and, as a result, the time to bring new products to market for will decrease. Finally, creating a new Innovation Department with the characteristics described in this section would send a strong message to postal employees, stakeholders, and Congress that management fully endorses a culture of innovation.

¹¹⁷ Just as an organization must manage differently its response to a disruptive technology, and, in the digital world, move quickly to bring a new product to market, regulatory agencies must regulate differently so that the lag time created by regulatory review does not threaten the competitiveness of the new product.

IV. IMMEDIATE ACTION STEPS

This paper reaches three positive conclusions. First, the Postal Service is uniquely positioned to fulfill the role of the bridge between the physical and digital worlds – the provider of products that enable customers to move easily between digital communication and physical delivery. This role could be the overarching objective of its digital strategy. Second, digital products that fulfill this objective, such as digital versions or digital complements of existing postal products, have a greater chance of obtaining regulatory approval. In any event, potential legal hurdles should not keep the Postal Service from moving forward with innovative products. Third, the Postal Service could take concrete steps now to create a culture of innovation, to encourage digital products, and to streamline its product development process.

In the short term, we recommend the following actions to expand the Postal Service's digital offerings:

1. Adopt an overall objective for its digital strategy, as suggested in this paper, and demonstrate that senior management and the Board strongly support a culture of innovation.
2. Continue to pursue a long-term legislative strategy to expand the mission and authority of the Postal Service to offer digital products, but not rest on this strategy alone.
3. Restructure and streamline the product development process by creating an Innovation Department with independent innovation teams and a realistic risk standard for digital products.
4. Prioritize digital products that complement current postal products or offer a digital version of an existing product and that can be easily increased in scale.
5. Seek PRC approval of several market tests for digital products and collect data to support their classification as postal services, to show their profitability, and to demonstrate the Postal Service's ability to offer these products on a larger scale.
6. Develop legal and operational guidelines for partnerships with private companies, actively solicit and provide incentives for strategic alliances, and explore public/private funding arrangements.
7. Appoint a coordinator to seek arrangements with other federal agencies for e-Government services and to monitor other postal-related government initiatives;
8. Develop a strategy to use and protect Postal Service intellectual property, including software, new digital applications, and address management products.