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Stamps.com: A Closer Look at the Creation of the Postage Reseller Program and its Flaws; Potential Solutions and Remedial Actions all Likely Have Negative Consequences for Stamps.com

Conclusion

Stakeholders offer potential policy solutions to "flaws" in reseller program. This article explains the history of the creation, implementation, and oversight of the postage reseller program. The article then lays out common criticism of specific aspects of the program and also offers a series of policy changes that stakeholders suggest would improve outcomes for the USPS and customers.

The policy solutions offered by stakeholders include: increased formal oversight of the postage reseller program; elimination of the postage reseller program; granting additional ePostage and PC postage licenses to foster competition and combat consolidation; and termination of the contracts of the entities that are violating the spirit and purpose of the reseller program.

History of the Postage Reseller Program

We interviewed a range of industry participants to better understand the history of the reseller program. Sources did not want to be quoted because they still do business with the postal service or were otherwise worried about retaliation from powerful industry participants. Our sources include industry stakeholders who have participated in the electronic postal industry since its inception, stakeholders who benefit from the reseller program, and individuals who currently work with IntuiShip.

Creation of the postage reseller program and responsible individuals. In 2008, DHL decided to give up on domestic shipments by the end of January of 2009 because it could not reach a critical mass of customers. At that time, either DHL employees approached the post office, or the post office—likely through Mary Anderson, whom a source familiar with the history of the postage reseller program indicated was responsible for the creation of the program—approached DHL. According to our source, the former DHL employees indicated that they knew former high-volume DHL customers that they could bring to the USPS if the post office created a discount postage program that the former DHL employees could use to entice customers to choose USPS over rivals UPS and FedEx.

The program officially launched via the Postal Accountability and Enhancement Act of 2006 (PAEA), which authorized the USPS to enter into Negotiated Service Agreements (NSA) for two categories of mail products—market dominant and competitive. The NSAs are contracts between the USPS and individual companies. Market dominant mail includes letter mail or flat mail and competitive mail includes package services. The PAEA directed the Postal Regulatory Commission to issue final regulations establishing procedures for its review of competitive and market dominant NSAs, which it did in October of 2007. The focus of the legislation and the standard GAO has applied in assessing the success in the growth of competitive products for the USPS is net revenue and not package volume.

The competitive rules for the reseller program have largely been implemented since inception through the negotiation or renewal of individually negotiated service agreements with postage resellers. While the negotiated service agreements that the PRC approves are heavily redacted, many of the agreements we were able to review were signed by [Cliff Rucker](), Senior Vice President of Sales and Customer Relations at the USPS. Importantly, the package shipping industry has successfully lobbied to have provisions of these contracts, including pricing information, secret.

Doomed since inception. According to a source who is familiar with the history of the reseller program, the creation of the reseller program was handicapped from the beginning because the post office did not provide the postage resellers with a means to print postage. Because, according to our source, ePostage was not yet approved for use by any entity—except Amazon—at this time, the resellers had no choice but to use one of the three approved PC postage providers: Stamps.com, Endicia, or Pitney.

In the end, it did not make sense for the postage resellers to go after new business, which required lots of effort, when they had hundreds of thousands of existing USPS customers from Stamps.com, Pitney, and Endicia to whom they could offer discounted shipping prices and satisfy volume requirements. According to a source, this created awkward situations where long-time customers would call an Endicia representative and say that they had just spoken with a postage reseller who stated that they could save the shipper 75 cents on each package shipped if the shipper took advantage of the reseller discount. Furthermore, they were told that they could continue to use the Endicia system.

Our source stated that the USPS took the position that the PC postage providers were not supposed to participate in the reseller program and that the program was only supposed to be used to attract new customers. But with a competitive pricing edge, the resellers began picking off Stamps.com and Endicia's customers one by one. In the end, according to our source, Stamps.com recognized an opportunity early on and realized that it could make money by interjecting itself into the reseller program and Stamps.com ultimately decided to put a large portion of its customers into the reseller program via a third-party relationship with IntuiShip (ostensibly at odds with USPS's intentions to not allow PC postage providers to offer reseller discounts).

Initially, as our investigation revealed, Stamps.com worked with a number of resellers—playing one off of the other and trying to extract the best deal from the postage resellers. Over time, Stamps.com solidified its relationship with IntuiShip and both entities have been able to benefit significantly from their relationship, as Intuiship has a steady flow of volume to improve the discount it receives from the USPS, and Stamps.com has a way to share in the spread between the discount price and the price it sells for stamps, enhancing the company's profit margins.

Endicia initially was unwilling to enter a relationship with a postage reseller because it did want to run afoul of USPS's intentions to keep PC postage providers independent from postage resellers. But in the year prior to the Stamps.com acquisition of Endicia, Endicia followed Stamps.com's lead and put only newly-signed Endicia customers into the postage reseller program. Although Endicia used different resellers, the primary reseller relationship was with Express1. Shortly after Stamps.com bought Endicia, Stamps.com routed all Endicia customers through Intuiship to benefit from the reseller discount.

As a result, the USPS suffered. For example, if the commercial base price was $5.00, before resellers the USPS would receive the full $5.00. But when the reseller was inserted into the process, the customer still pays $5.00, or a slightly lower commercial plus price, but now the USPS might only get $4.20 per package and the reseller would get the $.80 difference. The reseller then would kick back a large fraction of the $.80 to the PC postage provider.

According to a source, the reseller program has morphed from one designed to provide new package business for the USPS to one that simply increases the profitability of the PC postage industry.

According to a source, the argument made by proponents of the relationship between PC postage providers and resellers was that if existing USPS customers were given a discount, they might ship more packages with the postal service and might be less willing to switch to UPS or Fedex. However, our source believed the discount was unlikely to affect shippers' decisions, particularly because the USPS was already the cheapest shipping provider, regardless of the additional discount. Our source noted that " . . . a lot of customers we had only ship light weight packages. They only use USPS. So by getting them more discount, they're going to ship more stuff? No way. So that's a stupid argument."

Our investigation, including analysis of negotiated service agreements and interviews with industry participants familiar with USPS oversight, has revealed that there do not appear to be any clear program integrity rules for the reseller program to prevent kickbacks, to prevent cannibalization of existing USPS customers, or to discourage consolidation or otherwise promote competition to prevent abuse of volume thresholds in reseller agreements. There is also a lack of transparency about terms and prices of various agreements between USPS and industry participants.

Design of the system. Based on our review of the PRC's publicly available docket, and our conversation with numerous industry sources, the negotiated service agreements with postage resellers are largely focused on volume. Although each individual negotiated service agreement may be distinct, we believe that the contracts likely contain similar language prioritizing the importance of volume much like the contract that can be found here.

Presumably, as reflected in the contract, a postage reseller receives discounted prices based on the volume of contract packages shipped during the previous full contract quarter, which varies each year. And if the volume of contract packages falls under a specified threshold, the postage reseller may have to pay a higher price. According to our sources who are familiar with reseller specific contracts, the contracts include incentive kickers, which is likely similar to the contract language in the above-linked contract that provides "The Postal Service will monitor Customer's volume of Contract Packages, and, within 15 days after the start of each Contract Quarter, will notify Customer of the applicable tier for that Contract based on Tables B through H below."

Accordingly, in order to maximize the discount, postage resellers are incentivized to bring in as much volume as possible. But as we have established, the inherent design flaws in the program make it such that it was easier for some postage resellers to offer discounted shipping rates to existing USPS customers in order to satisfy volume requirements and to maximize their profit margins.

Flaws Industry Participants Have Identified in Design of System

1) **Limited oversight of cannibalization.** In our previous reporting, we spoke with representatives of the Postal Regulatory Commission—the agency tasked with reviewing and approving negotiated service agreements. For the competitive domestic class of products—which is the category into which postage reseller agreements fall—the PRC told us that they do not look for cannibalization of existing USPS customers. Instead, the PRC evaluates whether a contract covers its attributable costs and whether there will be any subsidization of

competitive products by market dominant products. These requirements appear to be part of the certification that must be submitted in connection with the amendment to a contract.

Put differently, even if a postage reseller were to satisfy its volume requirement and receive the lowest tiered discount rate possible solely by offering discounts to existing USPS customers, the Postal Regulatory Commission would not care so long as the volume targets in the contract justified the discount. The Capitol Forum verified this practice in a call with an IntuiShip representative, who offered to give us cheaper prices despite our statement that we were an existing USPS customer, indicating that volume metrics, rather than USPS revenue generation, were the key factor for resellers.

2) **No oversight of kickbacks/spread sharing.** In our first article and in subsequent articles, we detailed the existence of the postage spread—the difference between the price that the postage resellers purchase postage for and the commercial plus price at which they sell postage for. According to industry sources, that spread can range from $0.00 - $1.35 per package shipped. Presumably, the discount is tied to the tiered pricing structure and volume as demonstrated in the contract. That is, the more volume a reseller brings in, the cheaper the price at which that reseller purchases postage.

   We discovered in our investigation that Stamps.com likely has a sweetheart deal with IntuiShip under which Stamps.com receives a significant portion of the postage spread by routing customers through the IntuiShip discount. In fact, according to our sources, the Stamps.com likely shares the postage spread in a 90%-10% or 95%-5% split with IntuiShip. This arrangement is much more beneficial to Stamps.com than arrangements other resellers were willing to enter into. In short, IntuiShip functions primarily as a call center, and Stamps.com appears to manage IntuiShip's reseller discount. By limiting the amount of work that it has to do, IntuiShip appears happy to provide Stamps.com with the vast majority of the postage spread. In addition, there does not seem to be any monitoring of kickbacks between resellers/PC postage providers and end customers.

3) **Consolidation of the industry.** Given that the postage reseller program appears to be tied to volume, it encourages consolidation. The resellers with the most volume likely purchase postage at the lowest possible price and accordingly receive the greatest profit on packages shipped. Because parties that route customers through the reseller discount stand to benefit from participating in the postage spread, they are also incentivized to acquire the most customers.

   There are two main ways to acquire new customers. Compete and take share, or acquire competitors or other companies in the supply chain. A competitive reseller environment would theoretically protect against abuse of the volume thresholds because only superior service providers would be able to attract more volume. However, Stamps.com chose to acquire more volume via consolidation. In the past few years, Stamps.com has acquired Endicia—a rival PC postage printing company—and three multi-carrier software platforms—ShipStation, ShipWorks, and ShippingEasy. According to our sources, by acquiring these companies, Stamps.com is able to route all of the multi-carrier software company's USPS customers through the IntuiShip discount.

   Even if a customer was already using a reseller discount through Express1 or Parcel Partners—and was, therefore, a USPS customer—by routing the customer through the IntuiShip discount, Stamps.com could benefit from the steeper IntuiShip discount (because of the greater volume flowing through IntuiShip) and the more preferential profit split that Stamps.com has with IntuiShip versus alternative resellers like Express1 and Parcel Partners.

In our investigation, we discovered that ShipStation customers were informed that their Express1 discounts were included in their ShipStation subscription despite Express1 not being listed as a ShipStation partner. Instead, it appears that these discounts were provided to customers by IntuiShip and not Express1. One source who works with IntuiShip stated "Stamps and Endicia have taken control of the situation, even against Parcel Partners and Express1, they just shifted and took all that data from people that were supposedly their partners, and tried to shift as many of them to IntuiShip as possible, and that's the part that's messed up, because, hey we're all in the same space . . ." In effect, Stamps.com, via acquisition and industry influence, has been able to successfully ensure that volume flowed through Stamps.com and IntuiShip, harming Stamps.com's competitors, harming Intuiship's competitors, and exacerbating USPS losses (since volume discounts are driven by consolidation and not competition and since cannibalization is not discouraged or prohibited).

Why this matters: USPS losses and reseller program reform as a way to increase federal revenues. In its most recent fiscal year, the USPS reported a loss from operations of approximately $5.4 billion. Stamps.com, on the other hand has had a profitable year to date through the third quarter. Stamps.com's year to date net income was approximately $46 million. Stamps.com's service revenue year to date was approximately $221 million and the service revenue accounts for approximately 85% of Stamps.com's total revenue. Importantly, Stamps.com's year to date costs for the service category, which includes compensation earned by offering customers discounted postage rates provided to Stamps.com's customers by Stamps.com's partners and other type of revenue share agreements from customers and partners was only approximately $28 million. Finally, Stamps.com's gross profit margins are approximately 83%.

Stamps.com's profit, given that it is derived from a very beneficial arrangement that is contingent on a government contract between Intuiship and USPS, is vulnerable to policymakers in Congress who are looking for federal policies to raise revenue or to pay for other policy priorities (tax cuts, spending bills, etc.) because policymakers could simply write legislation to change the reseller program and CBO would likely score such legislation as saving the government a significant amount of money. Further, USPS staff, if they are interested in improving the financial outlook of the USPS, could easily amend reseller agreements to end or limit alleged abuses of the program.

Potential USPS Policy Solutions for Addressing Criticism of Reseller Program

We have spoken with numerous industry sources about potential changes to the postage reseller program. The consensus among our industry sources is that the postage reseller program is unlikely to continue in its current form; however, our sources had differing views on the menu of options or possible outcomes. Below, we present some of the solutions identified by our sources.

1) **Increased formal oversight of the program.** Although all of our industry sources noted that there is increased informal oversight of the postage reseller program, specifically from Mr. Rucker's office, some sources expected increased formal oversight of the program, which could include putting the onus on postage resellers to prove that any new volume they bring in to satisfy volume requirements or decrease the price at which they purchase postage is actually new volume.

2) **Elimination of the postage reseller program in its entirety.** Many sources we spoke with believe that the future of the postage industry is one in which there is no need for postage reseller middlemen. Instead, our sources believe the USPS would follow a model similar to the one it has established with Shippo in that the USPS will negotiate rates and the sale of postage directly with multi-carrier software platforms. Eliminating the postage reseller program may cause the USPS' internal sales force to thrive. As we have previously reported, the USPS' internal sales force has been hampered by the postage reseller program in that customized rates the USPS sales team offers are typically higher than the rates that customers can get by taking advantage of a postage reseller program.

3) **Granting additional ePostage and PC postage licenses to increase competition and reduce the need for reseller discounts and/or combat consolidation.** According to sources, when Stamps.com acquired Endicia, the USPS told industry participants not to worry about consolidation because the USPS had the ability to grant PC postage and ePostage licenses to combat consolidation. Recently, the USPS has been seemingly unwilling to grant additional ePostage licenses—other than to Shippo—reportedly citing concerns about the inability to ensure that shippers provide adequate postage.

   In the interim, according to sources, the USPS has indicated a willingness to grant PC postage printing licenses to any party that is willing to go through the onerous process of obtaining one. A source with knowledge of the situation recently confirmed that EasyPost recently completed all of the necessary requirements to obtain a PC postage printing license from the USPS.

   A precursor to obtaining an ePostage license is getting eVS certification, which is open to anyone. Recently, the USPS lowered the threshold for obtaining eVS certification, which signals that the USPS could be willing to open the door to granting additional ePostage licenses in the near-term. The USPS Office of the Inspector General is also currently conducting an audit of short-paid or inadequate PC postage.

   To the extent the OIG and USPS figure out how to address any concerns surrounding short-paid PC postage, which could then be applied to any concerns the USPS might have surrounding short-paid ePostage, the USPS could begin to grant ePostage licenses. We have spoken to a handful of sources who have indicated that they are trying to get ePostage licenses from the USPS. And, according to a source, because there is no significant intellectual property barrier to getting an ePostage license, opening up the process could result in a flood of licenses being granted.

   Finally, because the electronic postage industry is largely a technology driven industry, stakeholders should be cognizant of the fact that increased competition from ePostage licenses could come from any number of companies—including companies that are not currently on stakeholder's radars. If additional ePostage licenses are granted, the multicarrier software platforms could likely negotiate prices directly with the USPS and there would be no need for postage reseller middlemen.

4) **Terminating the contracts of the entities violating the spirit and purpose of the reseller program.** According to sources, there are some postage resellers who add value to the USPS by bringing in additional new volume every year and those entities should be rewarded and allowed to continue to function as resellers. But, according to our sources, IntuiShip is an actor that is clearly taking advantage of the reseller program. Accordingly, our sources believe that the USPS could simply terminate its relationship with IntuiShip

combined with increased oversight of the entire program, or simply not renew IntuiShip's NSA when it comes up for renewal.

Any remedy that reduces or threatens the postage spread likely harms Stamps.com. According to industry sources, Stamps.com dramatic revenue growth is likely attributable to monetizing the postage spread from its relationship with IntuiShip. Indeed, Stamps.com discloses as sources of service revenue in its 10-K: "4) we may earn compensation by offering customers a discounted postage rate that is provided to the customers by our partners; and (5) we may earn other types of revenue shares or other compensation from specific customers or partners."

The new disclosure regarding specific categories of service revenue first appeared in Stamps.com's 10-K filed on February 29, 2016. Prior to that, Stamps.com only listed sources of revenue without the additional detail regarding service revenue:

- 2014 10-K: Our revenue is derived primarily from five sources: (1) service and transaction revenues related to our mailing and shipping services; (2) product revenue from the direct sale of consumables and supplies through our Supplies Store; (3) package insurance revenue from our branded insurance offerings; (4) PhotoStamps revenue from the sale of PhotoStamps postage labels; and (5) other revenue, consisting of advertising revenue derived from advertising programs with our existing customers.

- 2015 10-K: Our revenue is derived primarily from five sources: (1) service and transaction related revenues from our USPS mailing and shipping services, our multi-carrier shipping services and our mailing and shipping integrations; (2) product revenue from the direct sale of consumables and supplies through our Supplies Stores; (3) package insurance revenue from our branded insurance offerings; (4) Customized Postage revenue from the sale of PhotoStamps and PictureItPostage postage labels; and (5) other revenue, consisting of advertising revenue derived from advertising programs with our existing customers. For service revenue, we earn revenue in several different ways: (1) customers may pay us a monthly fee based on a subscription plan; (2) customers may qualify under our USPS partnership to have their service fees waived or refunded and then we are compensated directly by the USPS; (3) customers may pay us a fee per shipping label printed; (4) we may earn compensation by offering customers a discounted postage rate that is provided to the customers by our partners; and (5) we may earn other types of revenue shares or other compensation from specific customers or partners.

Acquisitions and increased spread contribute to revenue growth. In a recent investor presentation, Stamps.com disclosed that ex the Endicia and ShippingEasy acquisitions, Q3 total revenue was up approximately 26% year over year. Total revenue, including the two more recent acquisitions of Endicia and ShippingEasy, was up approximately 79% year over year.