



# OFFICE OF **INSPECTOR GENERAL**

## UNITED STATES POSTAL SERVICE

## Extraterritorial Offices of Exchange

### White Paper

Report Number  
MS-WP-17-001

March 31, 2017





# OFFICE OF INSPECTOR GENERAL

## UNITED STATES POSTAL SERVICE

## Executive Summary

***Although the State Department's policy responsibilities include ETOEs, the State Department, Postal Service, and Postal Regulatory Commission are not responsible for overseeing ETOEs or their domestic operations – ETOEs are only subject to the same regulations and oversight as other U.S. businesses.***

Extraterritorial Offices of Exchange (ETOEs) are businesses operated by – or in connection with – foreign postal operators. ETOEs perform a wide range of postal functions that can vary by country, but generally include consolidating, documenting, and transporting outbound international mail. Since the early 1960s, organizations have been using a practice called “re-mailing,” in which they bypass the national postal operator for delivery of outbound international mail service in order to access lower rates. The term ETOEs was later coined to describe this practice of foreign postal operators seeking to send dispatches directly to other countries from countries outside their own territories.

In 1986, the U.S. Postal Service suspended laws that restricted the carriage and delivery of outbound international letters by organizations other than the Postal Service. This change was intended to foster competition in the international mailing and shipping industry and ultimately created an opportunity for ETOEs to operate in the U.S. The U.S. Department of State (State Department) formulates, coordinates, and oversees U.S. foreign policy related to international postal services. Although the State Department's policy responsibilities include ETOEs, the State Department, Postal Service, and Postal Regulatory Commission are not responsible for overseeing ETOEs or their domestic operations – ETOEs are only subject to the same regulations and oversight as other U.S. businesses.

The international postal community has long debated the role of ETOEs and their impact on national postal operators, including

the Postal Service. These discussions are complex as countries have different perspectives on the role, impact, and oversight of ETOEs. Past reports from the U.S. Postal Service Office of Inspector General have informed stakeholders on key aspects of ETOEs, including how they compete with the Postal Service and their competitive advantages.

Perspectives vary on ETOEs in the U.S., with some stakeholders arguing that ETOEs have unfair competitive advantages because they can access lower terminal dues (through their affiliation with national posts) and transportation rates, and are relatively free from regulatory oversight. Other stakeholders, however, support the role of ETOEs in a competitive marketplace, but question the inherent fairness of the two-tiered terminal dues system – a system that allows for lower shipping rates for developing countries and higher rates for developed countries.<sup>1</sup>

The recent growth in the international mailing and shipping market — recently estimated to be \$1.5 trillion — will likely continue to fuel discussions on the role and impact of ETOEs and the terminal dues system. ETOEs were a topic taken up during the 2016 UPU Congress and UPU member countries agreed on changes to the terminal dues system during that meeting, but it continues to be a topic of debate among the international mailing and shipping community. The future of ETOEs and their operations in the U.S. is unclear. This paper explores ETOE operations, their oversight structure, and stakeholder perspectives.

<sup>1</sup> The Universal Postal Union (UPU) established the terminal dues system to set guidelines for posts to compensate one another for international deliveries.

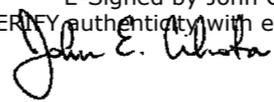
# Transmittal Letter



OFFICE OF INSPECTOR GENERAL  
UNITED STATES POSTAL SERVICE

March 31, 2017

**MEMORANDUM FOR:** DIANA (LEA) L. EMERSON  
EXECUTIVE DIRECTOR, INTERNATIONAL POSTAL  
AFFAIRS

E-Signed by John Cihota  
VERIFY authenticity with eSign Desktop  


**FROM:** *for*  
Janet M. Sorensen  
Deputy Assistant Inspector General  
for Retail, Delivery & Marketing

**SUBJECT:** Audit Report – Extraterritorial Offices of Exchange  
(Report Number MS-WP-17-001)

This report presents the results of our audit of the Extraterritorial Offices of Exchange (Project Number 15RG034MS000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Lisa Nieman, director, Marketing Initiatives, or me at 703-248-2100.

Attachment

cc: Corporate Audit and Response Management

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# Observations

**Extraterritorial Offices of Exchange (ETOE) are businesses operated by – or in connection with – foreign postal operators. ETOEs perform a wide range of postal functions that can vary by country, but generally include consolidating, documenting, and transporting outbound international mailings.**

**The international postal community has long debated the role of ETOEs and their impact on national postal operators, including the Postal Service.**

## Introduction

Extraterritorial Offices of Exchange (ETOE) are businesses operated by – or in connection with – foreign postal operators. ETOEs perform a wide range of postal functions that can vary by country, but generally include consolidating, documenting, and transporting outbound international mailings. Since the early 1960s, organizations have been using a practice called “re-mailing,” in which they bypass the national postal operator for delivery of outbound international mail service in order to access lower rates. The term ETOEs was later coined to describe this practice of foreign postal operators seeking to send dispatches directly to other countries under the Universal Postal Union (UPU) framework from countries outside their own territories.

In 1986, the U.S. Postal Service suspended laws that restricted the carriage and delivery of outbound international letters by organizations other than the Postal Service. This change was intended to foster competition in the international mailing and shipping industry and ultimately created an opportunity for ETOEs to operate in the U.S.

According to the U.S. Department of State (State Department), 33 ETOEs operated in the U.S. as of July 2016. The State Department formulates, coordinates, and oversees U.S. foreign policy related to international postal services. Although the State Department’s policy responsibilities include ETOEs, the State Department, Postal Service, and Postal Regulatory Commission (PRC) are not responsible for overseeing ETOEs or their domestic operations.

The international postal community has long debated the role of ETOEs and their impact on national postal operators, including the Postal Service. These discussions are complex as countries have different perspectives on the role, impact, and oversight of ETOEs. Past U.S. Postal Service Office of Inspector General (OIG) reports have informed stakeholders about key aspects of ETOEs, including how they compete with the Postal Service and their competitive advantages.<sup>2</sup>

This paper explores ETOE operations, their oversight structure, and stakeholder perspectives. To that end, we researched documentation and interviewed officials from the Postal Service, State Department, UPU, U.S. Postal Inspection Service, U.S. Department of Homeland Security (DHS), and PRC; reviewed related Postal Service policies, procedures, and data; observed operations at select Postal Service international service centers (ISC); visited selected ETOE facilities; and reviewed research on ETOE operations and other international mailing and shipping trends.

## Terminal Dues

*The terminal dues system is a multi-tiered pricing structure developed by the Universal Postal Union (UPU) that allows for lower rates for developing countries and higher rates for developed countries. The terminal dues system was, by design, based on setting rates by majority agreement of the UPU, and has not historically reflected the true economic cost of inbound international mail delivery. Terminal dues originated at a time when postal traffic was primarily letters. This terminal dues structure greatly impacts ETOEs role and operations and how stakeholders view them.*

*During the 2016 UPU Congress, the member countries agreed to changes to the terminal dues system. These changes included establishing a new payment formula for small packets that accounts for higher costs associated with their delivery compared to letters and flats and setting new caps on the rate at which payments can increase. These changes, which will take effect beginning in 2018, are intended to improve cost coverage for inbound international mail delivery, especially in light of the changing mail mix.*

<sup>2</sup> OIG, *Terminal Dues in the Age of Ecommerce* (Report Number [RARC-WP-16-003](#), dated December 14, 2015); *Competition in the International Outbound Mail Market* (Report Number [EN-WP-12-001](#), dated May 18, 2012); and *Audit Report - Air Transportation Networks – International Mail – Extra Territorial Offices of Exchange* (Report Number [NL-AR-05-010](#), dated September 9, 2005).

***ETOE*s perform a wide range of postal functions, which can vary from operator to operator and from country to country.**

## Extraterritorial Offices of Exchange Operations

ETOEes are businesses operated by – or in connection with – foreign postal operators. For example, Deutsche Post<sup>3</sup> provides universal postal services in Germany and also provides mail service from the U.S. to Germany and destinations worldwide through ETOEs it operates in Chicago, IL; Newark, NJ; Los Angeles, CA; and Miami, FL. A business customer delivers its mail to one of Deutsche Post’s ETOE facilities and pays fees directly to the ETOEs. The ETOEs then consolidates mailings and arranges to transport them overseas—where another mail consolidator or a local post completes the delivery. ETOEs have advantages over the Postal Service, such as the ability to provide discounted rates to business customers because their volume enables them to negotiate wholesale transportation rates, no need to maintain a large-scale retail presence, and are not obligated to provide international services. By contrast, the Postal Service is legally required to accept and deliver international mail, as well as offer basic outbound international services.

ETOEes perform a wide range of postal functions, which can vary from operator to operator and from country to country, but generally include the following outbound international mailing activities:

- **Consolidation**—consolidating mailings or shipments from commercial customers within the host country.
- **Documentation**—creating and applying necessary labeling and documentation required for international mailings, such as customs paperwork.<sup>4</sup>
- **Transportation**—arranging transportation from beginning to final delivery, including:
  - **Departing the host country**—this could include all steps in the outbound process, including transportation to the airport, to the international air carrier, or to a domestic postal operator (such as the Postal Service) who then would coordinate the transportation for mail leaving the country.
    - If the ETOE were to contract with a private entity for this transportation, the mailings and other shipments would be treated as “cargo.” When treated as cargo, shipments are subject to commercial customs clearance procedures, including international shipping laws and regulations.
    - If the ETOE were to use a domestic postal operator, the shipment would be treated as “mail.” When treated as mail, shipments are not subject to the same customs clearance procedures as commercial cargo, and they are subject to the terminal dues system, which can result in lower rates for last mile delivery in the destination country.
  - **Delivery in the destinating country**—this could be through a mail consolidator or foreign postal operator.

As of July 2016, 33 ETOEs were located in the U.S., according to the State Department (see [Table 1](#)).

<sup>3</sup> Deutsche Post provides postal services in Germany and is one of Europe’s largest mail services operators.

<sup>4</sup> This documentation includes only the necessary paperwork to transport items overseas as a commercial business and does not include the completion of UPU documentation.

**Table 1. List of Extraterritorial Offices of Exchange in the U.S.**

| Location    | ETOE's Foreign Postal Operator | Location       | ETOE's Foreign Postal Operator |
|-------------|--------------------------------|----------------|--------------------------------|
| California  | Jersey Post Limited            | Miami          | Posten AB                      |
| Chicago     | Posten AB                      | New Jersey     | Emirates Post                  |
| Chicago     | La Poste FR                    | New Jersey     | La Poste FR                    |
| Chicago     | Emirates Post                  | New Jersey     | Jersey Post Limited            |
| Chicago     | Royal Mail GB                  | New Jersey     | Royal Post NL                  |
| Chicago     | Royal Post NL                  | New Jersey     | An Post                        |
| Chicago     | Swiss Post                     | New Jersey     | bpost BE                       |
| Chicago     | Deutsche Post AG               | New Jersey     | bpost BE                       |
| Illinois    | Jersey Post Limited            | New York       | Royal Mail GB                  |
| Illinois    | bpost BE                       | New York       | Swiss Post                     |
| Los Angeles | Posten AB                      | Newark         | Posten AB                      |
| Los Angeles | Deutsche Post AG               | Newark         | Deutsche Post AG               |
| Los Angeles | La Poste FR                    | Pennsylvania   | Poste de la Russie             |
| Los Angeles | Swiss Post                     | Philadelphia   | La Poste FR                    |
| Miami       | C-Post International           | San Francisco  | Posten AB                      |
| Miami       | Royal Post NL                  | Washington, DC | Belgium (De Post/La Poste)     |
| Miami       | Deutsche Post AG               |                |                                |

Source: The State Department, July 2016.

The Postal Service identified only 740 unauthorized inbound ETOE shipments during its acceptance verification procedures between September 2014 and 2015.<sup>5</sup> Under these procedures, when inbound international mail receptacles are delivered to a Postal Service ISC, employees must scan each receptacle's international mail processing center (IMPC) code<sup>6</sup> to confirm specific mail information (e.g., sender and mailing contents). When a scan identifies an unauthorized ETOE shipment, the scanner creates a warning message, notifying the Postal Service employee that the mailing should be returned to the air carrier. Handling 740 unauthorized inbound shipments, which included about 32,540 mailpieces, over the course of a year represents a small fraction of the billions of mailpieces the Postal Service processes each year, albeit a larger portion of the inbound international mail it receives each year. Although a small portion of the overall mail volume, handling inbound ETOE shipments requires additional Postal Service resources associated with returning these items to the originator. This process requires extensive manual work, for which the Postal Service does not receive compensation or reimbursement.

In addition to inbound international shipments from ETOEs, outbound ETOE shipments can also create financial burdens on the Postal Service and other postal operators. For example, when foreign countries receive ETOE shipments from ETOEs located in the U.S., most all undeliverable items are returned to the U.S. Postal Service rather than the U.S.-based ETOE operators because of the U.S. return address in the upper left-hand corner of the mailpieces. The Postal Service then has to determine how to handle these pieces, often by going through the manual process of identifying and notifying the ETOEs where the mailpiece originated.

<sup>5</sup> Each incoming bag of international mail should be given a CN-35 tag that shows information such as the international mail processing center (IMPC) code, origin country, destination country, and weight. The Postal Service scanned 740 shipment tags that identified the inbound mail as ETOE shipments between September 25, 2014, and September 24, 2015.

<sup>6</sup> IMPCs include information such as the country of origin, the exchange office's location, and a qualifying character identifying the office of exchange.

***The regulatory and oversight structure of ETOE operations varies throughout the world – some countries are stricter than others.***

Postage was not paid for these items and the Postal Service incurs costs of trying to return them. The Postal Service's Global Business team and the Postal Inspection Service's Security and Investigations assessed the financial impact of return to sender items originally dispatched from ETOEs. In December 2008, they reported that the Postal Service incurs an estimated \$2 million a year from handling return to sender ETOE items.<sup>7</sup>

Other costs the Postal Service reports that it incurs from outbound ETOE shipments include being billed for shipments originating from U.S.-based ETOEs that have a confusing IMPC code and misuse of U.S. barcodes on UPU documentation and customs forms. These situations result from the destinating countries mistakenly charging the Postal Service for mailings that originated with a U.S.-based ETOEs. The Postal Service also stated that it incurs costs from having to handle ETOE shipments that airlines and ground handlers deliver to the ISCs. When this misdelivery occurs, Postal Service employees conduct extra work in contacting the U.S. ETOE operator to retrieve their dispatches from the ISCs.

## **Extraterritorial Offices of Exchange Oversight Structure**

In the U.S., ETOEs are subject to the same laws, regulations, and oversight as other U.S. businesses. They are not governed by the UPU Acts, which set out international mailing and shipping policies and require that international postal shipments use specific UPU customs forms and documentation. ETOEs operating in the U.S. are, instead, bound by federal regulations that all commercial cargo shipments must have commercial documentation (air waybill) and follow commercial customs clearance procedures.

### **The Universal Postal Union**

*The UPU is a specialized agency of the United Nations, charged with establishing rules for international mail exchange among its 192 member countries. It is the primary forum for cooperation between postal sector stakeholders, with the goal of ensuring a truly universal network of up-to-date products and services.*

*Its member countries meet every 4 years to discuss and establish policies. The most recent meeting was held in Istanbul, Turkey, in September – October 2016. Extraordinary Meetings may be held outside the quadrennial schedule, with the next Extraordinary Congress scheduled for 2018.*

When ETOEs contract for outbound transportation with private companies, these shipments are considered "cargo" and are subject to the international shipping laws and regulations of several government entities, including U.S. Customs and Border Protection (CBP) and the Transportation Security Administration (TSA). As commercial cargo, shipments from ETOEs are not part of the postal remuneration system<sup>8</sup> if the destination country determines that it will not accept inbound shipments at UPU terminal dues rates. Additionally, ETOEs are considered commercial, rather than postal, entities. Consequently, the State Department and the Postal Service do not oversee them.<sup>9</sup>

The regulatory and oversight structure of ETOE operations varies throughout the world – some countries are stricter than others. For example, European legislation requires that each member country designate a postal regulator to oversee all delivery service companies (including ETOEs, national postal operators, and other private sector delivery operators) within that country. Article 9 of the European Commission directive recommends that light regulatory oversight be applied to ETOEs to ensure compliance with "essential requirements," such as the confidentiality and security of mail. In practice, about half

<sup>7</sup> *Survey of International Inbound Return to Sender (RTS) Pieces from U.S. Extraterritorial Offices of Exchange (ETOE) and International Mail Service Providers (IMSPS)*, USPS Global Business and USPIIS Global Security and Investigations, December 2008.

<sup>8</sup> The UPU established a postal remuneration system in 1969, wherein the designated postal operator that sends a letter-post item to another country must pay the destination post for processing and delivering that item. This system of remuneration is known as terminal dues.

<sup>9</sup> In instances where ETOEs use the Postal Service for outbound shipments, those mailings are subject to Postal Service laws and regulations akin to other private companies in the U.S.

***In the U.S., the State Department formulates, coordinates, and oversees U.S. foreign policy related to international postal services.***

***Stakeholders in the international mailing and shipping community have varying perspectives on whether ETOEs should operate in the U.S. and what their role should be.***

of European Union countries require that ETOE operators have authorization or a license to operate. These countries include Belgium, Denmark, Germany, Czech Republic, Estonia, France, Greece, Ireland, Italy, Poland, and Slovakia.

In the U.S., the State Department formulates, coordinates, and oversees U.S. foreign policy related to international postal services.<sup>10</sup> A portion of State Department's international postal responsibility includes the development of policy regarding ETOE operations in the U.S. Under this authority, the State Department requests that foreign postal operators that have established, or intend to establish, ETOE operations in the U.S. inform the State Department and the Postal Service of the ETOE, and provide information including the full name of the operator, street address, telephone, fax, and email address of the person(s) responsible for the operation. The State Department and the Postal Service are not responsible for verifying this information and have no authority or responsibility to enforce this notification requirement or to approve or deny the establishment of ETOEs. In addition, ETOEs are not required to notify the State Department or the Postal Service if they move their operations to a new facility or discontinue operations. The PRC has no oversight responsibilities for ETOEs or other commercial delivery entities in the U.S.

We found differences in the number of ETOEs operating in the U.S. as tracked by the State Department and UPU, with State Department records showing 33 ETOEs and the UPU reporting 32 since last checked in February 2017.<sup>11</sup> We also attempted to visit 25 ETOE facilities listed on the State Department website and found that 18 (72 percent) were not physically located at the addresses on record. Officials also stated there are no formal enforcement mechanisms if foreign postal operators do not submit updated information. As a result, the U.S. government cannot be sure how many ETOEs currently operate in the U.S. or where they are located. This outdated information is just one of several stakeholder concerns with ETOEs, as discussed below.

## **Stakeholder Perspectives**

Stakeholders in the international mailing and shipping community have varying perspectives on whether ETOEs should operate in the U.S. and what their role should be. Some stakeholders argue that ETOEs have unfair competitive advantages because they enjoy lower terminal dues and transportation rates, have fewer regulatory burdens than national posts, and are not required to provide domestic universal service. Other stakeholders, however, support ETOEs role in a competitive marketplace and, instead, question the fairness of the multi-tiered terminal dues system. Additional information on each of these perspectives, along with stakeholder perspectives on the terminal dues system, is provided below.

### **Concerns About Extraterritorial Offices of Exchange**

Some stakeholders argue that ETOEs have unfair competitive advantages compared to national posts. They include:

- **Access to terminal dues system:** Each UPU member country is responsible for designating its national postal operators who provide universal postal service, like the Postal Service in the U.S. As the designated operators, these national postal operators have access to cross-border shipping rates under the UPU terminal dues system. ETOEs in the U.S., unlike private sector operators, can work with posts to access terminal dues, and can include a mark-up. This can give ETOEs a competitive advantage over non-designated operators, that must pay postage rates in the destination country that are typically above terminal dues rates in industrialized countries.

<sup>10</sup> According to 39 U.S.C § 407(b), the State Department is responsible for formulating, coordinating, and overseeing foreign policy related to international postal services and other international delivery services.

<sup>11</sup> The list currently posted to the State Department's website was last updated in July 2014 and identifies 30 ETOEs. The list is available at <http://www.state.gov/p/io/ipp/195867.htm>. The State Department provided us with a more recent list, last updated in July 2016, which identifies 33 ETOEs. The UPU's list of ETOEs worldwide is available at [http://www.upu.int/uploads/tx\\_sbdownloader/listStandardsImpcsWithTypeIndicationEn.xlsx](http://www.upu.int/uploads/tx_sbdownloader/listStandardsImpcsWithTypeIndicationEn.xlsx).

- **Favorable transportation rates:** ETOEs have the flexibility to contract with air carriers offering the lowest rates to facilitate transportation to destination countries. Some of these entities conduct operations in the destination country where they receive the shipment from the air carrier and deliver the mail directly to a postal operator and into the domestic mail stream in that country. ETOEs may also rely on a partner in the foreign country to process the shipment when received. ETOEs, as private businesses, are not restricted from negotiating favorable transportation pricing from all international air carriers, a savings they can pass along to their customers. By contrast, the Postal Service has little flexibility in air carriers, as it is legally required to use American flag carriers or code-share flights with American carriers when it contracts for air transportation. These limited choices makes it more difficult for the Postal Service to negotiate favorable transportation rates.
- **Favorable pricing strategies:** Unlike private operators, ETOEs can practice “arbitrage,” which occurs when the same product is priced differently in two or more markets and mailers take advantage of the imbalance to make a profit. The potential for arbitrage exists in the cross-border exchange of mail because the multi-tiered terminal dues system allows developing countries to pay lower rates to developed countries for the delivery of their mail. For example, a mail consolidator or an ETOE operator may contract with the designated postal operator of a transition system country and pay it for the use of its indicia. When the mail consolidator or ETOE operator uses the transition system country’s indicia, it can benefit by taking advantage of greatly reduced terminal dues rates available to the transition system country. Furthermore, ETOEs can offer products that are “loss-leaders,” meaning products sold for less than cost for the purpose of bringing in customers.
- **Relative freedom from postal-related regulatory oversight:** ETOEs in the U.S. are subject to the same laws, regulations, and oversight as other U.S. businesses, such as the Environmental Protection Agency and the Occupational Safety and Health Administration. They are not subject to entities that oversee the Postal Service, like the PRC. The Postal Service must comply with U.S. regulations that provide little flexibility regarding pricing, labor costs, availability of services, and service standards. For example, the Postal Service’s competitive products must cover an appropriate share of its institutional costs.

Unlike ETOEs and other private postal operators, the Postal Service is legally obligated to provide universal service domestically – a specified minimum level of service to every address in the nation. We reported in 2012 that Postal Service officials think ETOEs have unfair competitive advantages because they are not legally required to provide a minimum level of international mail delivery and service, as the Postal Service does, and therefore do not bear their associated costs.<sup>12</sup>

- **Limited visibility into ETOE operations:** Stakeholders raised concerns about potential security and operational risks based on limited visibility into ETOE operations. Our analysis of ETOE locations demonstrated that 72 percent of the ETOEs we attempted to visit were not at their addresses on record.<sup>13</sup> Outdated information about the locations and points of contacts for ETOE operations make it difficult for those entities trying to work with them, such as the Postal Service.

Stakeholders also raised concerns about potential security and revenue risks in handling ETOE shipments without sufficient contact information. Stakeholders state that some ETOEs could not be easily contacted if the need arose to address a security risk associated with a suspicious mailing or a revenue issue associated with billing or postage.

<sup>12</sup> OIG, *Competition in the International Outbound Mail Market* (Report Number [EN-WP-12-001](#), dated May 18, 2012).

<sup>13</sup> We attempted to visit 25 ETOE facilities listed on the State Department website and found that 18 (72 percent) were not physically located at the addresses on record. Out of the ETOEs successfully identified, we found three in the New Jersey area, two in the Chicago area, one in the Miami area and one in the Washington, D.C. area. No ETOEs listed in the Los Angeles area were able to be located. Posten AB (Sweden Post) has the most affiliations (5 facilities) with ETOE locations near each of the five International Service Centers.

***Some stakeholders support the role of ETOEs in a competitive marketplace.***

***Some stakeholders contend that the international mailing and shipping community should focus on re-evaluating the fairness of the terminal dues system.***

Some stakeholders also allege improper ETOE activities exacerbate their advantages. The U.S. has declared that UPU Acts do not apply to ETOE commercial operations in the U.S. As a result, ETOEs are prohibited from using UPU documentation for the sole purpose of exporting what is, therefore, deemed commercial cargo. However, UPU documentation may be included with air waybills, as long as the exportation from the U.S. relies on commercial documentation. They also are prohibited from using Postal Service equipment, such as bags, containers, and other receptacles, since they are not handling “mail.” Nevertheless, ETOEs operating in the U.S. may be able to access terminal dues rates, if items that leave the U.S. as cargo are accepted as mail in destination countries.

Stakeholders allege ETOEs have improperly used UPU documentation on certain mailings, giving them access to lower transportation rates and terminal dues. Airlines sometimes charge reduced transportation rates when UPU documents are included with shipments, as the carriers treat such shipment as “mail” rather than “commercial cargo” (which results in higher rates). In the course of our review, we were not able to find sufficient evidence to validate these allegations.

In summary, these collective competitive advantages present a challenge to the Postal Service and to private operators when competing with ETOEs. Some stakeholders argue that ETOEs should be subject to a higher level of oversight than their purely private sector counterparts based on these competitive advantages.

#### **Support for Extraterritorial Offices of Exchange**

Some stakeholders support the role of ETOEs in a competitive marketplace. These stakeholders argue that ETOEs in the U.S. do not, in fact, have competitive advantages over the Postal Service, as they face their own challenges that level the playing field. While ETOEs in the U.S. are not subject to the same oversight and regulation as the Postal Service, they are governed by the same laws, regulations, and oversight as other U.S. businesses. Additionally, these stakeholders argue the universal service obligation does not create a disadvantage for the Postal Service, as it only applies to domestic delivery, not to the international delivery that is the focus of competition from ETOEs.

#### **Impact of Terminal Dues on Extraterritorial Offices of Exchange**

Some stakeholders contend that the international mailing and shipping community should focus on re-evaluating the fairness of the terminal dues system. These stakeholders believe the multi-tiered terminal dues system, which allows for lower shipping rates for developing countries and higher rates for developed countries, creates an inequity across the international shipping community. The system was designed to set rates by majority agreement of the UPU (rather than reflecting the true economic cost of inbound international mail delivery). Terminal dues originated at a time when postal traffic was primarily letters and controlled almost exclusively by posts.

Today, however, international letter volume is in decline, and the Postal Service is moving more packages that flow through the terminal dues stream, including lightweight packets. The explosive growth in packages, fueled by increasing ecommerce, has greatly elevated concerns about the system’s fairness. International package volume continues to grow rapidly, but destination posts with higher postal rates protest that terminal dues do not cover their costs for delivering these packages. On the other hand, private sector shipping companies complain that terminal dues are only available to postal operators – as well as ETOEs – creating an unfair competitive advantage.

***During the 26th UPU Congress – held in September and October 2016 – the member countries agreed to changes to the terminal dues system, effective in 2018.***

Our 2015 report on terminal dues examined concerns about, and assessed the impact of, terminal dues distortions in the international small package market.<sup>14</sup> The research showed:

- The terminal dues received by the Postal Service do not fully cover its costs, leading to a loss on inbound mail and small packages; and
- Terminal dues create winners and losers. In certain instances, low terminal dues benefit China Post and Chinese online retailers in the lightweight, low-value package segment at the expense of the Postal Service and American retailers.

The report also pointed out international terminal dues are increasingly irrelevant in an age of ecommerce because they fail to meet customer demands for speed and reliability. Changes in circumstances since this report was issued in 2015 have begun to address some of these issues with the terminal dues system. The China Post terminal dues issue was largely resolved through a bilateral agreement that requires China e-packets to cover their costs plus a profit. Additionally, agreements made during the 2016 UPU Congress were intended to ensure that packets will cover their costs and provide a margin, when implemented by 2018.

**Updates from 2016 Universal Postal Union Congress**

During the 26<sup>th</sup> UPU Congress — held in September and October 2016 — the member countries agreed to changes to the terminal dues system, effective in 2018. One established a new formula for the way that terminal dues are calculated for small packets. This revised payment model accounts for the higher costs associated with delivery of small packets compared to letters and flats. Another change increases the rate at which the ceiling on terminal dues rates — in particular those relative to small packets — can increase. These changes are intended to reflect the changing composition of letter mail streams and the increasing number of small packets sent internationally.

To address some ETOE policies that are inconsistently applied, UPU member countries adopted a proposal to amend the Universal Postal Convention during the 2016 Congress that defines ETOEs. The new article builds on a UPU resolution adopted in 2004. Specifically, it confirms that, subject to national legislation or policy of the origin or destination country, only designated postal operators may use UPU documentation, and the associated legal privileges of the UPU. The article further states that allowing an ETOE to send postal items between two countries using UPU documentation must be approved by both countries. The U.S. delegation to the UPU Congress proposed an additional reform to international mail processing center IMPC codes, intended to increase transparency into ETOEs, but the proposal was not adopted.

Those involved indicated that the new agreements are a move toward better cost coverage under the terminal dues system, but that additional changes are needed.

Further progress expected during the 2018 UPU Extraordinary Congress includes approval of the second phase of the Integrated Product Plan, which would put the UPU on a path to modernize its physical mail products and associated remuneration. The initiative aims to align the UPU's product offerings with the needs of the market and emerging security and customs requirements for small packets. Members will achieve this alignment primarily by segregating the mail stream into documents and goods and then imposing a range of requirements on mail items containing goods. The UPU decided to take action on this during the 2016 Congress, but phase one is only the first small step – and a major decision point is expected during the 2018 Extraordinary Congress.

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<sup>14</sup> OIG, *Terminal Dues in the Age of Ecommerce* (Report Number [RARC-WP-16-003](#), dated December 14, 2015).

***The recent growth in the international mailing and shipping market – recently estimated to be \$1.5 trillion – will likely continue to fuel debate and discussions on the role and impact of ETOEs and the terminal dues system.***

## Summary

Perspectives vary on the value of ETOEs in the U.S., with some stakeholders arguing that ETOEs have unfair competitive advantages because they can access terminal dues (through their affiliation with national posts) and lower transportation rates, they are relatively free from regulatory oversight, and are free from obligations to provide domestic universal service or any minimum level of international delivery and service. Other stakeholders, however, support the role of ETOEs in a competitive marketplace, but think the multi-tiered terminal dues system that helps ETOEs to thrive is inherently unfair because it mandates lower rates for developing countries and higher rates for developed countries.

The recent growth in the international mailing and shipping market — recently estimated to be \$1.5 trillion — will likely continue to fuel debate and discussions on the role and impact of ETOEs and the terminal dues system.

## Management's Comments

Postal Service management provided observations on some matters in the report. First, management stated the State Department could not verify the accuracy of the list of ETOEs referenced in our report. Second, management stated that ETOEs are not required to fulfill any universal service obligations for inbound or outbound international basic postal services imposed only on designated operators under the UPU Acts.

Lastly, management clarified that U.S. policies regarding the handling of ETOE items have been well documented in UPU circulars. Management stated that ETOE policies, or any alleged lack of clarity thereof, are not why some ETOE shipments may have entered a Postal Service mail processing facility. Management also stated the UPU has advised its member countries that U.S. offices of exchange would refuse to accept inbound ETOE shipments on the basis of UPU documentation. Management stated that determining whether particular shipments are from ETOEs can be unclear, as they are mixed together among non-ETOE inbound shipments. Furthermore, management stated the [REDACTED] from how to handle ETOE shipments.

See [Appendix A](#) for management comments in the entirety.

## Evaluation of Management's Comments

The OIG considers management's comments responsive, and acknowledges management's clarifications made regarding the list of ETOEs and the universal service obligation. We have updated footnote 11 in our report accordingly to clarify that the State Department's website reflects a list of ETOEs last updated in July 2014, while the State Department provided a more updated list of ETOEs, last updated in July 2016.

Regarding their clarification on the universal service obligation, we believe the statement in our report includes an explanation of the Postal Service's obligation to deliver international inbound mail and provide a minimum level of international delivery and service. Further, the report specifically explains in the summary that ETOEs are "free from obligations to provide domestic universal service or any minimum level of international delivery and service."

Regarding management comments about ETOE policies, particularly those related to the [REDACTED] and have updated this report accordingly.

## Appendix A: Management's Comments

LEA EMERSON  
EXECUTIVE DIRECTOR  
INTERNATIONAL POSTAL AFFAIRS



March 23, 2017

LORI LAU DILLARD  
ACTING MANAGER; AUDIT POLICY, QUALITY, AND TRACKING

SUBJECT: Report Number MS-WP-17-DRAFT, Extraterritorial Offices of Exchange

Thank you for the opportunity to provide comments on Report Number MS-WP-17-DRAFT on Extraterritorial Offices of Exchange (ETOE). We appreciate the Office of Inspector General's valuable insights on this important matter. We do wish to share a few observations on some matters in the report.

First, the State Department web-site listing of ETOEs referenced on page 7 in footnote 12 is no longer current, since the State Department stopped publishing the ETOE list. Consistent with the finding in the report that found that 72 percent of the ETOEs were not physically located at the addresses on record, the State Department also could not verify the accuracy of the information.

Second, on page 7 under the heading "Stakeholder Perspectives", in addition to the fact that ETOEs "are not required to provide domestic universal service", another important consideration is that ETOEs are also not required to fulfill any universal services obligations for inbound or outbound *international* basic postal services imposed only on designated operators under the Universal Postal Union Acts.

[REDACTED]

regarding the handling of ETOE items have been well documented in Universal Postal Union circulars. The fact that some ETOE shipments were not rejected but rather entered in the Postal Service's mail processing facility is not the result of its ETOE policies or any alleged lack of clarity with respect thereto. The ETOE policies are clear and have been in effect for years. In 2005, the United States caused the UPU to issue IB Circular No. 127 to other UPU member countries to advise them that the United States offices of exchange would refuse to accept inbound shipments from ETOEs on the basis of UPU documentation. In accordance with that ETOE policy, the shipments at issue should have been refused to whatever extent that they could have been identified as shipments from ETOEs that were using UPU documentation. Whether particular shipments are in fact from ETOEs might not always be clear, particularly where, as may have been the case here, ETOE shipments are mixed together among non-ETOE inbound shipments.

[REDACTED]

and did not arise from the separate and distinct question of how to handle ETOE shipments.

Thank you for taking account of these observations.

A handwritten signature in blue ink that reads "Lea Emerson".

Lea Emerson

475 L'ENFANT PLAZA, S.W., ROOM 5136  
WASHINGTON, DC 20260-0004  
202-268-2574  
FAX: 202-268-8095  
WWW.USPS.COM



OFFICE OF  
**INSPECTOR  
GENERAL**  
UNITED STATES POSTAL SERVICE

U.S. Postal Service Office of Inspector General  
1735 N. Lynn Street  
Arlington, VA 22209

Telephone: 703-248-2100  
[www.uspsoig.gov](http://www.uspsoig.gov)

For media inquiries, contact Agapi Doulaveris  
Telephone: 703-248-2286  
[adoulaveris@uspsoig.gov](mailto:adoulaveris@uspsoig.gov)