

**BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001**

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**POSTAL RATE AND FEE CHANGES, 2006**

**DOCKET NO. R2006-1**

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**RESPONSES OF WITNESS HOROWITZ TO INTERROGATORIES OF  
THE UNITED STATES POSTAL SERVICE  
USPS/POSTCOM-T6-7-18**

The Association for Postal Commerce, the Mailing and Fulfillment Service Association, The Direct Marketing Association, and the Continuity Shippers Association (herein collectively "PostCom") hereby provides the responses of Witness Horowitz to Postal Service interrogatories USPS/PostCom-T6-7-18, filed October 4, 2006.

Each interrogatory is stated verbatim and followed by the response.

Respectfully submitted,

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**USPS/Postcom-T6-7.** Please refer to page 3, lines 22-23, through page 4, lines 1-2 of your testimony where you state, "More recently, our mix of new members have increasingly come from marketing channels that do not require the use of the mail to join, such as (1) the Internet, (2) in-bound telemarketing and (3) direct response television." Please indicate the relative costs of acquiring new members through each of these channels and compare them to the costs of acquiring customers through direct mail.

**RESPONSE:**

It is difficult to compare the relative costs of acquiring new members in different marketing channels because of the different cost drivers of the channels, i.e. the use of outside versus inside resources to perform various functions and the accounting for those activities.

Nevertheless, I can provide the following information. Without including any internal costs, direct mail is the most expensive channel for new member acquisition. Direct mail is approximately 20% more expensive than direct response television for new member acquisition. While we currently do not engage in new member acquisition through telemarketing, direct mail is approximately twice as expensive as telemarketing for reinstate or reenrollment.

Moreover, the relative cost of the acquisition itself is not the best measurement. The best measurement is the profitability of a marketing channel. If it costs more to acquire a new member in a particular marketing channel, those members need to generate more revenue than a member who joins via a less expensive marketing channel.

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**USPS/Postcom-T6-8.** Please refer to your testimony at page 5, line 19 where you note that the RSS was 10 cents per piece when first imposed in 1999.

a. Please confirm that when the RSS was imposed, the Postal Service offered evidence that the actual cost difference was 35 cents (see, for example, USPS-T-36, page 13, line 11, Docket No. R97-1), but that the full impact was not being imposed due to the desire to mitigate rate impact. If you do not confirm, please explain.

b. Please confirm that the 24.2 cents cited in your testimony at page 5, line 20, is still less than the original cost difference of 35 cents.

(a-b) I am not familiar with the Postal Service's cost data.

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**USPS/Postcom-T6-9.** Please refer to your testimony at page 7, lines 7-9 where you state that “it costs us more to drop enter our parcels at some West Coast bulk mail centers than we save in the drop entry discount.”

a. Please confirm that efficiency arguments, such as Efficient Component Pricing (please refer, for example, to the testimonies of witness Panzar or Sidak in this docket), suggest that the lowest cost provider – whether it be the USPS or the customer – should be performing the activities. If you do not confirm, please explain.

b. Please confirm that efficiency is supported if, because a mailer cannot dropship items at a lower cost than the Postal Service can transport such items, the mailer discontinues dropshipping those items. If you do not confirm, please explain.

**RESPONSE:**

(a) Confirmed, however I do not believe that the Postal Service is in fact the lowest cost provider of these services. See my response to (b).

(b) Not confirmed. The cost of actually transporting parcels to the bulk mail center is just one of the activities (and costs) that comprise the drop shipping process. The entire operation of how to organize the fulfillment process, including the picking and packing of orders, the printing of invoices and sorting of the orders, must all be considered in determining the most efficient flow. For example, it is more efficient and cost effective for Cosmetique to drop ship to the West Coast BMCs even though the actual transportation costs exceed the postal drop ship discounts.

In addition, a mailer may choose a higher cost alternate in order to gain other advantages such as speed of delivery.

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**USPS/Postcom-T6-10.** Please refer to page 8 of your testimony at lines 1-3 where you state, "As a result of the price increases, we will have to curtail our use of the mail as a marketing channel and expand our exploration of alternative media channels to obtain customer, and explore other ways of delivering our products to our members."

a. Please clarify whether the costs to you of advertising through other media have increased, decreased, or stayed the same over the past five years.

b. Please provide a list of the alternative ways that your products may be delivered to your members and provide an indication of relative costs when compared to using Standard Mail.

**RESPONSE:**

(a) In general, the costs to Cosmetique of advertising through other media have decreased over the past five years where the same marketing activity is being performed. For example, if Cosmetique placed the same volume of advertising in Sunday supplements, the cost has decreased. However, if Cosmetique changed the marketing program such as the mix of the advertising (tests versus rollout programs) or reduced quantities, the costs may have increased, decreased or stayed the same.

This is consistent with other vendors Cosmetique uses. The costs charged by other vendors have decreased for the same item or activity over the past five years assuming no changes.

(b) Cosmetique could look to use alternate delivery companies, such as Federal Express or United Parcel Service to deliver our collections to our customers.

Cosmetique has not obtained definite quotes from any company in order to provide a comparison of costs versus the Postal Service. However, Cosmetique would expect the cost of the delivery alone would be higher with the use of alternate delivery companies,

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without considering other internal costs or savings, nor considering the perceived higher value that members may have with alternate delivery.

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**USPS/Postcom-T6-11.** Please refer to page 8, lines 5-7 where you state, “our return on investment from mail marketing channels will be reduced to the point where the mail will no longer be a profitable marketing channel for us.”

a. Please provide an explanation of the decision process which would lead to this conclusion, including the variables considered and the timeframe over which this decision would be set into motion.

b. Please confirm that by “mail marketing channels” you are referring to ads included in the shipments of your product to customers. If you do not confirm, please explain.

**RESPONSE:**

(a) As mentioned in my response to interrogatory USPS/POSTCOM-T6-7, the profitability of each marketing channel is reviewed to determine whether to increase, decrease or stop marketing in that channel in the future. Profitability compares the cost of the channel against the revenues received.

Profitability is actually reviewed on a campaign by campaign basis within a marketing channel, and even on a segment by segment basis within a campaign. Certain segments may do very well, well, fair, poor, or not break even at all. Those segments that are not profitable are not marketed to again.

As costs increase, the revenue needed to continue with that marketing campaign increase as well. Costs can increase on a unit basis or because of a loss of economies of scale. For example, Cosmetique is charged a lower per unit cost to produce a mailing of 1 million pieces versus a mailing of 50,000.

When only a few segments of a campaign remain profitable, the entire campaign may no longer be viable because of increased costs resulting from the loss of the economies of scale in producing the campaign. In other words, while there may still be some segments that are profitable if all the segments were marketed, the few profitable

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segments would no longer be profitable when the unprofitable segments are not marketed. The same logic applies to marketing channels.

Cosmetique does not know whether the return on investment from mail marketing channels will, in fact, be reduced where Cosmetique will no longer engage in that marketing channel. Thus, Cosmetique does not have any timetable as to when (or if) Cosmetique will stop using the mail marketing channel. However, as the costs increase in the mail marketing channel, the revenue needed from the channel increases as well.

(b) Not confirmed. By "mail marketing channel," I am referring to any marketing activity which primarily uses the mail to present the offer to the potential member and/or receive the order from the member. Among other activities, this means direct mail, package inserts, Sunday supplements, etc.

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**USPS/Postcom-T6-12.** Please refer to lines 9-11 of page 8 of your testimony where you state that you “have begun a marketing initiative to reinstate members through electronic mail and through our website.”

- a. Please reconcile this statement with your testimony, for example on page 4, that First-Class Mail is used to sign up members, send invoices, etc.
- b. Please confirm that this marketing initiative has been underway independent of the outcome of the current rate case.
- c. Please confirm that the “multiplier effect” of your product mailings is weakened when the bill payment, marketing efforts, customer sign-ups are conducted via an electronic method.

**RESPONSE:**

- (a) I see no inconsistency to be reconciled. On page 4 of my testimony I explain:

For those customers who choose the open account pay method, First Class mail is used for payments and dun letters. We have found that members who join Cosmetique through the mail are more likely to be open account members as compared to members who join via electronic media. Members who join via electronic media generally pay with a credit card. Thus any reduction in the volume of acquisition through mail marketing channels will reduce the overall volume of mail, particularly First Class mail.

On page 8, I simply state "Cosmetique has begun a marketing initiative to reinstate members through electronic mail and through our website." The marketing initiative I refer to here is testing the use of electronic media for certain activities, including the reinstatement of members.

- (b) Confirmed. The tests have not been completed. However, assuming there are favorable results, the relative profitability (revenue minus cost) would affect the speed at which Cosmetique would adopt the marketing actions being tested.

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(c) Not confirmed. The question confuses the issue. As I interpret the question, by "product mailings," you are referring to the packages of product that we send to our customers. The "multiplier effect" of these packages is the additional mail volume that occurs as a result of additional sales of our own products and third party products or services and related correspondence that is generated from inserts in these packages. These inserts constitute a "marketing effort" that is conducted via the mail. A "customer signup" and "bill payment" generated from an insert may be conducted via mail or via an electronic method, but customers who respond to a mailed solicitation such as an insert frequently order by mail and pay their bills by mail. (See (a) above.)

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**USPS/Postcom-T6-13.** Please refer to your statement at lines 17-18 of page 8 that “each of these trends [toward electronic substitutes for mail] will accelerate dramatically in the near future, especially if the proposed postage rates for Standard Mail are implemented.” If Standard Mail rates were not increased at all, would these trends continue to “accelerate dramatically,” accelerate, stay stable, or decrease? Please provide any analysis used to arrive at your conclusion.

**RESPONSE:**

I would expect that the trends toward the use of electronic media will occur regardless of whether Standard Mail rates increase. The question is the speed at which it will occur. The higher the costs of mail, the faster the trend will be. This is so because companies like Cosmetique consider the relative profitability of our decisions. Where the cost for one action is higher than another and the revenue is the same, we will take the lower cost action.

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**USPS/Postcom-T6-14.** Please refer to your testimony at page 9, lines 2-4 where you state, "As the cost differential between the Postal Service and other services narrows, we will increasingly be willing to use other shipping providers who can guarantee the faster level of service sought by single-sale buyers." Please provide, if not actual rate comparisons, indications of the cost of these other service providers relative to the prices you would pay under Standard Mail and indicate what shipping and handling charges you would then charge the single-sale buyers for such shipments.

**RESPONSE:**

Cosmetique would expect the cost of the delivery alone would be higher with the use of alternate delivery companies, without considering other internal costs or savings, nor considering the perceived higher value that members may have with alternate delivery.

Hypothetically and only considering the variables of cost and perceived value, if a customer perceives a \$2.00 increased value in receiving a Cosmetique collection via an alternate delivery company as compared to the Postal Service, and if the postal cost is more than \$2.00 lower than the cost of the alternate delivery company, Cosmetique will choose the Postal Service. However, if the gap between the postal cost and the alternate delivery cost narrows to less than \$2.00, Cosmetique will choose the alternate delivery company.

As the cost of delivery (as one item within the larger costs associated with shipping and handling) increases, Cosmetique must make a decision whether to increase shipping and handling charges. If the cost of delivery through an alternate delivery company were so much higher than the Postal Service (or if the Postal Service raises its rates so much higher than current rates), Cosmetique considers whether to increase shipping and handling charges to cover the additional cost balanced against the loss of members and sales as a result of the increased cost. Since Cosmetique

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does not know the cost of delivery from a alternate delivery company, I cannot answer  
what Cosmetique would charge.

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**USPS/Postcom-T6-15.** Please refer to your testimony at page 10, lines 23-24, through page 11, lines 1-3 regarding the permission to include “non-print” materials in Bound Printed Matter. Is it your understanding that the inclusion of these materials is permissible if the weight limit of 15 pounds is exceeded?

**RESPONSE:**

No.

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**USPS/Postcom-T6-16.** Please refer to your testimony at page 11, lines 4-8.

a. Did Cosmetique determine the materials to be included in its packages independent of the Standard Mail weight limit of 16 ounces? Or did Cosmetique determine the materials to be included in its packages with consideration given to the 16-ounce limit?

b. If the Postal Service were to change the weight limit of Standard Mail to 13 ounces to be consistent with First-Class Mail's weight limit, would Cosmetique change the content of its packages?

c. If the Postal Service were to change the weight limit of Standard Mail to 1 ½ pounds, would Cosmetique change the content of its packages?

**RESPONSE:**

(a) Cosmetique determines the products and other material to be included in the package with great consideration given to the 16 ounce limit.

b) Yes. Cosmetique would probably have to reduce the number of products we send to our members in each collection. This would have a huge negative impact on Cosmetique. Among other things, I believe we would mail out fewer collections which would result in a decrease in the mail volume Cosmetique generates.

c) Yes. Cosmetique would probably increase the number of products we send to our members in each collection. This would have a huge positive impact on Cosmetique. Among other things, I believe we would mail out more collections which would result in an increase in the mail volume Cosmetique generates.

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**USPS/Postcom-T6-17.** Please refer to your testimony on page 11, lines 9-20 where you suggest that “ride alongs” should be permissible even if they increase the weight of the mail piece above its limit.

a. Would you agree that the positive effects you describe from including additional advertising material would accrue regardless of the class of mail to which the advertising material is added?

b. If your response to part (a) is affirmative, would you suggest that the weight limits for every subclass of mail be relaxed from their current “rigid approach” to permit advertising matter to result in a mailpiece over the limit set for that subclass?

c. Should the Postal Service relax the weight limits for any and all additional content, or just for advertising materials?

d. What mechanism should the Postal Service use to determine if the weight limit for Standard Mail was exceeded by the inclusion of additional advertising matter or by the inclusion of, for example, additional cosmetic products?

(a) I would not agree. The class of mail is not the determining factor as to the positive effects of a ride-along. The question is the relative cost of the increased postage to pay for the ride-along as compared to the revenue generated by including the ride-along, and comparing that net revenue of including ride-alongs against the cost of not including the ride-along at all.

Thus, I believe that Standard mail has a unique rate structure that would allow for ride-alongs without the increased postage being greater than the revenue generated from the ride-along, and the overall postage rate minus the additional ride-along revenue would not be greater than the postage rate if the ride-along was not included at all.

(b) See the answer to (a)

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(c) My proposal does not look to increase the weight limit for the actual product being sold.

(d) One possible mechanism to determine if the weight limit for Standard Mail was exceeded would be to have the additional advertising material in a separate envelope. The package could be weighed with and without the separate envelope.

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**USPS/Postcom-T6-18.** Please refer to your response to USPS/Postcom-T6-1 and USPS/Postcom-T6-4.

a. Please confirm that the proposed postage for a typical Cosmetique parcel drop-shipped to a BMC, \$1.51, is \$4.44 less than Cosmetique's current "standard offer" shipping and handling charge of \$5.95 and that the proposed postage is only 25.4 percent of the shipping and handling charge.

b. Please confirm that the proposed postage for a typical Cosmetique parcel drop-shipped to a BMC, \$1.51, is \$1.44 less than Cosmetique's lowest shipping and handling charge currently charged to customers who have joined Cosmetique within the last 7 and a half years, and confirm that the proposed postage is only 51.2 percent of Cosmetique's lowest shipping and handling charge for said customers.

c. Please confirm that on January 10, 1999 the postage for a typical 15.85 ounce Cosmetique parcel that was Basic presorted and drop-shipped to a BMC was \$0.856.

d. Please confirm that Cosmetique's shipping and handling charges have increased by 102 percent since January of 1999 to the present, whereas under the Postal Service's pricing proposals, the postage for a typical Cosmetique parcel described in part (c) would have only increased 76 percent over the same seven and a half years.

(a -d) Confirmed. However, the postage cost for an outbound package is not the only cost incurred by Cosmetique associated with shipping and handling. For example, Cosmetique incurs costs associated with mail preparation and drop shipping to the BMC, and Bulk Parcel Return Service.