

ORDER NO. 718

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION

Before

Chairman Goldway,
Vice Chairman Mark Acton,
Commissioners Blair, Hammond and Langley

Complaint of GameFly, Inc.

Docket No. C2009-1

ORDER ON COMPLAINT



Washington, DC 20268-0001

April 20, 2011

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Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman;
Dan G. Blair;
Tony L. Hammond; and
Nanci E. Langley

Complaint of GameFly, Inc.

Docket No. C2009-1

ORDER ON COMPLAINT

(Issued April 20, 2011)

This proceeding began on April 23, 2009, with the filing of a complaint by GameFly, Inc. (GameFly) under 39 U.S.C. 3662 alleging that rates and services offered by the Postal Service to certain DVD mailers violate prohibitions on undue or unreasonable discrimination contained in 39 U.S.C. 101(d), 403(c), 404(b), and 3622(b)(8). Since then, the parties have engaged in extensive discovery, testimony has been filed, hearings have been held, and legal briefs have been filed. This Order addresses the contentions of the parties and resolves the issues presented for decision.

I. EXECUTIVE SUMMARY

[1001] In this proceeding, the Commission considers a complaint filed by GameFly, Inc. (GameFly), a firm that rents and sells video games recorded on DVDs.¹ In its Complaint, GameFly alleges that it is the victim of undue discrimination by virtue of Postal Service violations of 39 U.S.C. sections 101(d), 403(c), 404(b) and 3622(b)(8).

[1002] GameFly mails DVDs to its customers via First-Class Mail. Customers return DVDs to GameFly via First-Class Mail Business Reply Mail. Both outgoing and incoming GameFly DVD mailers enter the mailstream as flats. GameFly alleges that two other DVD mailers, Netflix, Inc. (Netflix) and Blockbuster, Inc., (Blockbuster), both of which send and receive DVDs by letter mail, are accorded undue processing preferences and rates. Specifically, GameFly alleges that both Netflix and, to a lesser extent, Blockbuster receive hand processing at no additional charge and that GameFly is denied these or comparable benefits. GameFly asserts that these actions constitute unlawful preferences and/or discrimination.

[1003] Upon consideration of the evidentiary record and the arguments made in the initial and reply briefs of the parties, the Commission concludes that the Postal Service has unduly discriminated against GameFly in violation of 39 U.S.C. 403(c). In reaching this conclusion, the Commission expressly rules on GameFly's right to file its Complaint (see section IV.A.); discusses the legal standards for evaluating claims of discrimination and the filed rate doctrine invoked by GameFly (see sections IV.B. and C.); and evaluates the fact-based issues raised by the parties (see section IV.D.). In this latter section, the Commission confirms evidentiary rulings made by the Presiding Officer; finds that GameFly is similarly situated to Netflix and Blockbuster; concludes that Netflix and Blockbuster have been given a number of preferences, including various forms of manual processing coupled with the avoidance of the non-machinable

¹ Complaint of GameFly, Inc., April 23, 2009 (Complaint).

surcharge; and determines that the Postal Service has failed to present adequate and legitimate justifications for these preferences.

[1004] DVDs returned by subscribers to Netflix in its prepaid letter-sized mailers are non-machinable, and are frequently damaged or cause machine jams. DVDs returned by subscribers to GameFly also are damaged from processing on automated letter processing equipment. The Postal Service separates and hand processes a substantial proportion of Netflix's returns without imposing a non-machinable surcharge. The Postal Service is unwilling to hand process GameFly's returns causing GameFly to incur an additional ounce charge on its mail, which the Postal Service refuses to waive.

[1005] To remedy this unreasonable preference, the Commission orders the Postal Service to establish two parallel rate categories within First-Class Mail for round-trip DVD mail. One category establishes that DVDs sent as presorted First-Class Mail letters to subscribers will not be subject to the non-machinable surcharge when returned. The other rate category provides that DVDs mailed as First-Class Mail flats to and from subscribers will not be subject to an additional ounce charge.

[1006] The Postal Service is given 60 days to implement this remedy.

II. PROCEDURAL HISTORY

A. Background

[2001] GameFly is a Delaware corporation founded in 2002 with Headquarters located in Los Angeles, California.² GameFly is engaged in the online rental of video games, most of which are recorded on DVDs. Joint Statement ¶¶ 1, 13. Subscribers to GameFly's service receive and return their DVDs by mail. *Id.* ¶¶ 15, 18.

[2002] GameFly is not the only company that rents DVDs and uses the mail to deliver and recover its rentals. Netflix also rents DVDs and distributes and recovers those DVDs by mail. *Id.* ¶ 64. Unlike GameFly, Netflix rents movies rather than video games. *Id.* Other companies, such as Blockbuster, compete directly against GameFly by engaging in the DVD by mail video game rental business. *Id.* ¶¶ 14, 93.

[2003] DVD mailers have not been without their problems. DVDs enclosed in lightweight mailers can experience breakage when processed on Postal Service processing equipment. *Id.* ¶ 27. DVD mailers can also jam Postal Service processing equipment. See *id.* ¶ 83; see also Postal Service Brief at 91.³

[2004] At the request of the Postal Service, a November 2006 study, *USPS Mail Characteristics Study of DVD-by-Mail*, was prepared by Christensen Associates (Christensen Study).⁴ One year later, the Postal Service's Office of Inspector General

² See Joint Statement of Undisputed and Disputed Facts, July 20, 2009 (Joint Statement), ¶¶ 2-4. The Joint Statement was filed in response to Order No. 235 as part of an effort to facilitate discovery. See Order Denying Motion of the United States Postal Service for Partial Dismissal of Complaint and Notice of Formal Proceedings, July 1, 2009 (Order No. 235). The Joint Statement included both disputed and undisputed facts. Unless otherwise noted, references in this Order will be to those facts set forth in the Joint Statement that are undisputed.

³ Initial Brief of United States Postal Service, November 8, 2010 (Postal Service Brief).

⁴ The Christensen Study was filed in this proceeding by GameFly on November 12, 2010. See Application of GameFly, Inc. for Non-Public Treatment of Portions of Compendium of Documents, November 12, 2010 (GameFly Application for Non-Public Treatment).

(OIG) issued a report at the conclusion of a self-initiated audit addressing concerns regarding potential preferential treatment given to Netflix.⁵

[2005] In addition to the threat of breakage, GameFly DVDs have been targeted by thieves, some of whom proved to be Postal Service employees and contractors. Joint Statement ¶¶ 56-57.

[2006] Working with the Postal Service, the OIG, and the Postal Inspection Service, GameFly attempted to address both the breakage and theft issues. *Id.* ¶¶ 113-18. During December 2007, a number of mailer configurations were tested at the Postal Service facility in Merrifield, Virginia in an attempt to design a mailpiece that would be mechanically culled out of the letter mailstream into the flats mailstream. *Id.* ¶ 116. By working with the OIG and Postal Inspection Service, theft has been reduced, but not eliminated. *Id.* ¶ 58.

[2007] During December 2007, GameFly also began asking the Postal Service either to offer a reduced rate for round-trip DVD mailers, or a niche classification that would avoid the need to pay a two-ounce flats rate for qualifying DVD mailers. *Id.* ¶ 120. Other proposals were subsequently made by GameFly for postage rate relief. *Id.* ¶ 121. The Postal Service declined to adopt these proposals. *Id.* ¶ 122.

[2008] GameFly currently uses First-Class Mail flats for both outbound and return mailings. *Id.* ¶¶ 15, 18, 20. The GameFly flats are designed to reduce breakage. Tr. 5/692; Joint Statement ¶ 48. These mailpieces also rely upon a non-distinctive appearance to deter theft. Tr. 5/698.

[2009] At some point during late 2008 or early 2009, GameFly sought legal and consulting services to assist in its negotiations with the Postal Service. Joint Statement ¶ 126. During those discussions, GameFly asserted a claim of undue discrimination,

⁵ United States Postal Service, Office of Inspector General Audit Report Review of Postal Service First-Class Permit Reply Mail (Report Number MS-AR-08-001), November 8, 2007 (OIG Audit Report). See *also* GameFly Application for Non-Public Treatment; Joint Statement ¶¶ 83-84.

alleging that other mailers had received preferential treatment denied to GameFly. See *id.* ¶¶ 127-30.

[2010] The Postal Service ultimately declined to respond to GameFly's request for a proposal that satisfactorily addressed its claims. *Id.* ¶ 130.

[2011] On April 23, 2010, GameFly filed the Complaint that is the subject of this proceeding. The Postal Service vigorously contests GameFly's claims. Formal adjudicatory hearings have been held, evidence presented, and legal briefs filed. The case is now ripe for decision.

B. Commission Proceedings

[2012] *The Complaint.* GameFly filed its Complaint on April 23, 2009 alleging that "the rates and service provided by the Postal Service to customers who use First-Class Mail to send and receive DVDs...violate 39 U.S.C. §§ 101(d), 403(c), 404(b) and 3622(b)(8), which prohibit undue or unreasonable discrimination among users of the mails, undue or unreasonable preferences to users of the mails, and unjust, unreasonable and inequitable rates and practices." Complaint at 1. Commission jurisdiction was alleged under 39 U.S.C. 3662. *Id.*

[2013] Section I of the Complaint sets forth a series of factual allegations. Subsection A described GameFly's business. *Id.* ¶¶ 5-15. Subsection B sets forth GameFly's alleged problems with its mail service. *Id.* ¶¶ 16-25. Subsection C describes GameFly's attempts to negotiate a mutually satisfactory solution of its concerns and problems with the Postal Service. *Id.* ¶¶ 26-34. Subsection D summarizes the preferential treatment that GameFly alleges was being given by the Postal Service to other DVD mailers. *Id.* ¶¶ 35-39. Subsection E discussed the nature of the evidence that GameFly either had, or expected to obtain during the course of discovery, which would support its factual allegations. *Id.* ¶¶ 40-42. Subsection F includes a statement that none of the issues raised in the Complaint were pending in, or

had been resolved by, Commission proceedings or proceedings in any other forum to which GameFly was a party. *Id.* ¶ 43. Finally, in subsection G, GameFly summarizes the steps that it had previously taken to confer with the Postal Service and resolve its issues without the filing of the Complaint. *Id.* ¶¶ 44-47.

[2014] Section II of the Complaint sets forth four causes of action.

- Count I alleges unlawful discrimination among DVD mailers. More specifically, GameFly asserts that the Postal Service's manual processing of one-ounce letters for certain large DVD mailers, while failing to offer similar service to GameFly and other similarly situated mailers, constituted undue or unreasonable discrimination or preferences in violation of 39 U.S.C. 403(c). *Id.* ¶¶ 48-49.
- Count II alleges unlawful discrimination among flats mailers. This allegation asserted that it was unduly or unreasonably discriminatory or preferential and a violation of 39 U.S.C. 403(c) for the Postal Service to provide flats processing to most mail matter entered at higher flat-shaped First-Class Mail rates, while requiring GameFly and other similarly situated mailers to pay the second-ounce rate for flats in order to obtain flats, as opposed to letter, processing of DVDs. *Id.* ¶¶ 50-51.
- Count III alleges that the Postal Service violated 39 U.S.C. 404(b) by collecting First-Class flats rates for DVDs entered into the mail by GameFly and other similarly situated mailers and processing those DVDs on letter sorting equipment unless the mailer also paid second-ounce postage. *Id.* ¶¶ 52-53.
- Count IV alleges an unreasonable practice and a violation of 39 U.S.C. 404(b) for the Postal Service to collect flats rates for DVDs entered by GameFly and other similarly situated mailers as First-Class flats while failing to process the DVDs on flats sorting equipment. *Id.* ¶¶ 54-55.

[2015] Section III of the Complaint requests (1) that hearings be held on the Complaint; (2) that reasonable and non-discriminatory rates and terms of service be prescribed for GameFly; (3) that GameFly be accorded the same prices and terms of

service, including the same degree of manual processing as Netflix and Blockbuster; and (4) such other relief as the evidentiary record justifies. *Id.* ¶¶ 56-57.

[2016] *The Postal Service's response.* On May 26, 2009, the Postal Service responded to GameFly's Complaint with two filings. First, it filed a motion for partial dismissal of the Complaint, stating that the Commission lacked jurisdiction under 39 U.S.C. 3662(a) to entertain alleged violations of subsection 404(b), and that to the extent that GameFly attempted to rely upon subsection 404(b), it had failed to state a claim upon which relief could be granted.⁶

[2017] Second, the Postal Service filed an answer in which it addressed each paragraph of the GameFly Complaint.⁷ With respect to GameFly's factual allegations, the Postal Service admitted, denied, or stated that it lacked sufficient information to admit or deny those allegations, or it stated that the nature of the allegation required neither an admission nor a denial. *See, e.g., id.* ¶¶ 1, 9, 18. The Postal Service also made certain affirmative allegations that went beyond those presented by GameFly. *See, e.g., id.* ¶ 16.

[2018] With respect to the four causes of action set forth in counts I through IV of the Complaint:

- The Postal Service denies the allegations in count I and, in doing so, specifically denies that GameFly had ever sought or requested manual processing of outgoing or incoming mail and further denies that it had a policy of manual processing outgoing or incoming mail of other DVD mailers. *Id.* ¶¶ 48-49.
- The Postal Service also denies the allegations in count II and, in so doing, specifically denies that mail entered as First-Class Mail, either as two-ounce automation flats or single-ounce automation letters, should always

⁶ Motion of the United States Postal Service for Partial Dismissal of Complaint, May 26, 2009 (Motion for Partial Dismissal).

⁷ Answer of the United States Postal Service, May 26, 2009 (Answer).

be processed other than as automation flats or letters, respectively. The Postal Service further denies that First-Class Mail single-ounce automation letters must always be processed in the automation letter mailstream, or that First-Class Mail automation flats must always be processed in the automation flats mailstream. Finally, the Postal Service denies that GameFly, a mailer of First-Class Mail automation flats, was similarly situated to mailers of First-Class Mail automation letters. *Id.* ¶¶ 50- 51.

- The Postal Service denies the allegations in counts III and IV. *Id.* ¶¶ 52-55.

[2019] Finally, the Postal Service denies each of GameFly's requests for relief. *Id.* ¶¶ 56-57.

[2020] *GameFly's reply.* On June 2, 2009, GameFly moved for leave to reply to portions of the Postal Service's Answer that GameFly characterized as "threshold motions" seeking dispositive relief.⁸ In its reply, GameFly addresses the Postal Service's May 26, 2009 Motion for Partial Dismissal, as well as motions that GameFly asserts were embedded in the Postal Service's Answer.⁹ With respect to the former, GameFly argues that although the substantive standard of subsection 404(b) is not expressly listed in section 3662, it is implicit in two other sections, namely, sections 401(2) and 101(d) that are expressly listed in section 3662 as proper subjects of a complaint filed under section 3662. With respect to the "threshold motions" allegedly contained in the Postal Service's Answer, GameFly argues that because the case raised substantial and material issues of fact, the Commission should deny those motions and hear the case under the procedures for "full-blown complaints," including the allowance of discovery and evidentiary hearings. GameFly Reply at 6.

⁸ Motion of GameFly, Inc. for Leave to File Reply to Requests of the USPS for Disposition of Complaint, June 2, 2009 (Motion for Leave to File Reply).

⁹ Motion of the United States Postal Service for Partial Dismissal, May 26, 2009 (Motion for Partial Dismissal); Reply of GameFly, Inc. to Requests of the USPS for Disposition of Complaint, June 2, 2009 (GameFly Reply).

[2021] *The Commission's initial order.* In Order No. 235, the Commission, after summarizing the major allegations and representations in the Complaint and Answer, the Postal Service's Motion for Partial Dismissal, and GameFly's Reply, denied the Motion for Partial Dismissal finding that "the pleadings raise issues of both law and fact relevant to whether or not the actions, or inactions, of the Postal Service violate 39 U.S.C. 101(d) or 403(c), either by (a) rising to the level of undue discrimination or preferences among users of the mails, or (b) charging rates inequitably among such mailers. 39 U.S.C. 3662(b)." Order No. 235 at 6. The order also instituted formal proceedings, directing that GameFly and the Postal Service prepare a prehearing memorandum identifying facts that were not in dispute, scheduled an initial prehearing conference, appointed a Public Representative, and established a deadline for the filing by interested persons of notices of intervention.¹⁰ *Id.* at 6-8.

[2022] Beginning with the Commission's initial order and throughout this proceeding, the parties have consistently been encouraged to negotiate and informally resolve their disputes on their own terms. *Id.* at 7. (Parties were directed to meet prior to the prehearing conference and to prepare a memorandum identifying undisputed facts and to stipulate regarding a streamlined and orderly discovery process.) The parties were encouraged to reach a settlement and thereby avoid costly and time consuming litigation. Regrettably, in this case, settlement among the parties has proven to be unattainable. Nevertheless, the Commission remains willing to consider any settlement the parties are able to negotiate within the period established for implementation of the remedy prescribed herein.

[2023] *Discovery.* Following the filing of the Joint Statement and a prehearing conference on July 23, 2009, the parties entered into a period of extensive discovery.

¹⁰ Five persons or entities sought to intervene pursuant to rule 20a of the rules of practice. See Valpak Direct Marketing Systems, Inc. Notice of Intervention, July 21, 2009; Valpak Dealers' Association, Inc. Notice of Intervention, July 21, 2009; Notice of Intervention of Time Warner Inc. as a Limited Participator, July 22, 2009; Douglas F. Carlson Notice of Intervention as a Limited Participator, July 22, 2009; and Request to Intervene as a Limited Participator by David B. Popkin, April 27, 2011.

By the time hearings commenced on June 12, 2010, GameFly and the Postal Service had served over 100 discovery requests, respectively. Additional discovery requests were subsequently propounded by both parties as prepared witness testimony was filed. During this period, the Presiding Officer issued 23 rulings on various discovery motions.¹¹ A complete list of the rulings by the Presiding Officer is set forth in Appendix A.

[2024] A substantial amount of the material produced during discovery was produced under seal in accordance with the requirements of 39 CFR part 3007. The reliance by the parties and their witnesses on this non-public material necessitated the filing of public and non-public pleadings, testimony, and briefs, the occasional bifurcation of hearings into public and non-public sessions, and the preparation of public and non-public hearing transcripts.

[2025] *GameFly's direct case*. GameFly filed its direct case on April 12, 2010, consisting of the written testimony of Sander A. Glick.¹² In his testimony, witness Glick estimated the difference in costs of handling Netflix and GameFly DVD mailers, and compared that difference to the difference in average postage per piece paid by the two companies. Tr. 3/80.

[2026] GameFly also filed the Memorandum of GameFly, Inc., Summarizing Documentary Evidence (GameFly Memorandum),¹³ and a compendium of the documents discussed in the GameFly Memorandum.¹⁴ The documents summarized in

¹¹ Subsequent to the issuance of Order No. 235, in which the Commission ruled that it would sit *en banc* in this proceeding, the Chairman designated Commissioner Blair to serve as the Presiding Officer. See Notice of the Chairman Designating Presiding Officer, July 21, 2009.

¹² Testimony of Sander Glick for GameFly, Inc. (GFL-T-1), April 12, 2010 (GFL-T-1).

¹³ See Application of GameFly, Inc., for Non-Public Treatment of Two Documents, April 12, 2010. The GameFly Memorandum was never admitted into evidence. Tr. 4 155-57 (filed under seal). Counsel for GameFly expressly acknowledged that the GameFly Memorandum was in the nature of a memorandum brief and did not itself constitute record evidence. *Id.* at 155 (filed under seal).

¹⁴ The documents discussed in the GameFly Memorandum were subsequently admitted into evidence over the objection of the Postal Service. See *infra*.

the GameFly Memorandum contained information produced under seal by the Postal Service in response to earlier GameFly discovery requests. GameFly Memorandum at 1.

[2027] Hearings on GameFly's direct case began on June 16, 2010, with the presentation of GameFly's witness Glick. After authentication, the public version of witness Glick's pre-filed written testimony was admitted into evidence and copied into the transcript (Tr. 3/78, 79-91), as was the non-public version of that same pre-filed testimony (Tr. 4/135, 136-54 (filed under seal)). Written cross-examination was also admitted into evidence. Witness Glick's oral cross-examination was conducted in both the public and non-public sessions. Tr. 3/92-120; Tr. 4/653-64 (filed under seal).

[2028] Also at the June 16, 2010 hearing, the Presiding Officer admitted into evidence the compendium of documents referred to in the GameFly Memorandum and had those documents copied into the transcript. Tr. 4/157, 158-652 (filed under seal). The Postal Service objected to the admission of those documents. *Id.* at 155 (filed under seal).

[2029] On July 6, 2010, the Presiding Officer directed GameFly to produce an institutional witness.¹⁵ On July 28, 2010, witness Glick and David Hodess, Chief Executive Officer of GameFly, appeared as institutional witnesses for cross-examination by the Postal Service. Tr. 5/683-84. Witness Hodess was cross-examined in both public and non-public sessions. See Tr. 5/876, Tr. 6/1168 (filed under seal).

¹⁵ P.O. Ruling C2009-1/ 24 expressly limited the scope of the Postal Service's cross-examination. *Id.* at 11-18. As discussed, *infra*, the Postal Service continues to contest these and other evidentiary rulings that determined the content of the record upon which this decision is based.

[2030] *The Postal Service's responsive case.* The Postal Service filed its responsive case on July 29, 2010,¹⁶ consisting of the written testimony of Robert Lundahl,¹⁷ Larry J. Belair,¹⁸ Troy R. Seanor,¹⁹ and Nicholas F. Barranca.²⁰

[2031] Witness Lundahl's testimony addressed the qualities of, and fundamental differences among, different types of DVDs, as well as the actions that mailers can take to manage and reduce breakage of DVDs and Postal Service equipment. Tr. 7/1213.

[2032] The purpose of witness Belair's written testimony was to give an overview of how and why letter and flat-shaped DVD mail is processed on both outbound trips from the mailer to the customer and inbound trips from customers to the mailer's facilities. Tr. 9/1593.

[2033] Witness Seanor's testimony explained Headquarters and Area involvement in decisions regarding the movement of mail, including DVDs, as well as mail processing decisions at the plant level, the factors influencing those decisions, and why mail processing of Netflix and GameFly mail is not identical. USPS-T-3 at 1. Witness Seanor also explained why differences in the mail processing of Netflix and

¹⁶ Non-public versions of the testimony of Postal Service witnesses were filed on July 7, 2010. GameFly's access was limited pending the completion of the Postal Service's cross-examination of GameFly witnesses. See P.O. Ruling C2009-1/27.

¹⁷ Direct Testimony of Robert Lundahl on Behalf of the United States Postal Service (USPS-T-4), July 29, 2010 (USPS-T-4).

¹⁸ Direct Testimony of Larry J. Belair on Behalf of the United States Postal Service (USPS-T-2), July 29, 2010. On August 6, 2010, the Postal Service filed a revised version of witness Belair's direct testimony. See Notice of the United States Postal Service of Filing Revised Version of USPS-T-2 Direct Testimony of Larry J. Belair on Behalf of the United States Postal Service, August 6, 2010; and Direct Testimony of Larry J. Belair on Behalf of the United States Postal Service, as Supplemented on August 6, 2010 (USPS-T-2), August 6, 2010 (USPS-T-2).

¹⁹ Direct Testimony of Troy R. Seanor on Behalf of the United States Postal Service (USPS-T-3), July 29, 2010 (USPS-T-3).

²⁰ Direct Testimony of Nicholas F. Barranca on Behalf of the United States Postal Service (USPS-T-1), July 29, 2010; Errata to Direct Testimony of Nicholas F. Barranca on Behalf of the United States Postal Service (USPS-T-1), October 8, 2010 (USPS-T-1).

GameFly mail should be considered predictable, consistent with operational imperatives, efficient and reasonable. *Id.*

[2034] In his testimony, witness Barranca explained the Postal Service's defense against GameFly's allegations and sought to place them in context from the perspective of Postal Service operations, business, and policy objectives. USPS-T-1 at 1.

[2035] Hearings on the Postal Service's case were held October 5, 2010 and October 14, 2010. During the October 5, 2010 hearing, witness Lundahl's testimony was admitted into evidence. Tr. 7/1209. Cross-examination of witness Lundahl was conducted in both public and non-public sessions. Tr. 7/1314-79, Tr. 8/1383-1579 (filed under seal). In addition, the written testimony of witness Belair, as supplemented, was admitted into evidence during the October 5, 2010 hearing. Tr. 9/1587. Cross-examination of witness Belair was conducted entirely during the public session. *Id.* at 1637-49.

[2036] Witnesses Seanor and Barranca appeared during the October 14, 2010 hearing at which time the testimony was admitted into evidence. Tr. 10/1738, 1850. Both witnesses were cross-examined in the public session.

[2037] *GameFly's surrebuttal case.* On October 21, 2010, GameFly filed rebuttal testimony of witness Glick that addressed contentions made by all four Postal Service witnesses. (Tr. 11/1907).²¹ The public version of witness Glick's rebuttal testimony was admitted into evidence at the October 28, 2010 hearing. Tr. 11/1905-37. The non-public version of the witness's testimony was also admitted into evidence.

²¹ Rebuttal Testimony of Sander Glick for GameFly, Inc. (GFL-RT-1), October 21, 2010. Corrections to Mr. Glick's rebuttal testimony were served upon the parties by GameFly's counsel the evening before the October 28, 2010 hearing. Tr. 11/1897. Public and non-public copies of the revised testimony were filed on October 29, 2010. See Rebuttal Testimony of Sander Glick for GameFly, Inc. (GFL-RT-1), October 29, 2010 (GFL-RT-1); GameFly, Inc. Notice of Errata to Rebuttal Testimony of Sander Glick (GFL-RT-1), October 29, 2010; Application of GameFly, Inc. for Non-Public Treatment of Portions of Corrected Rebuttal Testimony of Sander Glick, October 29, 2010.

Tr. 12/2008, 2009-44 (filed under seal). Cross-examination was conducted in both the public and non-public session. Tr. 11/1938-99, Tr.12/ 2045, 2105 (filed under seal).

[2038] Following the conclusion of hearings, the Presiding Officer issued several rulings that admitted additional documents into evidence. See P.O. Ruling C2009-1/41, P.O. Ruling C2009-1/43, P.O. Ruling C2009-1/45.

[2039] In an effort to ensure ready access to all documents cited by the parties in their briefs, the Presiding Officer also ordered that briefs be accompanied by an appendix that included the relevant portions of cited documents or agency orders or decisions, other than orders or decisions of the Commission, that were not previously made a part of the public or non-public transcript of this proceeding. P.O. Ruling C2009-1/42. Both GameFly and the Postal Service filed such appendices.²²

[2040] *Briefs.* Briefs were filed by GameFly, the Postal Service, and the Public Representative on November 8, 2010. GameFly and the Postal Service filed both public and non-public versions of their briefs.²³ As indicated in the public version of its brief, the Postal Service included with its non-public brief an attachment that presents “a more detailed analysis” of certain examples of allegedly questionable citations contained in the GameFly Memorandum as identified by witness Barranca in his prepared testimony. Postal Service Brief at 120. This reference to the attachment can also be found in the non-public version of the Postal Service’s brief. Postal Service Brief-NP at 129. The Public Representative filed only a public version of his brief.²⁴

²² Compendium of Documents Cited in Post-Hearing Brief of GameFly, Inc. (Confidential. Do Not Post on Web), November 12, 2010 (GameFly Compendium); Appendix to Initial Brief of the United States Postal Service (Confidential. Do Not Post on Web), November 12, 2010.

²³ Post-Hearing Brief of GameFly, Inc. (Public (Redacted) Version), November 8, 2010 ; Post-Hearing Brief of GameFly, Inc. (Confidential. Do Not Post on Web), November 8, 2010; Initial Brief of the United States Postal Service, November 8, 2010; and Initial Brief of the United States Postal Service (Confidential), November 8, 2010. GameFly’s redacted initial brief and its non-public initial brief are referred to herein as GameFly Brief and GameFly Brief-NP, respectively. The Postal Service’s redacted and non-public initial briefs are referred to as Postal Service Brief and Postal Service Brief-NP, respectively.

²⁴ Public Representative Initial Brief, November 8, 2010.

Reply briefs were filed by GameFly and the Postal Service on November 18, 2011. Both parties filed both public and non-public versions of their briefs.²⁵ Attached to GameFly's Reply Brief was an appendix that responded to the critique of the GameFly Memorandum sponsored by witness Barranca as an attachment to the Postal Service Brief.²⁶

²⁵ Reply Post-Hearing Brief of GameFly, Inc. (Public (Redacted) Version), November 29, 2010; Reply Post-Hearing Brief of GameFly (Confidential. Do Not Post on Web), November 29, 2010; Reply Brief of the United States Postal Service, November 18, 2010; and Reply Brief of the United States Postal Service (Confidential), November 18, 2010. GameFly's redacted and non-public reply briefs are referred to herein as GameFly Reply Brief and GameFly Reply Brief-NP, respectively. The Postal Service's redacted and non-public briefs are referred to herein as Postal Service Reply Brief and Postal Service Reply Brief-NP, respectively.

²⁶ On November 18, 2010, written comments were filed by Netflix. Comments of Netflix, November 18, 2010. Netflix is not a party to this proceeding. Comments of Netflix on GameFly, Inc., Motion to Compel, August 30, 2010, at 1. Consistent with the prior ruling by the Presiding Officer, the Commission will not exclude Netflix's comments from the record, but will accord them the status of commenter remarks and accord them appropriate weight. P.O. Ruling C2009-1/39.

III. POSITIONS OF THE PARTIES AND SUMMARY OF THE EVIDENCE

[3001] *GameFly*. GameFly takes the position that the Postal Service has unlawfully discriminated against it and other DVD mailers by providing relief to selected mailers from a common mailing industry problem. The common industry problem identified by GameFly is the unacceptably high level of DVD breakage and the jamming of Postal Service equipment that results when DVD return mailers are processed on automated letter processing equipment. To avoid this problem, the Postal Service allegedly provides “an array of preferential treatment—including hand culling, diversion from the automated letter stream, and hand processing—at no extra charge.” GameFly Brief at 1. Unlawful discrimination allegedly results from the fact that the Postal Service has provided such relief to the two largest DVD mailers, Netflix and Blockbuster, but has refused to provide smaller DVD mailers, such as GameFly, the same type and extent of relief from DVD breakage. GameFly argues further that the Postal Service’s refusal to give it the same relief as Netflix and Blockbuster has forced GameFly to avoid automated letter processing by mailing and receiving DVD mailers as two-ounce flats. This alternative solution requires GameFly to pay additional postage of \$1.22 per round trip on each of its round-trip DVD mailers.

[3002] GameFly bases its claim of discrimination on 39 U.S.C. 403(c) which provides that the Postal Service shall not give “any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preference to any such user.” GameFly argues that it is entitled to the protections of section 403(c) because (1) it is similarly situated to Netflix and Blockbuster, (2) it has been treated differently than either of those two mailers, and (3) the Postal Service has failed to provide reasonable and legitimate reasons for treating GameFly differently.

[3003] To support its case, GameFly relies on the July 20, 2009 Joint Statement, *supra*. GameFly also offered into evidence an array of Postal Service documents produced during discovery and testimony of Sander Glick, a consultant engaged by GameFly to assist in this proceeding. In addition, GameFly relies on the testimony of its

Chief Executive Officer, David Hodess, during his cross-examination by the Postal Service as an institutional witness.

[3004] The stipulated facts and documentary evidence obtained from the Postal Service provide a description of GameFly's operations, the DVD rental industry, the DVD breakage problem, and the equipment jams caused by DVD return mailers. This evidence also provides information regarding the nature and extent of the Postal Service's manual processing of Netflix and Blockbuster DVD mailers; communications within the Postal Service that concern DVD mail and its processing; communications between the Postal Service and outside parties that concern DVD mail and its processing; and the impact on Postal Service costs of manual DVD return mail processing. In addition, stipulated facts and documentary evidence obtained from the Postal Service provide information regarding the Postal Service's decision not to impose a non-machinable surcharge for hand processing of DVD return mail.

[3005] Witness Glick's testimony set forth an estimate of the difference in the Postal Service's costs of handling Netflix and GameFly DVD mailers and a comparison of that cost difference to the difference in average postage per piece paid by the two companies. Witness Glick's rebuttal testimony opposed a number of claims made by Postal Service witnesses Barranca, Belair, Seanor, and Lundahl. *See infra*.

[3006] The Postal Service's cross-examination of witness Hodess elicited evidence regarding GameFly's business model; the composition of GameFly DVDs; and GameFly's DVD mailing history and decisions.

[3007] As further support for its claim of undue discrimination, GameFly challenges the preferences given to Netflix and Blockbuster as violations of the filed rate doctrine as those preferences have never been published in the Mail Classification Schedule, the Domestic Mail Manual (DMM), or any other publicly available document.

[3008] To remedy the alleged discrimination, GameFly proposes one or both of two possible remedies. First, GameFly argues that the Postal Service should be

directed to offer every other DVD rental company manual culling and manual processing of DVD mailers entered at machinable letter rates to the same extent that Netflix receives. As part of this remedy, specific elements of processing would be included, and the remedy would be implemented by means of a Headquarters' directive or other directive of national scope. To ensure compliance, periodic reporting by the Postal Service would be required.

[3009] A second remedy, which could be imposed either as an alternative or as a supplement to the first remedy, would require the Postal Service to publish and offer a reduced automation rate for flat-shaped DVD mailers sent and received by GameFly. This reduced rate would be set to produce an average per-piece contribution to institutional costs equal to the per-piece contribution that the Postal Service receives from Netflix DVD mailers entered at letter rates. This alternative rate would also be made available to other DVD rental companies.

[3010] *The Postal Service.* The Postal Service takes the position that GameFly has failed to establish that it has been the victim of unlawful discrimination. In both its initial and reply briefs, the Postal Service repeats arguments made during the course of the hearing which challenge various evidentiary rulings by the Presiding Officer. The Postal Service asserts that the evidentiary record is fatally flawed. The Postal Service argues further that GameFly has relied upon an overly simplistic interpretation of the requirements for establishing undue discrimination under 39 U.S.C. 403(c). According to the Postal Service, section 403(c) requires a more detailed comparison of the differences between GameFly's and Netflix's practices and capabilities than the comparison presented by GameFly. In the Postal Service's view, a proper comparison leads to the following conclusions: (1) GameFly and Netflix are not similarly situated; (2) GameFly and Netflix are not treated differently; and (3) there are reasonable and legitimate reasons for the Postal Service's actions.

[3011] The Postal Service argues that GameFly cannot be similarly situated to Netflix or other DVD mailers for several reasons. A principal argument to which the

Postal Service returns throughout its briefs is that GameFly cannot be similarly situated to Netflix and Blockbuster because GameFly, unlike those mailers, has never used letter mail, electing instead to send and receive its DVDs as flats. Moreover, GameFly has designed its flat mailpieces to weigh two ounces in order to ensure machine processing. The Postal Service also points to GameFly's use of a less distinctive mailpiece design, which is more difficult to identify and process by hand than the distinctive Netflix and Blockbuster mailpieces. The Postal Service alleges that GameFly intentionally chose this design in order to deter theft. Finally, the Postal Service notes that Confirm service purchased by GameFly is only available to mailers of flats.

[3012] Going beyond the bases relied upon by GameFly to show that it is similarly situated to Netflix and Blockbuster, the Postal Service identifies a variety of differences between GameFly and these other mailers that, it alleges, preclude a finding that these mailers are similarly situated. These differences include: (1) differences in the business models of GameFly and other DVD mailers; (2) differences in the composition and properties of the DVDs used by different mailers and in the commitment by these different mailers to improve the physical properties of their DVDs; and (3) differences in the effect of mailpiece design and mailing patterns on Postal Service mail processing. The Postal Service argues that these additional factors must be considered and, when they are, the appropriate conclusion is that GameFly is not similarly situated to Netflix or Blockbuster.

[3013] Responding to GameFly's argument that it receives treatment different from the treatment accorded other DVD mailers, the Postal Service presents several arguments in opposition. The Postal Service asserts that it has never made any commitment to Netflix or Blockbuster for a certain minimum level of hand processing and that, in general, mail processing decisions are made at the local level in response to operational demands that are constantly changing. The Postal Service argues further that, in any event, GameFly has never attempted to obtain service on the same terms as Netflix or Blockbuster.

[3014] Finally, the Postal Service sets forth reasons why it believes the manual processing of Netflix and Blockbuster return DVD mail is appropriate and non-discriminatory:

- Processing of Netflix and Blockbuster mail is the result of local processing decisions that seek to improve mail processing efficiency.
- The “one-touch” manual processing of Netflix and Blockbuster DVD return mail produces cost savings.
- It is infeasible to give other mailers the same level of manual processing as Netflix and Blockbuster.
- Differences in volumes, density, length of haul, and number of mailer pickup points significantly affects Postal Service costs.
- The Postal Service’s method of processing Netflix and Blockbuster mail is a necessary means of meeting service standards.
- The decision not to impose a non-machinable surcharge on Netflix and Blockbuster mail does not constitute discrimination.
- The decision not to reclassify First-Class DVD mail does not constitute discrimination.
- Netflix and Blockbuster have not been given preferential access to Postal Service facilities, employees, or management.

Postal Service Brief-NP at 8-13, 45-64, 67, 84-93, 119-20, 124-25; Postal Service Reply Brief-NP at 65.

These reasons, individually and collectively, are presented by the Postal Service as reasonable and legitimate grounds for precluding a finding that the Postal Service has unlawfully discriminated against GameFly.

[3015] To support its case, the Postal Service, like GameFly, relies, in part, on the Joint Statement, *supra*. The Postal Service also relies upon the testimony of witnesses Lundahl, Belair, and Barranca.

[3016] Finally, the Postal Service relies upon testimony elicited on the record and upon GameFly and Postal Service discovery responses in the form of designated written cross-examination.

IV. ANALYSIS

A. GameFly's Right to File a Complaint Under Section 3662

[4001] GameFly filed its Complaint under 39 U.S.C. 3662. Subsection (a) of that section authorizes the filings of complaints by “any interested person”:

(a) In general.—Any interested person (including an officer of the Postal Regulatory Commission representing the interests of the general public) who believes the Postal Service is not operating in conformance with the requirements of the provisions of sections 101(d), 401(2), 403(c), 404a, or 601, or this chapter (or regulations promulgated under any of those provisions) may lodge a complaint with the Postal Regulatory Commission in such form and manner as the Commission may prescribe.

[4002] Subsection 3662(c) authorizes the Commission to order corrective action if it finds the complaint to have been justified:

(c) Action required if complaint found to be justified.—If the Postal Regulatory Commission finds the complaint to be justified, it shall order that the Postal Service take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance (such as ordering unlawful rates to be adjusted to lawful levels, ordering the cancellation of market tests, ordering the Postal Service to discontinue providing loss-making products, or requiring the Postal Service to make up for revenue shortfalls in competitive products).

[4003] The Postal Service presents two threshold arguments for denying GameFly relief. First, it argues that GameFly lacks standing “to challenge the Postal Service’s conduct under section 403(c) based upon the facts alleged.” Postal Service Brief at 35. Second, it argues that the Complaint is barred by the Federal Tort Claims Act (FTCA), 28 U.S.C. chapter 171. *Id.* at 67-68.

[4004] Citing *UPS Worldwide Forwarding, Inc. v. United States Postal Service*, 66 F.3d 621 (3rd Cir. 1995), the Postal Service argues that in order to have standing to base its Complaint on section 403(c), GameFly must be able to show (1) actual or

imminent injury in fact of a legally protected interest that is not conjectural or hypothetical; (2) a causal connection between the injury and conduct complained of; and (3) a likelihood that a favorable decision will redress the injury. *Id.* at 35. According to the Postal Service, GameFly has failed to make the showing necessary to establish standing because (1) its alleged injury is hypothetical; (2) the alleged causal connection is hypothetical; and (3) GameFly has not proposed an effective remedy. *Id.* at 35-37.

[4005] GameFly responds to the Postal Service's standing argument by challenging its legal basis. First, GameFly asserts (1) that neither section 3662 (the section that authorizes the filing of complaints), nor section 403(c) (the undue or unreasonable discrimination or preferences) are "conditions standing on a complainant's actual use of the service at issue"; and (2) that the Commission has previously ruled that the zone of interests protected by section 403(c) includes potential users of a service willing to meet the same non-discriminatory conditions of service. GameFly Reply Brief at 3-4. Second, GameFly points out that courts and other regulatory agencies have ruled that statutory provisions, like those in section 3662, that grant "any interested person" the right to file a complaint do not require the complainant to have used the service at issue. *Id.* at 4-5. (Emphasis deleted.)

[4006] GameFly also disputes the factual basis for the Postal Service's standing argument by pointing out that GameFly had in fact attempted to use letter mail to send and receive its DVDs just as Netflix uses letter mail, but that, without the special processing received by Netflix, breakage rates were unacceptable. *Id.* at 6. As a result, GameFly has argued that it has incurred an additional \$700,000 per year in increased postage expenses to avoid breakage of its DVDs. *Id.* at 6 n.3. GameFly also states that during the course of this proceeding it has stipulated that it would send its DVDs at letter rates if it were to receive service on nondiscriminatory terms. *Id.* at 7.

[4007] With respect to the second prong of the test for standing, *i.e.*, the causation requirement, GameFly argues that it is the unavailability to it of manually processing DVDs entered as letter mail that causes its increased postage expenses.

Id. at 6 n.3. GameFly also argues that it satisfies the third element for standing because it has proposed a remedy that would redress the injury it has suffered. *Id.*

[4008] Upon consideration of the forgoing arguments, the Commission rejects the Postal Service's argument that the traditional standing requirement articulated in *UPS Worldwide Forwarding* precludes GameFly from pursuing its Complaint filed pursuant to section 3662.

[4009] The Postal Service's second threshold argument is that GameFly's Complaint is barred as a collateral attack on the FTCA. Postal Service Brief at 68. This argument is predicated on two contentions. First, the Postal Service asserts that "GameFly's legal claim presumes that the Postal Service is legally responsible for breakage." *Id.* at 67. Second, the Postal Service points to the provisions of 28 U.S.C. 2680(b) that provide the Postal Service with immunity for "[a]ny claim arising out of the loss, miscarriage, or negligent transmission of letters or postal matter." *Id.* at 67-68.

[4010] The Commission is not persuaded by the Postal Service's FTCA argument. As GameFly points out, the FTCA has been interpreted by the courts as a limitation on tort claims against the Postal Service and the Complaint is not a tort action. GameFly Reply Brief at 8-9 and cases cited therein. Moreover, if accepted, the Postal Service's broad reading of the FTCA would effectively eviscerate section 401(1), which authorizes the Postal Service to sue and be sued and, even more importantly for the present case, section 3662, which authorizes the filing of complaints. Accordingly, the Commission rejects the Postal Service's attempt to use the FTCA as a bar to GameFly's Complaint.

B. Legal Standards for Evaluating Claims of Undue or Unreasonable Discrimination and Practices

[4011] *GameFly's claims.* GameFly's Complaint is based upon claims of unlawful discrimination and unreasonable practices that allegedly violate sections 101(d), 403(c), 404(b), and 3622(b)(8). Complaint ¶ 2. In denying the Postal Service's

Motion for Partial Dismissal, which sought to eliminate counts III and IV from consideration in this proceeding, the Commission found that GameFly had raised issues of law and fact regarding alleged violations of sections 101(d) and 403(c), which together provided the requisite statutory basis for each of the four counts set forth in the Complaint. See Order No. 235 at 6.²⁷

[4012] Despite the Commission's earlier ruling, both parties continue to spar over the statutory basis for this proceeding and whether all of the counts in the Complaint remain at issue. In its brief, GameFly asserts without further explanation that in addition to section 403(c), it continues to rely upon sections 101(d), 404(b), and 3622(b)(8). GameFly Brief at 55 n.15. Instead, GameFly focuses its arguments on how the evidence adduced during this proceeding relates to section 403(c). By omitting from its legal briefs any discussion of sections 101(d), 404(b), or 3622(d)(8), GameFly has implicitly elected to prosecute its case upon alleged violations of section 403(c). Accordingly, the Commission's analyses are limited by, and to, the arguments presented by the parties based on section 403(c).

[4013] In its brief, the Postal Service suggests that "GameFly appears to have dropped causes of action 2) through 4" (*i.e.*, counts II, III, and IV) of its Complaint. Postal Service Brief at 19. The Postal Service bases this suggestion on its assumption that GameFly has abandoned reliance upon section 404(b). *Id.* n.10. As noted above, this assumption is incorrect. Even if GameFly were to have abandoned reliance upon section 404(b), this would not necessarily result in the abandonment of counts II, III and IV since, as the Commission ruled in Order No. 235, each of the four counts in GameFly's Complaint is predicated upon sections 101(d) and 403(c). See note 2,

²⁷ In its Motion for Partial Dismissal, the Postal Service sought dismissal of counts III and IV of the Complaint on the grounds that those counts were based upon section 404(b), a section not referenced in the statutory complaint provisions of section 3662(a). However, in Order No. 235, the Commission noted that counts III and IV were also based upon section 101(d), expressly listed in section 3662(a) as a possible ground for a complaint. See Complaint ¶¶ 2, 52, 54.

supra. Accordingly, the Commission will consider all four of the counts set forth in GameFly's Complaint.

[4014] *Standards under section 403(c)*. Section 403(c) prohibits undue or unreasonable discrimination and preferences among or to users of the mails:

(c) In providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not, except as specifically authorized in this title, make any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preferences to any such user.

In this case, GameFly, a mailer, alleges unlawful discrimination and preferences that favor other mailers, namely, Netflix and Blockbuster.

[4015] GameFly argues that under section 403(c) a claim of undue discrimination must contain essentially three elements: (1) a demonstration that the favored and disfavored mailers be "similarly situated;"²⁸(2) a showing that favored mailers are offered better prices or terms and conditions of service than disfavored mailers; and (3) the absence of a rational or legitimate basis for the different service offerings. GameFly Brief at 56. GameFly supports this formulation of a *prima facie* case of undue discrimination with citations to discrimination cases from other industries,²⁹ as well as to orders issued by the Commission or its predecessor, the Postal Rate Commission.³⁰

[4016] The Postal Service "does not contest the general description [of the elements of unlawful] discrimination embodied in...quotations" from cases arising in

²⁸ In its discussion of this element of a discrimination claim, GameFly argues that the concept of "functional equivalence" is a factor to be considered in determining whether two mailers are "similarly situated." *Id.* at 57-58. As the Postal Service correctly points out, the concept of functional equivalence is related to a comparison of negotiated service agreements and serves purposes that are separate and distinct from those of the concept of "similarly situated." Postal Service Brief at 31-35. This point, however, does not impede GameFly from establishing a *prima facie* case or from rebutting an affirmative defense as to functional availability.

²⁹ See *id.* at 54-59.

³⁰ *Id.* at 57-58, 60 citing PRC Op. MC2002-2 (Capital One); and PRC Op. MC79-3 (Red Tag).

other industries. Postal Service Brief at 14. Instead, the Postal Service argues that these cases “do not provide a roadmap to analyzing GameFly’s Complaint.” *Id.* Similarly, the Postal Service acknowledges that the Postal Rate Commission’s decision in the Red Tag proceeding cited by GameFly involved claims of discrimination under section 403(c), but asserts that the Commission’s decision in that case “did not enunciate any concise test for evaluating all claims of discrimination under section 403(c)...” *Id.* at 15.

[4017] The central thrust of the Postal Service’s arguments appears to be captured by the Postal Service’s assertion that claims of undue discrimination must be evaluated on the basis of “a discrete evidentiary record” (*id.*); that “particular facts established through the evidentiary record...assume critical importance” (*id.*); that “it will be necessary [for the Commission] to focus on the precise nature of the Postal Service conduct, or other conditions, of which GameFly complains” (*id.* at 17); that “[o]nly in the context of the precise nature of the conduct or other condition claimed to be discriminatory will the general principles that GameFly enunciates have any meaning” (*id.*); and that “all of the factual elements of the situation” must be evaluated, “as well as the empirical justification for different treatment.” *Id.* at 15, 17, 24, 26.

[4018] GameFly responds to these assertions by the Postal Service by stating its agreement that “the questions of whether mailers are similarly situated, and, if they are, whether their differing treatment is rationally justified, must turn on a detailed factual inquiry.” GameFly Reply Brief at 10-11. Thus, both parties seem to agree that any standard for evaluating claims of undue discrimination will require a case-specific, fact-specific, record-based analysis.

[4019] A substantial portion of the remaining portion of the Postal Service’s argument regarding the proper standard for evaluating claims of undue discrimination does not address the basic legal elements of such discrimination claims but, rather, how the standard should be applied and what subjects should, or must, be considered. For example, many of the subjects which the Postal Service argues must be considered by

the Commission relate to the third element of undue discrimination claims as posited by GameFly—namely, the absence of a rational or legitimate basis for differing treatment. Postal Service Brief at 28 (Postal Service authorities and responsibilities); *id.* at 38-58 (statutory scheme, costs, efficiencies, administrative feasibility, and business rationale); *id.* at 17, 24 (context in which the alleged discrimination occurs);³¹ and *id.* at 24 (the need for a “practical, comprehensive approach” in evaluating the “reasonableness of discrimination”). To the extent that any subject is relevant and material to the evaluation of one of the elements of a claim of undue discrimination, the Commission agrees that it must be carefully and seriously considered.

[4020] Included in the Postal Service’s discussion of the proper legal standard for evaluating claims of discrimination are arguments that GameFly has failed to present adequate proof to support its claims. *See, e.g., id.* at 16-17. The sufficiency of GameFly’s proof and the record developed in this proceeding will be discussed *infra*.

[4021] Subject to the forgoing discussion, the Commission concludes that in order to establish its claim of undue discrimination, GameFly must establish three elements. First, it must establish that it has been offered less favorable rates or terms and conditions than one or more other mailers. Second, it must demonstrate that it is similarly situated to the other mailer or mailers who have been offered more favorable rates or terms and conditions of service. Third, it must demonstrate that there is no rational or legitimate basis for the Postal Service to deny it the more favorable rates or terms and conditions offered to others.

³¹ While the Commission agrees that the context in which alleged discrimination occurs is a relevant consideration, it does not necessarily agree with the Postal Service’s assertion that context includes the context of “the Commission’s own comprehensive annual review of Postal Service products and prices under the PAEA”, or that complainants must address the “many considerations that annual review and approval of rates and products entails.” *Id.* at 27. Nothing in section 3662 remotely suggests that a complaint proceeding must be tantamount to a comprehensive annual review conducted under sections 3652 and 3653.

C. The Filed Rate Doctrine

[4022] The filed rate doctrine is a recognized legal doctrine of long standing that affects a broad range of regulated industries. The filed rate doctrine is an outgrowth of provisions of the Interstate Commerce Act that prohibited carriers from charging rates other than those expressly filed as part of their tariffs with the Interstate Commerce Commission. The general legal proposition embodied by the filed rate doctrine is that a filed rate is the only rate that may be lawfully charged and that non-price features can be considered part of a rate. See *AT&T v. Central Office Telephone, Inc.*, 524 U.S. 214 at 221-223 (1998). Over time, the filed rate doctrine has been extended to other industries through the enactment of additional regulatory statutes. *Id.* The filed rate doctrine has been interpreted by the courts to apply to terms and conditions of service as well as rates. *Id.*

[4023] In its briefs, GameFly cites the filed rate doctrine as a further bar to the alleged preferences given to Netflix and Blockbuster by the Postal Service. GameFly Brief at 83-86; GameFly Reply Brief at 70-72. GameFly contends that the filed rate doctrine is “an essential corollary of Section 403(c) and similar prohibitions against unjust discrimination among ratepayers.” GameFly Brief at 85. GameFly asserts further that even if the Postal Service could provide a rational justification for the alleged preferences it has provided to Netflix and Blockbuster, those preferences would be illegal because the Postal Service has not published those preferential terms and conditions of service. *Id.* at 86.

[4024] The Postal Service takes the position that the filed rate doctrine does not apply in this case and that GameFly has not demonstrated that “the Postal Service has an affirmative obligation to establish separate classifications for every variant of mail processing that might be associated with postal products, or for any expectation that a mailer might have about the type and quality of service it should receive, as a result [of] purchasing service under one of the Postal Service’s product descriptions.” Postal Service Brief at 60. In its reply brief, the Postal Service reiterates its opposition to the

application of the filed rate doctrine to the facts of this case. Postal Service Reply Brief at 70-72.

[4025] While the filed rate doctrine may be easily stated, its application depends upon an analysis of the specific facts presented and the circumstances surrounding GameFly's claim, including the regulatory framework that applies to the Postal Service.

D. Evidentiary and Fact-Based Issues

1. Evidentiary Issues

a. Admission of Documents and Cross-Examination of GameFly Witnesses

[4026] During the course of the hearings, the Presiding Officer issued several evidentiary rulings which the Postal Service contests in its briefs. The rulings disputed by the Postal Service are:³²

[4027] *Presiding Officer's June 16, 2010 Rulings on the Record.* During the hearing on June 16, 2010, the Presiding Officer admitted into evidence a compendium of documents cited by GameFly in its April 12, 2010 Memorandum. Tr. 4/156 (filed under seal). The Postal Service objected to the admission of those documents on the grounds that no sponsoring witness had been presented to support their credibility or trustworthiness or "that they are trustworthy under some exception to the rule...." *Id.* at 155-56 (filed under seal). The admission of the documents into evidence was subject to the Postal Service's right to file a motion to strike by June 23, 2010. *Id.* at 666 (filed under seal). The Postal Service did not file a motion to strike.

³² The Postal Service has not identified the specific evidentiary rulings with which it takes issue. However, the arguments advanced by the Postal Service on brief (*i.e.*, lack of foundation, lack of sponsorship, hearsay, authenticity, reliability, accuracy, and failure to comply with Commission rules governing the admission of studies and analyses) were previously presented to the Presiding Officer and were addressed in the Presiding Officer rulings discussed *infra*.

[4028] *P.O. Ruling C-2009-1/24, Presiding Officer's Ruling Granting, in Part, Postal Service's Motion for Institutional Witness, July 6, 2010.* Acting pursuant to rule 30(e)(3) of the Commission's rules of practice, the Presiding Officer ordered GameFly to produce an institutional witness to stand cross-examination on the written cross-examination previously designated by the Postal Service at the June 16, 2010 hearing. P.O. Ruling C2009-1/24 at 9.

[4029] In doing so, the Presiding Officer limited the Postal Service's opportunity to cross-examine in the following respects:

- Cross-examination was denied with respect to legal conclusions in the GameFly Memorandum. *Id* at 12.
- Cross-examination was denied regarding the authenticity of the documents cited in the GameFly Memorandum or the application of the rule to those documents. Cross-examination was permitted with respect to GameFly's interpretation of documents cited in its institutional discovery responses, including documents that were also cited in the GameFly Memorandum. *Id.*
- Cross-examination regarding GameFly's business decisions was limited to decisions referenced in those GameFly discovery responses that related to the effects of theft, loss, or breakage of DVDs on GameFly's mailpiece design. *Id.* at 13.
- Cross-examine was denied with respect to transportation cost information that GameFly did not possess. *Id.* at 13-14.
- Cross-examination regarding special Netflix mail drops and signage for Netflix returns was limited to factual contentions or inferences drawn by GameFly in its institutional discovery responses. *Id.* at 14.
- Cross-examine was denied with respect to information that GameFly claimed it did not have concerning DVD composition and prices. *Id.* at 14-15.
- Cross-examination was denied with respect to GameFly's interpretation of legal principles, such as the filed rate doctrine, the applicability of the filed rate doctrine, or the relationship between the filed rate doctrine and section 403(c). *Id.* at 15-16.

- Cross-examination was permitted with respect to any documents responsive to Postal Service discovery requests USPS/GFL-41, 43, 44, or 45. *Id.* at 16-18.

[4030] *P.O. Ruling C-2009-1/41, Presiding Officer's Ruling on Objections to Admission of GFL-CX-1, October 18, 2010.* This ruling admitted into evidence two letters on Postal Service stationery signed by Postal Service officials. The Postal Service had opposed their admission on grounds of lack of foundation, authenticity, and reliability. *P.O. Ruling C2009-1/41* at 1. Admission was based in part on *P.O. Ruling C2009-1/24, supra*. The Postal Service was invited to file a motion to strike and to attach any affidavit or declaration demonstrating a genuine discrepancy that might call into question the authenticity or reliability into question. *Id.* at 2. The Postal Service failed to move to strike the documents.

[4031] *P.O. Ruling C-2009-1/45, Presiding Officer's Ruling Granting the October 29, 2010 Motions of GameFly and the Public Representative, November 8, 2010.* This ruling admitted into evidence the OIG Audit Report, the Christensen Study, memoranda of a Postal Service working group that had considered the appropriate rate and classification treatment for round-trip DVD mailers, and certain spreadsheets used by Christensen Associates in preparing its report. The Postal Service opposed the admission of these documents on grounds of lack of foundation, lack of sponsorship, hearsay, authenticity, reliability, accuracy, and failure to comply with Commission rules governing the use of the OIG Audit Report and the Christensen Study as evidence.

[4032] The Presiding Officer overruled each of the Postal Service's objections. With respect to the OIG Audit Report, the Presiding Officer ruled that portions of the report had been admitted into evidence during the June 16, 2010 hearing and that the June 16, 2010 ruling had become the law of the case by virtue of the Postal Service's subsequent failure to move to strike those portions of the report. *See supra*. Without any further showing, the law of the case controlled. *P.O. Ruling C2009-1/45* at 8-9. Moreover, the admission of portions of the OIG Audit Report on June 16, 2010

supported the admission of the remaining portions of the report in order to provide proper context to the pages previously admitted. *Id.* at 9-10.

[4033] The Presiding Officer also ruled that the OIG Audit Report was subject to official notice under rule 31(d) of the rules of practice. *Id.* at 9. Finally, because he had concluded that the entire Christensen Study should itself be admitted into evidence, see *infra*, the Presiding Officer overruled the Postal Service's objection to the admission of the OIG Audit Report because of its reliance upon the Christensen Study, which the Postal Service also asserted was seriously flawed. *Id.* at 10.

[4034] With respect to the Christensen Study, the Presiding Officer ruled that since portions of the report were admitted on June 16, 2010, and the Postal Service failed to file a motion to strike those pages, the law supported admission of the entire report. *Id.* In addition, the Presiding Officer found that because the Postal Service had itself relied upon the Christensen Study in several of its responses to GameFly discovery requests, it could not "successfully interpose a blanket objection to the admission of the report into evidence." *Id.* at 11. Moreover, the Postal Service's reliance on the Christensen Study constituted an adoptive admission which negated the Postal Service's argument that the report should be excluded because of GameFly's failure to authenticate the report and thereby qualify it as a business record exception to the hearsay rule. *Id.*

[4035] Finally, the Presiding Officer rejected the Postal Service's attempted reliance on rule 31(k) of the rules of practice which imposes foundational requirements for the admission of studies and analyses. *Id.* at 11-12. The Postal Service's adoptive admission of the report barred the invocation of rule 31(k). *Id.* at 12. While the report was admitted into evidence, the Presiding Officer expressly noted that "admission of the Christensen Study into evidence does not preclude the Postal Service from arguing in its brief that limitations on the probative value of the report undercut GameFly's attempts to rely on the report to support its case." *Id.* at 11.

[4036] Like the OIG Audit Report and the Christensen Study, the memoranda of the Postal Service working group were admitted by the Presiding Officer on the basis of the June 16, 2010 rulings that already covered portions of these memoranda, *i.e.*, the law of the case; the fact that admission of these additional documents would provide context and evidence of a course of conduct; and the fact that these documents are properly viewed as admissions of a party opponent or statements against interest by a party's employees. *Id.* at 12-14.

[4037] Finally, the spreadsheets underlying the Christensen Study were admitted by the Presiding Officer as adoptive admissions. The Presiding Officer expressly noted that the Postal Service remained "free to critique the spreadsheets on brief." *Id.* at 14.

[4038] *P.O. Ruling C-2009-1/46, Presiding Officer's Ruling Denying Motion to Strike, Resolving Remaining Motions, and Closing the Record, November 8, 2010.* This ruling denied a Postal Service motion to strike the rebuttal testimony of GameFly witness Glick. The motion was based in part on the witness' reliance on documents, such as those that were the subject of the Presiding Officer's rulings during the June 16, 2010 hearing and set forth in P.O. Ruling C2009-1/24, P.O. Ruling C2009-1/41, and P.O. Ruling C2009-1/45, *supra*. In addition, the Postal Service challenged the witness' testimony on the grounds that his statements were not based upon personal knowledge, observation, or expertise. P.O. Ruling C2009-1/46 at 2. The Presiding Officer rejected these arguments and denied the motion to strike, noting, in part, that opinion testimony of experts does not have to be based upon personal knowledge. *Id.* at 3.

[4039] In its post-hearing briefs, the Postal Service contests these rulings on the same grounds previously argued to the Presiding Officer. For example, in its initial brief, the Postal Service reiterates its earlier objections to the Presiding Officer's evidentiary rulings arguing that the documents offered by GameFly should not have been admitted because they were not sponsored, authenticated, or shown to be reliable. Postal Service Brief at 93.

[4040] According to the Postal Service, the improper admission of these documents into evidence “has caused the record to be inaccurate, incomplete and unreliable.” *Id.* Building on these claims, the Postal Service argues that GameFly’s “limited” reliance upon “testimony from competent experts or company officials” and its primary reliance upon “a disparate collection of documents obtained from the Postal Service in discovery” has created serious problems. *Id.* at 117. Specifically, the Postal Service “believes that there are significant flaws in the representativeness and quality of much of the information cited, and the accuracy with which GameFly interprets it.” *Id.* at 118.³³

[4041] Throughout its reply brief, the Postal Service repeatedly asserts these claims in contesting the admission of specific documents and groups of documents. The Postal Service’s attack on the admission of the documents in question has essentially two prongs. First, the Postal Service argues that these documents fail to pass traditional tests for admissibility as either admissions by a party opponent, as business records or as public documents. *Id.* at 113; Postal Service Brief-NP at 126-27, 125-26. Second, the Postal Service takes issue with the procedure that was followed in admitting the contested documents. *Id.* at 93-95. It argues that the admission of the contested documents without requiring GameFly to produce a sponsoring witness was unfair to the Postal Service and a denial of due process. *Id.* at 127-28.

[4042] One of the main targets of the Postal Service’s arguments regarding admissibility is the Christensen Study. Postal Service Brief-NP at 93-127; Postal Service Reply Brief-NP at 70-73. That report is relied upon heavily by GameFly and witness Glick. GameFly Brief at 25, 28, 37; GameFly Brief-NP at 19, 23, 30, 32, 68-71, 73; GameFly Reply Brief at 17-21; GameFly Reply Brief-NP at 39-58, 60-61. The

³³ The alleged flaws in the representativeness and quality of the information contained in the admitted documents, as well as the accuracy of GameFly’s interpretations of the documents, is more properly addressed *infra* in connection with arguments regarding the reasonableness of the Postal Service’s actions. In this section, the Commission will focus its discussion on the threshold question of whether the documents were properly admitted.

Christensen Study was admitted by the Presiding Officer in P.O. Ruling C2009-1/45 over the Postal Service's objection, discussed *supra*. In its brief, the Postal Service renews its opposition to the admission of the report on the grounds that no GameFly or Christensen witness sponsored it to establish its authenticity and/or the accuracy of its results. Postal Service Brief-NP at 121, 122, 124. It argues further that the Christensen Study does not qualify for admission as a business record exception to the hearsay rule. *Id.* at 125-26.

[4043] GameFly replies to the Postal Service by pointing to the Presiding Officer's prior rulings and by arguing that those prior rulings were correct. GameFly Reply Brief at 18-21; GameFly Reply Brief-NP at 22-24.

[4044] The arguments advanced by the Postal Service in its post-hearing briefs essentially restate arguments previously presented to the Presiding Officer. The Presiding Officer thoroughly considered and overruled those arguments. The Commission sees no basis for reversing those rulings. For the reasons given by the Presiding Officer in P.O. Ruling C2009-1/45, the Commission hereby confirms the admissibility of the Christensen Study.

[4045] A second document relied upon heavily by GameFly and witness Glick is the OIG Audit Report. This report was also admitted into evidence by P.O. Ruling C2009-1/45. In its brief, the Postal Service argues that the OIG Audit Report should have been excluded because it was not sponsored by a GameFly witness or any other witness. Postal Service Brief-NP at 99-101, 125-27. It also argues that the OIG Audit Report does not qualify for admission under the business record exception to the hearsay rule. *Id.* at 125-26.

[4046] GameFly again replies to the Postal Service by referring to the prior rulings of the Presiding Officer and by arguing that those rulings were correct. GameFly Reply Brief at 18-22.

[4047] The Postal Service restated arguments previously presented to the Presiding Officer and rejected in P.O. Ruling C2009-1/45. Upon consideration of the Postal Service's arguments, the Commission hereby confirms the admission of the OIG Audit Report for the reasons given in P.O. Ruling C2009-1/45.

[4048] The arguments presented by the Postal Service in opposition to the admission of the Christensen Study and the OIG Audit Report are also made with respect to the documents appended to the GameFly Memorandum. Postal Service Brief-NP at 127-30. While the Postal Service does not specifically address other documents and classes of documents admitted by the Presiding Officer (such as the memoranda of the Postal Service working group that considered round-trip DVD mailer rates and classifications and the spreadsheets underlying the Christensen Study, both of which were admitted by P.O. Ruling C2009-1/45), it appears that it intends the same arguments that it makes with respect to the Christensen Study, the OIG Audit Report and the documents appended to the GameFly Memorandum to apply to the admission of these latter documents as well.

[4049] GameFly, once again, supports the Presiding Officer's rulings and argues that the documents of the Postal Service working group were properly admitted, as were other internal documents generated by Postal Service employees. GameFly Reply Brief at 24-25.

[4050] No new grounds to justify the exclusion of these latter documents have been offered by the Postal Service, and the Commission hereby confirms the admission of those documents for the reasons previously given by the Presiding Officer.

b. GameFly's Reliance Upon Documents Obtained in Discovery

[4051] In addition to its claims that documents were improperly admitted into evidence, the Postal Service asserts "that there are serious problems with GameFly's approach...[and that in particular]...there are significant flaws in the representativeness

and quality of much of the information cited [by GameFly], and the accuracy with which GameFly interprets it.” Postal Service Brief-NP at 128. To support its position, the Postal Service cites the testimony of witness Barranca which “critiqued GameFly’s methodology and usage” of Postal Service documents obtained during discovery and cited in the GameFly Memorandum.³⁴ *Id.*

[4052] The attachment to the Postal Service’s brief presents a more detailed analysis of the examples cited in witness Barranca’s testimony by restating 19 excerpts from the witness’s prepared testimony and discussing the specific documents to which each excerpt relates. Postal Service Brief-NP at 129-30; *id.* Attachment A.

[4053] For convenience, the documents challenged by the 19 excerpts from witness Barranca’s testimony can be characterized as follows:

Excerpt 1: Documents that are unreliable because of age and failure to reflect more recent mail processing changes. USPS-T-1 at 18-19;

Excerpt 2: Documents that GameFly refers repeatedly to, *id.* at 19;

Excerpt 3: Documents reflecting obsolete Postal Service policies and practices, *id.*;

Excerpt 4: A communication by a high level Postal Service official to which GameFly repeatedly refers, *id.*;

Excerpt 5: Documents reflecting employee views that are not official Postal Service policy or reflective of consensual policy, *id.*;

³⁴ The Postal Service states in its brief that witness Barranca “reviewed all of the documents that GameFly cites.” *Id.* According to the witness, however, his review appears to have been somewhat more limited (“I have not read every page of every document, but I believe I have reviewed enough to make an overall assessment.”). USPS-T-1 at 18. It should also be noted that the GameFly Memorandum, which contains the documents critiqued by witness Barranca, was a trial brief and, as such, not among the reply briefs considered by the Commission in reaching its decision. Moreover, not all of the documents cited in the GameFly Memorandum have been cited by GameFly in its briefs.

Excerpt 6: Documents GameFly refers only selectively, *id.* at 19-20;

Excerpt 7: Documents that show a diversity of mail processing operations, *id.* at 20;

Excerpt 8: Documents cited by GameFly that reflect Postal Service practices that have changed, *id.*;

Excerpt 9: A broad variety of documents, many of which are e-mails between Postal Service employees, *id.*;

Excerpt 10: Documents containing Postal Service communications with mailers, *id.*;

Excerpt 11: Documents containing slide presentations given or prepared within the Postal Service or for the Postal Service by mailers, *id.*;

Excerpt 12: Documents containing copies of slides with tersely stated bullet points that lead to expanded GameFly conclusions, *id.*;

Excerpt 13: Documents with no indication of author, circumstance, or date, *id.*;

Excerpt 14: Documents containing the notes of Postal Service employees, *id.*;

Excerpt 15: Documents cited by GameFly that do not directly support its assertion, *id.* at 21;

Excerpt 16: A document that refers to a time period prior to the period being discussed by GameFly, *id.*;

Excerpt 17: Documents that are allegedly ambiguous, *id.*;

Excerpt 18: Documents that GameFly improperly suggests imply an admission of discrimination by the Postal Service, *id.*; and

Excerpt 19: Documents that contain employee speculations regarding legal actions that do not reflect official views or legal opinions of the Postal Service, *id.* at 21-22.

[4054] As noted earlier, GameFly's reply brief contains a response to the attachment to the Postal Service's brief. In general, GameFly takes the position that the Postal Service's "Attachment A is an elaborate attempt to discredit secondary documents that are not critical to GameFly's case...[and that]...[t]hese criticisms are repetitious, trivial or immaterial." GameFly Reply Brief, Appendix at A2. More specific challenges to the Postal Service's attachment are contained in the non-public portions of the GameFly appendix. GameFly Reply Brief-NP, Appendix at A2-A9.

[4055] In Section IV.D.1.a., *supra*, the Commission addresses Postal Service challenges to the admission of the documents that are the subject of witness Barranca's critique. In this section, the Commission addresses Postal Service challenges to GameFly's reliance upon these documents on the grounds that the documents are unrepresentative, inaccurate, unreliable, have been misinterpreted, or suffer from other deficiencies. Together with other arguments presented in connection with specific issues, the general conclusions reached here will be used to assess the probative value of each document relied upon as evidentiary support for the respective positions taken by the parties. For convenience, the 19 excerpts from witness Barranca's prepared testimony are grouped in the discussion that follows.

[4056] *Documents challenged on the basis of age and subsequent changes in policy and mail processing practices (Excerpts 1, 3, and 8)*. In general, the date of a document does not necessarily prohibit reliance upon it. It depends upon the purpose for which the document is used. Subsequent changes in policy or mail processing practices shown to be relevant to a document's interpretation or application will be considered in determining whether and to what extent such documents can be relied upon.

[4057] *Documents referred to repeatedly (Excerpts 2 and 4).* Absent a specific reason, such as undue prejudice, repeated reference to a document is not prohibited when the document is relevant and material to the issues being considered.

[4058] *Documents prepared by postal employees, including internal e-mails (Excerpts 5, 9, 14, and 19).* To be considered by the Commission, documents prepared by Postal Service employees do not necessarily have to represent official postal policy. Such documents can have probative value for a variety of reasons, including the establishment of purely factual information, such as dates; the establishment of how policies or practices are interpreted or applied; or the establishment of whether or not consideration was given to particular factors or circumstances. The Commission will consider the Postal Service's objections to GameFly's reliance on these documents with reference to the purposes for which they are cited.

[4059] *Documents are cited selectively or do not directly support a party's contentions (Excerpts 6, 7, and 15).* The Commission routinely reviews citations to documents to assess whether the cited documents support the party's contentions. Opposing parties have the opportunity to call selective citations or incorrect inferences to the Commission's attention. In this case, the Commission duly notes the criticisms of the Postal Service and considers those criticisms in its review of specific issues.

[4060] *Documents containing communications between the Postal Service and mailers (Excerpt 10).* There is nothing inherently improper about relying upon documents that contain communications between the Postal Service and mailers. In this case, witness Barranca presents a single example of such a document. USPS-T-1 at 20 n.10. While the document was cited in the GameFly Memorandum, it was not relied upon by GameFly in its briefs and will not be relied upon by the Commission in reaching its decision. See paragraph 4051, *supra*, and appended footnote.

[4061] *Documents containing slide presentations (Excerpts 11 and 12).* Documents containing slide presentations may be relied upon depending upon their

relevance and potential probative value. The Postal Service objects to GameFly's attempted reliance upon certain slides because it believes the slides do not "lead to the expanded conclusions...that GameFly represents." GameFly asserts that it relies solely upon the slides for factual assertions contained in the slides. As so framed, the Commission will consider whether, and to what extent, probative weight should be accorded to the slides at issue.

[4062] *Documents with no indication of author, circumstance, or date (Excerpt 13)*. The documents challenged by witness Barranca were produced by the Postal Service during discovery. Because they do not contain information regarding authorship, the circumstances under which they were prepared, or even their date, their evaluation is problematic. Accordingly, the Commission will accord no evidentiary weight to these, or to any other such documents.

[4063] *A document that refers to a time period prior to the period discussed by the party citing the document (Excerpt 16)*. This is essentially a claim by the Postal Service that the document has either been miscited or that its import has been inadequately explained. In either event, this document will not be accepted as evidentiary support for the proposition for which it was cited. The same conclusion applies to any other documents that are miscited or inadequately explained.

[4064] *Documents alleged to be ambiguous (Excerpt 17)*. Witness Barranca cites an example of an e-mail that he claims is ambiguous. USPS-T-1 at 21 n.17. Assuming this document is, by itself, ambiguous, it has been cited by GameFly in its initial brief as one of several documents to support its contention in the preceding sentence. The question is one of interpretation of the subject document in the context of the other cited documents and the weight, if any, to be given to the document in dispute. The Commission finds there is nothing improper about either the citation to this or other such documents, or to the interpretation of such documents in context.

[4065] *Documents that improperly imply an admission of discrimination (Excerpt 18)*. Witness Barranca argues that GameFly has drawn unfounded inferences from a number of internal communications of Postal Service employees and attempts to use those inferences as evidence of discrimination. USPS-T-1 at 21 n.18. The Commission has reviewed the documents at issue and concludes that although they do not demonstrate a conclusive admission of discrimination that is attributable to the Postal Service, they are relevant to the issue of discrimination and can properly be relied upon by GameFly for the purposes for which they have been cited.

c. Spoliation

[4066] During the course of the hearings in this case, GameFly disclosed that certain documents responsive to four Postal Service discovery requests (USPS/GFL-41, 43, 44, and 45) had either been lost or destroyed. P.O. Ruling C2009-1/24 at 16-18. The Presiding Officer directed GameFly to attempt to identify deleted or lost documents responsive to the Postal Service's discovery requests. *Id.* at 18. The Presiding Officer ruled further that if any such documents were identified, the Postal Service could cross-examine an institutional witness with respect to each document as necessary to shed light on the facts responsive to the four Postal Service discovery requests. *Id.*

[4067] In its brief, the Postal Service charges GameFly with the spoliation of admissible evidence. Postal Service Brief-NP at 131. GameFly responds by asserting that on July 27, 2010, it produced a substantial quantity of additional documents, including former GameFly employee documents, previously thought to be lost. GameFly Reply Brief at 25 n.13. In that same response, GameFly alleges that the Postal Service has made little or no use of the material produced by GameFly, thereby implicitly suggesting that the Postal Service has not been harmed. *Id.*

[4068] The Commission takes the subject of spoliation of evidence seriously. In this case, however, even if the Commission were to conclude that GameFly was guilty of spoliation, which it has not concluded, it would remain to decide what the appropriate

remedy for such spoliation should be. For its part, the Postal Service “requests that the Commission impose sanctions against GameFly in the form of negative inferences drawn against GameFly where its failure to impose a litigation hold has created gaps in the record.” Postal Service Brief-NP at 131-32. However, without identification by the Postal Service of the gaps in the record that it believes exist because of GameFly’s alleged failure to impose a proper litigation hold, as well as the relevance of those gaps to the issues presented, the Commission lacks even the most basic information needed to respond to the Postal Service’s request. Accordingly, the Commission denies the Postal Service’s request.

2. Are GameFly, Netflix and Others “Similarly Situated”?

[4069] GameFly and the Postal Service agree that the issue of whether two mailers of DVDs are similarly situated is an issue that turns upon a detailed comparison of relevant facts and circumstances regarding the mailers being compared. *See supra*. GameFly takes the position that it is similarly situated to both Netflix and Blockbuster based upon three factors discussed below. The Postal Service challenges the bases for GameFly’s position and cites numerous differences that lead it to the opposite conclusion.

[4070] In analyzing and assessing these competing arguments, the Commission is guided by its prior rulings in proceedings involving negotiated service agreements (NSAs).³⁵ NSAs are subject to the section 403(c) prohibition of unlawful discrimination

³⁵ See PRC Op. MC2002-2 (Capital One) and PRC Op. MC2005-3 (Bookspan).

and unlawful preferences. PRC Op. MC2002-2, ¶ 7005. This is the same section 403(c) relied upon by GameFly in the present case.³⁶

[4071] In the Capital One case, the Commission noted that section 403(c) imposed “a legal requirement that ‘similarly situated’ mailers be offered NSAs on ‘similar terms.’” *Id.* ¶ 7011; see also ¶ 7005. With respect to the “similarly situated” branch of this requirement, the Commission acknowledged that “identifying the circumstances and conditions that would make an applicant ‘similarly situated’...will, in all likelihood, have to be determined on a case-by-case basis....” *Id.* ¶ 7014. The Commission subsequently explained that the term “[s]imilarly situated’ refers to a comparison of the *relevant* characteristics of different mailers as the characteristics apply to a particular Negotiated Service Agreement.” (Emphasis added.)³⁷ Finally, the Commission declared that “[a] qualifying mailer that is similarly situated to a mailer participating in a Negotiated Service Agreement must have a similar *opportunity* to participate in a functionally equivalent Negotiated Service Agreement...[and that]...[n]ot providing this *opportunity* would raise the possibility of discrimination.” *Id.* at 52. (Emphasis added.) With the preceding principles in mind, the Commission turns now to an analysis of the basis for GameFly’s claim that it is similarly situated to Netflix and Blockbuster and the additional factors that the Postal Service relies upon to argue that GameFly has failed to demonstrate that it is similarly situated to either of these mailers.

³⁶ This complaint proceeding does not involve an alleged denial of a service functionally equivalent to a formal NSA. The Postal Service has no NSA with either Netflix or Blockbuster. The GameFly Complaint nevertheless presents an analogous situation. With or without a formal NSA between the Postal Service and either Netflix or Blockbuster, GameFly alleges that it has been denied the same service as either Netflix or Blockbuster. GameFly alleges that the Postal Service’s failure to provide the same service provided to either Netflix or Blockbuster violates the same anti-discrimination provisions of section 403(c) that apply to NSAs. Since the “similarly situated” requirement of section 403(c) applies in both the NSA context and the context of the instant proceeding, the Commission’s prior NSA and NSA-related orders provide legal guidance in the instant case.

³⁷ See Docket No. RM2003-5, Order Establishing Rules Applicable to Requests for Baseline and Functionally Equivalent Negotiated Service Agreements, February 11, 2004, at 51 (Order No. 1391).

a. Basis for GameFly's Claim That It is Similarly Situated to Netflix and Blockbuster

[4072] *GameFly's position.* GameFly asserts that it is similarly situated to Netflix and Blockbuster because (1) each company uses First-Class Mail to ship DVDs in mailers to and from subscribers; (2) each company's DVDs are small and light enough to be mailed as one-ounce letters if sent in lightweight mailers; and (3) each company's DVDs experience high breakage rates if subjected to automated letter processing when mailed back from subscribers. GameFly Brief at 61.

[4073] *Postal Service's response.* Although the Postal Service acknowledges that the record supports GameFly's claim that both it and Netflix use First-Class Mail to send and recover their DVDs, the Postal Service dismisses this similarity as so broad as to be meaningless. Postal Service Reply Brief at 29-31. More specifically, the Postal Service argues that because First-Class Mail covers such a broad range of products, rates, and mailers that this factor "does not demonstrate meaningful or sufficient similarity for purposes [of] analyzing [the] claimed discrimination." *Id.* at 29.

[4074] The Postal Service also challenges the adequacy of the record to support the second and third alleged similarities relied upon by GameFly. The second alleged similarity is that GameFly and Netflix discs are small and light enough to be mailed as one-ounce letters. The third alleged similarity is that both GameFly and Netflix DVDs suffer high breakage rates when processed on automated letter equipment when mailed back by subscribers. The Postal Service contests these alleged similarities on the grounds that they "rest upon hypothetical conduct that GameFly has never undertaken." *Id.* at 30. By this, the Postal Service makes reference to the fact that GameFly has never mailed its discs as letters, or packaged its discs for mailing as letters. *Id.*; Postal Service Brief at 63-65. The Postal Service adds that because GameFly has intentionally chosen to purchase a service different from the one purchased by Netflix, GameFly should have no expectation of similar service. Postal Service Brief at 64, 65.

[4075] To further reinforce the difference between GameFly, Netflix, and Blockbuster, the Postal Service points to the fact that GameFly has “always purchased flats service” to mail its DVDs; has “never even attempted” to mail its DVDs as letters; has not identified a specific instance in which it requested and was denied letter service with manual processing; and has not responded to proposals by the Postal Service to provide GameFly with the same service provided to Netflix. *Id.*

[4076] Finally, the Postal Service suggests that it is GameFly’s fear of theft that has motivated GameFly to design and use a flats mailpiece with a non-distinctive design that will be processed on automated flats processing equipment and thereby avoid manual processing by Postal Service employees. *See, e.g., id.* at 34-35, 36 n.26, 67 n.40, 72-73, 75. In this connection, the Postal Service also points to the fact that, as part of this mailing strategy, GameFly has purchased Confirm service to track the mailing of games to its subscribers and that Confirm service is only available to mailers of flats. *Id.* at 36 n.26, 85-86; Postal Service Reply Brief at 11-12.

[4077] *GameFly’s reply.* With respect to the Postal Service’s factual assertions, GameFly acknowledges that both its outbound and return DVDs have been mailed as flats, not letters. GameFly Brief at 1, 7-8. However, it points out that the initial decision to use flats mail service was driven by the fact that GameFly DVDs processed on automatic letter processing equipment were severely damaged or destroyed. *See* Tr. 5/890, 895. At the time GameFly made its decision to mail DVDs as flats, it was unaware that Netflix, and to a lesser extent Blockbuster, were already receiving hand processing of return DVDs in order to avoid the same problem of breakage. *Id.* at 895. GameFly’s continuing concern over DVD breakage was confirmed during the cross-examination of GameFly witness Hodess, when he testified regarding his personal observations of significant DVD damage during tests of GameFly mailpieces on automated letter processing equipment. *Id.* at 890. Those observations were made in 2007 at the time of a significant increase in flats rates. *Id.* at 890-91. Since then, GameFly has continued to mail its DVDs as flats. *See* Appendix USPS/GFL-1

(Non-Public) in response to Answers of GameFly, Inc., to USPS Discovery Requests USPS/GFL-1-4, 6-7, 9-38, 40-45, May 18, 2010 (admitted into evidence at Tr. 6/964 (under seal)).

[4078] GameFly asserts further that since learning that the Postal Service offered hand processing for letter DVDs, it has attempted to obtain such hand processing on the same terms as Netflix and Blockbuster. See Tr. 5/896. In this regard, GameFly responds to the Postal Service's claim that by a letter dated May 17, 2010,³⁸ it offered GameFly the same terms and conditions of service enjoyed by Netflix, by arguing, in effect, that the offer is illusory. GameFly Brief at 36-41; GameFly Reply Brief at 30-32. In making this argument, GameFly points to the fact that the Postal Service's offer lacks any quantitative commitment to hand processing. GameFly Brief at 37. In addition, the May 17 Letter requires as a precondition for Netflix service that GameFly collect its return mail at the same number of collection points as Netflix, *i.e.*, 130 collection points. Tr. 5/951. GameFly states that it has far fewer pickup points than Netflix and that this would increase its costs without any significant reduction in Postal Service costs. GameFly Brief at 39-40; GameFly Reply Brief at 31-32.

[4079] GameFly also disagrees with the Postal Service's assertion that GameFly sought to have its DVDs processed on automated flats processing equipment in order to avoid the risk of theft presented by manual processing. While GameFly does not dispute that the issue of theft has been of concern, it contends that its desire to have its return DVDs processed on automated flats processing equipment has been driven by its concern over the certain damage to its return DVDs that would be caused by automated letter processing equipment. See Tr. 5/885. GameFly asserts that without hand processing, the only way it could avoid breakage of its return DVDs was by insuring that they received automated flats processing. *Id.* at 887-88.

³⁸ Letter from Andrew German, May 17, 2010 (May 17 Letter).

[4080] In a similar vein, GameFly asserts that its use of non-distinctive mailpiece design was adopted after being advised by the Postal Inspection Service that GameFly's bright orange mailers were being identified by thieves. *Id.* at 698. During the course of this proceeding, GameFly has indicated that if given the opportunity to mail its outbound and return DVDs as letters and receive the same hand processing as Netflix, it would use a distinctive mailpiece. GameFly Brief at 62-63.

[4081] In response to the Postal Service's argument that GameFly's purchase of Confirm service (which is only available to mailers of flats) demonstrates GameFly's true lack of interest in letter service of the type received by Netflix, GameFly asserts that it would willingly give up Confirm service for the opportunity to take letter service with manual processing like Netflix. GameFly Reply Brief at 7 n.4 (citing testimony of witness Hodess, Tr. 5/936).

[4082] While GameFly believes that the background to, and reasons for, its reliance upon flats mail service adequately refute the Postal Service's contention that it is not similarly situated to Netflix and Blockbuster, GameFly also argues that, as a matter of Commission precedent, "similarly situated" customers include not just other mailers who are currently using the same rate and service package, but also other mailers willing to meet the same conditions and terms. *Id.* at 34. GameFly asserts that it is such a prospective mailer that is willing and able to meet the same terms and conditions of the service received by Netflix and Blockbuster. *Id.* at 35.

[4083] *Commission analysis.* The Postal Service argues that the use of First-Class Mail by GameFly, Netflix, and Blockbuster is meaningless for purposes of determining whether these three mailers are similarly situated. That argument might be persuasive if the use of First-Class Mail were the only factor relied upon by GameFly to demonstrate that it is similarly situated to Netflix (and, for that matter Blockbuster). However, GameFly does not rely solely upon this one factor as the basis for its claim that it is similarly situated to Netflix. GameFly argues that this factor together with two other factors meets the test for being similarly situated. GameFly Brief at 61-63. The

threshold issue, therefore, is whether the three factors together are adequate to show that GameFly is similarly situated to Netflix.

[4084] The Postal Service is correct in asserting that both outbound and inbound GameFly DVDs are mailed as flats, whereas Netflix and Blockbuster DVDs are mailed as First-Class letters.³⁹ Postal Service Brief at 63-64. However, as the record demonstrates, GameFly initially resorted to flats service in order to avoid the same type of damage to its DVDs that Netflix and Blockbuster were seeking to avoid. In that connection, GameFly's concerns over theft, while demonstrated on the record, have not been established as the motivating reason for GameFly's decision to mail its DVDs as flats. The record supports the conclusion that even without any concerns over theft, GameFly would have chosen flats service to address the issue of breakage. The conclusion that GameFly relied upon flats as a means of avoiding disc breakage is reinforced by GameFly's continued use of flats after its CEO, David Hodess, witnessed substantial disc breakage in 2007 by automated Postal Service letter processing equipment during a field test of GameFly mailpieces. ¶ 4077, *supra*.

[4085] The record also supports GameFly's assertion that it chose flats service without awareness that the type of hand processing of letter service obtained by Netflix and Blockbuster was potentially available. Nor does GameFly's continued reliance upon automated flats processing after learning of the potential availability of hand processing of DVD letter mail preclude GameFly from asserting that it is similarly situated to Netflix and Blockbuster. Indeed, the terms contained in the Postal Service's May 17 Letter support the conclusion that it was GameFly's refusal to accept what it viewed was a far lower likelihood that its mail would receive hand processing by the Postal Service that led GameFly to continue purchasing flats service.

³⁹ In returning their DVDs, Blockbuster customers have the option of returning DVDs to a Blockbuster retail store or mailing the DVD back to Blockbuster. All Blockbuster DVDs returned by mail are sent by First-Class Mail. Joint Statement, ¶ 98.

[4086] GameFly has also represented that if it is offered hand processing, it is prepared to adopt, like Netflix and Blockbuster, a distinctive mailpiece design that facilitates hand processing. Similarly, GameFly has stated that it is willing to forgo Confirm service if it is given letter service with hand processing on the same terms and conditions as Netflix and Blockbuster. The Commission has no reason to doubt those representations.

[4087] In light of the forgoing, the Commission agrees with GameFly's assertion that a determination of whether it is similarly situated to Netflix and Blockbuster depends not upon whether those three mailers are currently purchasing the same postal services, but rather upon whether GameFly is willing and able to mail its DVDs as letters employing a distinctive mailpiece and forgoing Confirm service. See PRC Op. MC2002-2, ¶ 7014; Order No. 1391 at 52. The mere fact that GameFly does not currently receive letter mail service does not, by itself, preclude GameFly from establishing that it is similarly situated to Netflix and Blockbuster. Accordingly, the Commission finds that GameFly has established the three basic elements that it argues make it similarly situated to Netflix and Blockbuster. The Commission turns next to the additional factors the Postal Service contends preclude a finding that these DVD mailers are "similarly situated."

b. Differences Between GameFly, Netflix, and Blockbuster

[4088] The Postal Service also relies upon a variety of additional differences between GameFly, Netflix, and Blockbuster which it asserts precludes a finding that the three mailers are similarly situated. For convenience, these differences can be grouped as (1) differences between GameFly's business and the businesses of Netflix and Blockbuster; (2) differences in GameFly's DVDs and GameFly's commitment to improving its DVD and mailpiece designs; and (3) differences in the effect of GameFly's mailpiece designs and mailing patterns on Postal Service processing decisions.

(1) Differences Between GameFly's Business and the Businesses of Netflix and Blockbuster

[4089] In its brief, the Postal Service makes the point that "GameFly and Netflix have respective business models that overlap only in superficial ways, such as the fact that both rent DVDs via the mail...[and that]...[a]s a mailer of game discs, GameFly must deal with costs and risks different from the costs and risks of video disc mailers." Postal Service Brief at 72. The Postal Service then suggests that two significant differences are the cost to GameFly of game discs and a higher risk of theft. *Id.* The Postal Service concludes that the higher cost of game discs "causes GameFly to react differently to certain business conditions as compared to other video disc mailers....[and that]...GameFly concedes that its business decisions reflect theft concerns." *Id.*

[4090] The Postal Service also repeats its arguments that GameFly and Netflix purchase different services (flats and letters) and thus operate in different markets. In addition, the Postal Service argues that GameFly and Netflix cannot be similarly situated because the two companies do not compete. GameFly offers a video game rental service whereas Netflix offers a video rental service. *Id.* at 30 n.22.

[4091] *GameFly's position.* GameFly responds to the forgoing arguments by asserting (1) that the comparative costs and values of game discs and video discs and the risk of theft are totally irrelevant in determining whether two rental companies are similarly situated, absent some showing that the costs and values of game discs and video discs affect Postal Service costs; (2) that the fact that Netflix and Blockbuster purchase letter service, whereas GameFly purchases flats service does not preclude a finding of similarly situated; and (3) that the protections of section 403(c) prohibit discrimination between "mailers," not just competitors. GameFly Reply Brief at 37.

[4092] *Commission analysis.* On the basis of the record developed in this proceeding, the Commission is not persuaded that differences in the cost of game discs versus video discs are relevant to a determination of whether GameFly is similarly situated to either Netflix or Blockbuster. For those differences to be relevant, it would

be necessary for the Postal Service to demonstrate either that the cost differences between game discs and video discs impact Postal Service costs or operations or that those cost differences are responsible for GameFly's choice of flats service as opposed to letter service as chosen by Netflix and Blockbuster. The cited cost differences may be relevant to GameFly's business decisions, but unless they can be shown to impact the Postal Service or the mail service selected by GameFly, they have no relevance for a determination of whether GameFly is similarly situated to Netflix or Blockbuster. Without a demonstration of how those inherent differences between mailers impact the Postal Service or the mailer's service choices, such differences could be used to distinguish virtually every mailer from every other mailer. For example, different prices could then be justified for the same Standard Mail product used by two competing banks solely on the grounds that each bank markets a slightly different financial product, has different costs of doing business, or serves different customers.

[4093] Nor does GameFly's concern with the issue of theft preclude a finding that it is similarly situated to Netflix and Blockbuster. As discussed above, GameFly's choice of flats service has been driven by the issue of DVD breakage since GameFly began operations. The record developed in this case supports the conclusion that, with or without its concerns over theft, GameFly would have chosen service that avoids automated letter processing. In raising the concern over theft as a distinguishing attribute or characteristic of GameFly's business model, the Postal Service has failed to demonstrate a connection between GameFly's theft concerns, Postal Service costs and operations, or GameFly's choice of flats mailing service.⁴⁰ The Postal Service's reliance upon GameFly's concession that "its business decisions reflect theft concerns" does not identify which business decisions reflect those concerns. As such, this concession fails to establish that theft concerns have a causal, or even significant, connection to

⁴⁰ While the record does demonstrate a connection between concerns over theft and GameFly's use of a non-distinctive mailpiece, that connection does not preclude a finding that GameFly is similarly situated to Netflix and Blockbuster given GameFly's expressed willingness to use a distinctive mailpiece design if it can obtain letter service on the same terms as Netflix. See *supra*.

GameFly's choice of flats service. Accordingly, GameFly's concern over theft does not distinguish GameFly from Netflix and Blockbuster for purposes of determining whether GameFly is similarly situated to these other two mailers.

[4094] In section IV.D.2.a., the Commission rejects the Postal Service's argument that GameFly cannot be similarly situated to Netflix or Blockbuster because it currently purchases flats service as opposed to the letter service purchased by Netflix and Blockbuster. The Postal Service's argument that GameFly operates in a different mailing market (the flats market) than do Netflix and Blockbuster (the letter market) is merely a variant of its earlier argument. For the reasons set forth earlier, the Commission concludes that the participation by GameFly in a different mailing market does not, on the facts of this case, preclude a finding that GameFly is similarly situated to Netflix and Blockbuster.

[4095] The Commission also finds that GameFly is not required to demonstrate that it is a competitor of either Netflix or Blockbuster in order to establish that it is similarly situated to either of those companies. Section 403(c) prohibits undue or unreasonable discrimination "among users of the mails," as well as undue or unreasonable preferences to "any such user." Section 403(c), by its terms, provides protection to "users of the mails," whether or not those users happen to be competitors.

(2) Differences in GameFly's DVDs and Differences in Its Commitment to Improving DVDs and DVD Mailpiece Designs

[4096] *Postal Service's position.* As noted earlier, as part of its case, the Postal Service presented the testimony of Robert Lundahl, Vice President of the Automated Systems Division at Advanced Technology and Research Corporation.⁴¹ That testimony addressed "(1) the fundamental qualities and differences among DVDs,

⁴¹ Witness Lundahl had previously been engaged by Netflix to provide advice regarding DVDs, including the effects of various types of stress on DVDs. Postal Service Reply Brief at 11 n.1.

including gaming, movie, standard definition and Blu-ray DVDs; and (2) actions mailers can take to manage or reduce damage to both DVDs and Postal Service equipment incurred during automated or manual processing of DVD mail.” Tr. 7/1213.

[4097] In its brief, the Postal Service argues that witness Lundahl’s testimony is relevant to the issue of whether GameFly and Netflix are similarly situated. Postal Service Brief at 69-71. According to witness Lundahl, while Netflix has availed itself of various ways to protect its DVDs from damage, GameFly has failed “to attend to the properties of DVDs...” *Id.* at 71. The Postal Service argues that because of these differences “Netflix DVDs are less vulnerable to damage than are GameFly DVDs.” *Id.* at 74. As a result, GameFly and Netflix are not similarly situated. *Id.* at 69-74.

[4098] Expanding further on this theme, the Postal Service charges that GameFly is responsible for an “absolute failure to inform itself about the video disc (of any type) business and how to minimize breakage risk...[and that this]...lack of knowledge contrasts sharply with Netflix’s situation.” *Id.* at 73. According to the Postal Service, “GameFly’s lack of knowledge about its mail content, the mail content of other disc mailers and the disc mailing industry as a whole undermine the validity of its claim that GameFly is similarly situated to Netflix.” *Id.* at 73-74.

[4099] Finally, the Postal Service asserts that GameFly’s “lack of attention to the disc mailing industry” is, at least partially, responsible for GameFly’s failure to be “as proactive in dealing with the Postal Service as other postal customers.” *Id.* at 74. This is yet another reason why, in the Postal Service’s view, GameFly and Netflix are not similarly situated.

[4100] *GameFly’s position.* GameFly responds by asserting that the alleged differences cited by the Postal Service are simply irrelevant to the issue of whether GameFly and Netflix are similarly situated. GameFly Reply Brief at 36-37. According to GameFly, the physical variations among DVDs and the different techniques used by DVD rental companies to protect their DVDs from breakage in postal processing are the

concerns of the DVD companies and, in the absence of evidence that these differences affect Postal Service costs, totally irrelevant to a determination of whether GameFly and Netflix are similarly situated. *Id.*

[4101] *Postal Service's reply.* In its reply brief, the Postal Service seeks to reinforce its claims regarding the relevance of GameFly's alleged failure to investigate or implement any of the methods used by Netflix to forestall damage to its DVDs. The Postal Service argues that because GameFly has failed to take these steps, its damage rate would increase if it were "to receive essentially the same handling as Netflix pieces...." Postal Service Reply Brief at 29 n.8.

[4102] *Commission analysis.* The Commission concludes that the differences between GameFly and Netflix or Blockbuster DVDs are irrelevant for purposes of determining whether GameFly and Netflix are similarly situated under section 403(c). The Commission reaches the same conclusion regarding differences in the extent to which these DVD mailers have engaged in efforts to improve the composition of their DVDs or to work with the Postal Service to resolve DVD mail processing issues. The Commission bases its decision on several considerations. First, the efforts of Netflix, while commendable, appear not to have eliminated its desire for manual processing in order to protect its discs from breakage. Netflix, as well as GameFly, continues to require protection from the risk of breakage by automated letter processing equipment. Netflix's protection comes in the form of manual mail processing. GameFly's protection comes in the form of automated flats processing.

[4103] Nor is the Commission persuaded by the Postal Service's argument that because of its failure to be more proactive in exploring ways to protect its DVDs, GameFly would experience increased breakage rates if it were to send its DVDs by letter mail like Netflix. Were GameFly to send its DVDs by letter mail and to receive the same handling as Netflix, that hand processing would, as a substitute for automated flats processing, protect GameFly's DVDs from breakage. Since, in all other respects, the handling of GameFly DVDs by its employees, customers, and others would remain

unchanged, the expected breakage rates would not necessarily increase as the Postal Service as suggested.

(3) Differences in the Effect of GameFly's Mailpiece Designs and Mailing Pattern on Postal Service Processing Decisions

(a) Mailpiece Designs

[4104] *Postal Service's position.* In its brief, the Postal Service argues that GameFly is not similarly situated to Netflix or Blockbuster because of the different effects on Postal Service processing decisions of GameFly's mailpiece design and mailing patterns. Postal Service Brief at 4, 67; Postal Service Brief-NP at 75, 118-20, 124-25. According to the Postal Service, visibility and volume are the most important factors in enabling and justifying hand separation of mail from the mailstream. Postal Service Brief-NP at 118.

[4105] With respect to mailpiece design, the Postal Service points out that GameFly's mailpiece, unlike the red mailpiece of Netflix and the yellow mailpiece of Blockbuster, is non-distinctive and therefore less visible. Postal Service Brief at 4, 67; Postal Service Brief-NP at 118-119, 124. The distinctiveness of these mailpieces facilitates manual culling and processing by making them more readily identifiable to postal workers. Postal Service Brief at 4, 67. By contrast, GameFly's non-distinctive mailpiece makes manual culling and processing more difficult. Postal Service Brief-NP at 118-19, 124.

[4106] *GameFly's position.* GameFly responds to these assertions by stating that it adopted a non-distinctive mailpiece design after learning from the Postal Service Inspection Service that GameFly's bright orange mailer was being targeted by thieves and that a distinctive mailpiece design has not been necessary in order to have its mailpieces processed as flats. Tr. 5/698. GameFly has also asserted that it would adopt a more distinctive mailpiece design if it were given the same manual mail

processing enjoyed by Netflix and Blockbuster. GameFly Brief at 62-64; GameFly Reply Brief at 35.

[4107] *Commission analysis.* The Commission is persuaded by the Postal Service's argument that a distinctive mailpiece design is a relevant factor in its ability to hand process DVD mail. At the same time, GameFly has adequately explained the reasons for its choice, to date, of a non-distinctive mailpiece design. GameFly has also stated that its choice is not immutable, and has asserted that it would adopt a distinctive mailpiece design if its DVD mail were to be manually processed. Under these circumstances, the Commission concludes that the current difference in GameFly's mailpiece design does not preclude a finding that it is similarly situated to Netflix and Blockbuster.

(b) Mailing Patterns

[4108] *Postal Service's position.* The Postal Service points next to differences between the mailing patterns of GameFly and those of Netflix and Blockbuster. Postal Service Brief at 3-4; Postal Service Brief-NP at 67, 119-20, 124-25. GameFly has lower overall volumes, different density patterns, fewer return mail collection points, and more and longer intermediate transportation legs than either of the other two mailers.

[4109] It is clear on the record that GameFly's overall volumes are substantially lower than those of either Netflix or Blockbuster. Postal Service Brief at 66, 109. The density of GameFly returns passing through many processing facilities and delivery units is also relatively low. *Id.* According to the Postal Service, this would make looking for GameFly return mail "futile and amount to...looking for a needle in a haystack, if that." *Id.* at 109.

[4110] In addition, it is undisputed that GameFly has far fewer return DVD collection centers than either Netflix or Blockbuster. *Id.* at 3. GameFly has four such collection centers, whereas Netflix has nearly 60. *Id.* The Postal Service argues that

GameFly's smaller return volumes and the nationwide dispersion of those volumes "result in very low densities of mail locally on the return trip" to those four collection points. *Id.* Netflix, by contrast, has both high volumes and densities returning to most of its locations. *Id.*

[4111] Finally, it is also undisputed that Netflix enters its mail deeper into the mailstream and picks up its return mail at approximately 130 locations. By contrast, all of GameFly's outbound and return DVD mail originates from, and returns to, four DVD distribution/collection centers. Postal Service Brief-NP at 3. The steps taken by Netflix result in fewer and shorter mail transportation segments between Netflix and its customers than there are between GameFly and its customers. *Id.*; Postal Service Brief at 79.

[4112] *GameFly's position.* In its brief, GameFly argues that these differences in mailing patterns "are immaterial to the question of whether GameFly and Netflix are substantially similar under Section 403(c)." GameFly Brief at 63. In its reply brief, GameFly takes a different tact arguing that "[t]hese differences, while real, are insignificant." GameFly Reply Brief at 36.

[4113] As the Commission acknowledged in the Capital One opinion, a determination of whether two mailers are similarly situated is best determined on a case-by-case basis. PRC Op., ¶ 7104. Accordingly, the Commission must review each of the mailing pattern differences relied upon by the Postal Service in arguing that GameFly, Netflix, and Blockbuster are not similarly situated.

[4114] *Overall volumes and density.* In its reply brief, GameFly contends that the differences between its overall volumes and mail densities and those of Netflix are insignificant in regard to the issue of whether it is similarly situated to those DVD mailers. GameFly Reply Brief at 36. GameFly also argues that from the perspective of the Postal Service the relevant densities of DVD mailpiece volume are the combined densities of the DVD return mail of all DVD mailers. *Id.*

[4115] The Commission concludes that differences in overall mail volumes and mail densities for GameFly, Netflix, and Blockbuster do not preclude a finding that these DVD mailers are similarly situated. First, from almost the outset of Netflix's operations, its DVDs have been hand processed by the Postal Service to avoid automated letter processing equipment. Netflix's volumes represented a fraction of its current operations. Tr. 4/164-66. Density or, more appropriately, the lack of it did not preclude the Postal Service hand culling Netflix's return DVDs when it had only 12 distribution centers. That result may be due, in part, to Netflix's distinctively colored return mailers. To obtain equivalent service, GameFly has indicated a willingness to use a similarly distinctive return mailer.

[4116] Second, neither the discovery responses of the Postal Service nor the testimony of its witnesses identified minimum volumes or densities of return mail required for manual culling or hand processing. See Tr. 10/1747 in response to GFL/USPS-T3-7(b) (failure to identify the metrics used for making culling decisions based upon volume or density); *id.* at 1764, response to GFL/USPS-T3-21(a) (failure to specify the lowest density that makes culling efficient); *id.*, response to GFL/USPS-T3-28(b) (failure to identify the cross-over point at which attempts to cull all DVD return mailpieces would interfere with the efficiency of culling and add, rather than reduce, costs).

[4117] Third, Blockbuster has been a beneficiary of the longstanding preferential treatment given Netflix's volumes. That treatment has not been extended to GameFly's DVDs, notwithstanding that they are subject to the same processing risks. Thus, given that the Postal Service provides hand culling for some but not all DVDs, mailer-specific densities, while not immaterial as GameFly suggests, are not dispositive under the circumstances presented in this proceeding. Rather, for purposes of hand processing DVDs, the combined volume and densities of the DVD return mail of all DVD mailers are the relevant considerations. This conclusion is supported by Postal Service testimony on the point.

[4118] The feasibility of manually processing combined volumes and densities can be found in witness Seanor's acknowledgment that the separation of "one or more groups of highly visible pieces that are known to aggregate to substantial volume in the local processing plant is plausible and reasonable. USPS-T-3 at 19 (emphasis added). The mechanics of hand processing depends upon identification of the mailpiece. If GameFly were to adopt a distinctive mailpiece (as it has indicated it is willing to do), there appears to be no reason why its DVDs could not be hand processed along with other Netflix and Blockbuster DVDs. While the incremental burden or cost of additional DVD mailers could, at some point, become excessive, there is no evidence to suggest that such a limit has already been reached by Netflix's and Blockbuster's volumes.

[4119] For the forgoing reasons, the Commission concludes that current differences in the overall volumes and densities of Netflix and GameFly return DVD mail do not preclude a finding that the two companies are similarly situated.

[4120] In reaching this conclusion, the Commission appreciates the role that experience and judgment plays in the day-to-day decisions of operational personnel. Nevertheless, the similarly situated requirement that the Commission is obligated to apply in cases brought by complainants under section 403(c) does not require that the situations of individual mailers be identical in order to be similarly situated. It is the Commission's judgment in this case that the record provides adequate support for concluding that GameFly is similarly situated to Netflix and Blockbuster with respect to its volumes and mail densities, such that hand processing of GameFly mail together with Netflix and Blockbuster mail would be feasible.

[4121] *Number of collection points.* GameFly argues that the difference between it, Netflix, and Blockbuster with regard to the number of return mail collection points is also insignificant. GameFly Reply Brief at 36. While the Commission is not prepared to agree that the differences in the number of collection points is "insignificant," it does conclude that these differences are not significant enough to preclude a finding that GameFly, Netflix, and Blockbuster are similarly situated.

[4122] The Commission reaches its conclusion upon consideration of the following record evidence. First, in its discovery responses, the Postal Service states that the alleged benefits of hand culling high density mailings that it relies upon to justify the special processing of Netflix and Blockbuster return mail “could still be attained regardless of the number of pickup points.” Tr. 10/1773.⁴² Second, the history of Netflix’s mail processing demonstrates that Netflix was the beneficiary of manual processing at the time when it had only 12 distribution centers. Tr. 4/164 (filed under seal). That smaller number of distribution centers, which is much closer to the current number of GameFly distribution centers, is consistent with, and supportive of, the Commission’s conclusion that the difference in the number of each DVD mailer’s collection points does not preclude the finding that GameFly, Netflix, and Blockbuster are similarly situated.

[4123] *Transportation distances.* Finally, GameFly asserts that differences in the distances that its DVD returns travel in the mailstream is insignificant. GameFly Reply Brief at 36. For the reasons that follow, the Commission believes that the differences in the distances that DVD return mail is transported by the Postal Service from the point of receipt from DVD customers to the point of delivery to DVD rental companies is more properly considered in connection with the reasons offered by the Postal Service to demonstrate that differences in the services provided to GameFly, Netflix, and Blockbuster are reasonable, and, therefore, not unduly discriminatory or preferential.

[4124] In its briefs, the Postal Service refers to the fact that it transports GameFly return DVDs much longer distances than the return DVDs of Netflix and Blockbuster. See Postal Service Brief at 3, 79; Postal Service Reply Brief-NP at 66-67. In his prepared written testimony, Postal Service witness Seanor states that “on average, Netflix pieces average less than 70 miles through the mail...[whereas]...

⁴² In this discovery response, the Postal Service goes on to argue that a reduction in the number of pickup points would, nevertheless, cause the Postal Service to assume additional transportation costs.

GameFly return pieces...[average]...over 459 miles per piece...from origin to the destination GameFly processing site.” Tr. 10/1738; USPS-T-3 at 7.

[4125] The significance of this difference in transportation distances is discussed by the Postal Service in terms of the difference in costs imposed on the Postal Service. Postal Service Reply Brief-NP at 66-67 (citing Tr. 10/1738; USPS-T-3 at 7). As such, the Commission views this alleged difference between GameFly and the other DVD mailers as more properly considered, *infra*, in connection with its review of the reasonableness of the Postal Service's actions. Accordingly, the Commission concludes that the difference in average transportation differences of GameFly, Netflix, and Blockbuster DVDs does not preclude a finding that all three mailers are similarly situated.

[4126] Upon consideration of the forgoing, the Commission concludes that GameFly, Netflix, and Blockbuster are similarly situated mailers.

3. GameFly Receives Less Favorable Rates and Terms and Conditions of Service Than Similarly Situated Mailers

[4127] *GameFly's position.* GameFly claims that it receives less favorable rates and terms and conditions of service than similarly situated mailers. GameFly Brief-NP at 21-53. More specifically, GameFly points to a number of advantages enjoyed by both Netflix and Blockbuster, including (1) diversion of Netflix and Blockbuster DVD mailers from the automation letter stream; (2) hand culling by collectors, Associated Offices and Stations; before and after dual pass/rough cull; and culling by Advanced Facer-Cancellation System (AFCS) operators; (3) exclusive use of Express Mail manifest (EMM) trays and sleeving of EMM trays; (4) exclusive use of shelved all-purpose containers (APCs); (5) placing of EMM trays in APCs in bricklaid orientation; (6) hand processing; and (7) postage at machinable letter rates. *Id.* at 21-22, 29-30. The evidence cited by GameFly shows that such special processing is provided to the substantial majority of Netflix DVD return mailers and to a significant share of

Blockbuster's inbound DVD mail volume. *Id.* at 23-24, 28, 29. GameFly charges that the preferential processing services that Netflix receives are the responsibility of the Postal Service as evidenced by a broad spectrum of Standard Operating Procedures (SOPs) and policies either supported by, or at least condoned by, the Postal Service. *Id.* at 24-27; GameFly Brief at 38-39.

[4128] GameFly asserts that the Postal Service has denied it the preferential services for DVD return mailers described above that have been given in varying degrees to both Netflix and Blockbuster. GameFly Brief at 33-36. Having been denied the Netflix-like services it has requested, GameFly claims that it has resorted to the use of flats for its DVD mailings and has been compelled to pay the second-ounce flats rate in order to avoid the same automatic letter processing that Netflix and Blockbuster avoid at the one-ounce letter rate. *Id.* at 22.

[4129] *Postal Service's position.* The Postal Service argues that it has never committed to providing Netflix or Blockbuster a certain level of manual processing. Postal Service Brief at 79. According to the Postal Service, the manual processing received by Netflix and Blockbuster is the result of discretionary decisions made at the local level by operational employees. *Id.* To support its position, the Postal Service points to the fact that it has never issued a national directive or SOP governing the processing of Netflix mail. *Id.* at 80. In essence, the Postal Service argues that operational decisions by its local mail processing personnel cannot be legally attributed to the Postal Service, at least for purposes of a finding of undue discrimination or unreasonable preferences.

[4130] The Postal Service also claims that GameFly has never attempted to obtain service on the same terms as Netflix. *Id.* at 77. Nevertheless, the Postal Service states that it "has expressed its willingness to provide service to GameFly on the same terms as service is provided to Netflix." *Id.* One such offer was provided in response to a GameFly interrogatory in which the Postal Service stated that if GameFly were to begin entering its DVDs in lightweight mailers like those of Netflix, the Postal Service

“would allow field officials to determine whether to manually cull GameFly return mail, based on the discretion of field operations management to carry out what they consider the most efficient processes for GameFly’s return mail.” *Id.* at 78 (citing Postal Service response to GFL/USPS-63). A second offer was made by the Postal Service to GameFly on the eve of hearings in its May 17, 2010 Letter from Postal Service counsel to GameFly counsel. *Id.* at 77-78. The May 17 Letter purported to lay out the terms of service provided to Netflix and offered those same terms to GameFly.

[4131] *GameFly’s reply.* GameFly contends that both of the Postal Service’s offers continue to leave the method of processing GameFly mailers to local discretion. GameFly Reply Brief at 30. GameFly also cites two conditions in the May 17 Letter that it asserts are unnecessary and make the Postal Service offer “an empty and unenforceable service commitment....” *Id.* at 31.⁴³

[4132] *Commission analysis.* The Commission concludes that the Postal Service has given GameFly less favorable rates and terms and conditions of service than other similarly situated mailers.

[4133] As a threshold matter, the Postal Service cannot insulate itself from local operations. With one possible exception, this is not a case in which local operators acted contrary to the policies, directives, or wishes of Postal Service Headquarters by providing special processing of Netflix and Blockbuster return DVD mailings. That exception related to the special Netflix mail slots and signage provided at certain post offices for return Netflix DVDs. When it learned of these mail slots and signage, Postal Service Headquarters issued a directive ostensibly prohibiting such mail slots and signage. GameFly Compendium at C206, 208, 227, 229 (filed under seal). In all other

⁴³ The two conditions are that GameFly take delivery of its return mail via caller service at approximately 130 locations (the approximate number of locations at which Netflix takes delivery) and that it enter outbound mailpieces significantly deeper into the mailstream (similar to Netflix’s practice). *Id.*

respects, it appears that local operators were given the freedom to provide Netflix and Blockbuster special processing.⁴⁴

[4134] Nor is this a case in which Postal Service Headquarters was unaware of the forms of special processing that were being afforded to Netflix and Blockbuster by local operators. Internal Postal Service communications between local operators and Headquarters personnel make it abundantly clear that the forms and extent of special processing were known to Headquarters personnel and were both tacitly and expressly condoned. GameFly Brief-NP at 66 n.17 (citing, *inter alia*, Joint Statement ¶¶ 79, 87, 90; Tr. 4/304, 641, 375-76, 586 (filed under seal)). Indeed, Headquarters' knowledge of these practices led to the Postal Service's commissioning of the Christensen Study.

[4135] Second, the Postal Service cannot use the need for operational flexibility at the local level as a basis for completely dissociating itself from the differences in treatment given to Netflix and, to a lesser extent, Blockbuster, on the one hand, and GameFly, on the other. In reaching that conclusion, the Commission expressly accepts the fact that the efficient and effective processing of mail requires operational flexibility at the local level. The Commission will not interfere with that operational flexibility by attempting to dictate how mail is physically processed. In that same vein, the Commission can understand why Postal Service Headquarters should accord significant discretionary authority to local plant and facility managers to make day-to-day, hour-to-hour, and minute-to-minute operational decisions.

[4136] However, this case involves more than operational decisions. It involves Postal Service Headquarter decisions regarding rates. Specifically, Postal Service

⁴⁴ While it appears the Postal Service sought to prohibit special Netflix mail slots and signage, the Postal Service has conceded that some post offices have continued to designate mail slots solely for Netflix return mail. *Compare* P.O. Ruling C2009-1/5 at 18 (Postal Service directed either to survey the extent of Netflix-only drop slots at local post offices or to stipulate that other post offices have mail slots that have been improperly designated as being solely for Netflix discs), *with* Status Memorandum of the United States Postal Service in Response to Presiding Officer's Ruling No. C2009-1/15 at A1-A2 (Postal Service statement of intent not to contest the continued existence of Netflix-only mail slots).

Headquarters made decisions regarding whether the non-machinable surcharge should be imposed on Netflix and Blockbuster return DVD mail, in full view of evidence that return DVDs were being broken by automated letter processing equipment and that DVD return mailers were jamming that same equipment thereby leading local operators to hand sort and cull return DVD mail. GameFly Compendium at C7 (OIG Audit Report at 4) (filed under seal). Without the decision by Postal Service Headquarters to refrain from imposing the non-machinable surcharge, the Postal Service could conceivably have made a case that differences in processing of DVD return mail was purely an operational decision driven solely by pragmatic considerations involved in the efficient and effective physical processing of mail. However, the decision to allow extensive hand processing of Netflix and Blockbuster return DVD mail without a non-machinable surcharge when it was surcharging other non-machinable First-Class Mail letters makes the difference in treatment between Netflix and Blockbuster, on the one hand, and GameFly on the other, a difference in rates and terms and conditions of service for which the Postal Service is clearly responsible.

[4137] The Postal Service's claim that GameFly does not mail its DVDs as letter mail does not necessarily lead to the broader conclusion advocated by the Postal Service that GameFly has knowingly and voluntarily chosen to mail its DVDs as flats rather than as letters. As noted earlier, testimony by GameFly's CEO establishes that GameFly's decision to mail its DVDs as flats, not letters, was originally driven by its first-hand observations of automated Postal Service letter processing equipment destroying DVDs during tests at Postal Service processing facilities. See Tr. 5/890, 895. Moreover, GameFly's CEO testified that it was only later that it learned special hand processing was available to Netflix and Blockbuster. *Id.* at 895. Since then, the record reflects that GameFly has been attempting to receive the same type of hand processing as Netflix and Blockbuster. *Id.* at 896. In this connection, the Commission would also note that GameFly's CEO has stated that (a) Confirm service, that is only available to flats mailers, is a service that GameFly is willing to forgo if it can obtain hand processing

comparable to Netflix and Blockbuster, GameFly Reply Brief at 7 n.4 (citing testimony of witness Hodess, Tr. 5/936); and (b) that GameFly is also willing to use distinctive packaging if that is necessary in order to obtain comparable hand processing. GameFly Brief at 62-63. In short, the differences in mail service between Netflix and Blockbuster, on the one hand, and GameFly on the other, are not due to a knowing and voluntary decision by GameFly to mail as flats, rather than letters. The differences are due to differences in the service offered by the Postal Service.

[4138] Nor does GameFly's refusal to pursue the service offered by the Postal Service in the May 17 Letter support the Postal Service's contention that GameFly desires flats service, as opposed to letter service. The Postal Service presents the offer in the May 17 Letter as evidence of its willingness to accommodate GameFly. However, by tailoring its service offering so precisely to the circumstances of Netflix, it has effectively created a class of one, namely, Netflix, since it appears from the record that no other DVD mailer in the country could qualify for the service. Indeed, it seems clear that even Blockbuster, which has been the beneficiary of hand processing, could not qualify for hand processing or relief from the non-machinable surcharge based upon the terms and conditions offered to GameFly by the May 17 Letter. The extraordinarily strict terms presented in the May 17 Letter only reinforce the conclusion that differences in the service between Netflix and Blockbuster, on the one hand, and GameFly on the other, are not due to GameFly's business choices, but to distinctly different treatment offered by the Postal Service only to certain favored mailers.

[4139] For the reasons set forth above, the Commission concludes that the Postal Service has given GameFly less favorable rates and terms and conditions of service than other similarly situated mailers.

4. Are There Reasonable or Legitimate Reasons for Providing Other Mailers Preferential Rates or Terms and Conditions of Service?

[4140] In its initial and reply briefs, the Postal Service argues that the allegedly preferential rates and terms of service given to Netflix and Blockbuster are supported by reasonable or legitimate reasons that justify the Postal Service's actions and preclude a finding that it has unduly discriminated against GameFly or has provided undue preferences to Netflix and Blockbuster. Postal Service Brief at 84-93; Postal Service Reply Brief at 65-87. GameFly argues that the reasons given by the Postal Service fail to demonstrate that its actions are lawful. GameFly Brief-NP at 39-58, 63-69; GameFly Reply Brief-NP at 13-28, 39-68.

a. Mail Processing Decisions Are Made by Local Operators

[4141] *Postal Service's position.* The Postal Service asserts that mail processing decisions are made by local operators on a day-to-day basis. Postal Service Brief at 84. In making those decisions, local operators exercise significant discretion, subject to certain limitations such as budgetary constraints, service standards, and applicable supervisory processes. *Id.*

[4142] According to the Postal Service, the processing of DVD mail is no exception. *Id.* at 85. It argues that processing decisions for both Netflix and GameFly DVD mail are made at the discretion of local managers on the basis of available equipment, mail flow (volume, service commitment, shape, and weight), destination, density, mail visibility and ease of access, and a consideration of benefits and costs (including time). *Id.* at 85-86.

[4143] The Postal Service asserts further that in exercising their discretion, local managers have used a range of processing methods for Netflix from "one-touch" manual separation to standard automation. *Id.* By contrast, the processing of GameFly's DVD mail is more consistent because of GameFly's desire to have its mail

processed on automated flats sorters. *Id.* at 85. Nevertheless, the Postal Service states that some facilities manually separate both Netflix and GameFly mail. *Id.* at 86.

[4144] In support of its claim that local managers control the choice of processing methods within generally applicable parameters, the Postal Service emphasizes the expertise and experience of witnesses Barranca, Seanor, and Belair and contests the credibility of witness Glick. *Id.* at 87-88. The Postal Service also questions the reliability of the Christensen Study as outdated and untrustworthy because of its reliance upon limited information. *Id.* at 88-89, 92-93.

[4145] In its reply brief, the Postal Service elaborates further on its policy of decentralized operational decision making by arguing that GameFly has presented no credible evidence that senior Postal Service management had “deliberately chosen” to discriminate in favor of Netflix and against GameFly.” Postal Service Reply Brief at 15. Nor, according to the Postal Service, has GameFly offered a credible explanation for why the Postal Service would pursue “a course of blind favoritism.” *Id.* In addition, the Postal Service asserts that when presented with requests by Netflix and Blockbuster for adoption of a national SOP governing DVD processing, Headquarters decided that local managers should make processing decisions and that a national SOP would interfere with the exercise of their discretion. *Id.* at 16.

[4146] *GameFly’s position.* GameFly responds to the Postal Service’s attempted reliance upon the authority of local managers to make processing decisions by arguing that, as a legal matter, the Postal Service is ultimately responsible for the actions of lower level managers and employees. GameFly Brief at 65.

[4147] GameFly argues further that “the fingerprints of Postal Service Headquarters officials are all over the key decisions that led to this case.” *Id.* at 66. In particular, GameFly cites to the 2002 decision at national Headquarters to treat Netflix return mail as machinable and therefore not subject to a non-machinable surcharge. *Id.*

GameFly points out that the surcharge decision remains unaltered notwithstanding the recommendations of the 2007 OIG Audit Report. *Id.*

[4148] GameFly also relies upon the numerous SOPs issued by local, district, and area offices that provided guidance and directives to local processing managers regarding the manual processing procedures to follow with respect to Netflix and, in some cases, Blockbuster DVD return mailpieces. *Id.* at 24-28. GameFly notes that the rescission or revocation of SOPs has frequently not prevented Netflix from continuing to receive special, manual processing. *Id.* at 25 n. 7; 75 n.20. GameFly cites to a number of Postal Service documents that it says evidence the knowledge and acquiescence of Headquarters officials in the manual processing being received by Netflix and Blockbuster. *Id.* at 66-67.

[4149] GameFly cites to e-mails and other Postal Service documents to demonstrate that Headquarters personnel were clearly aware of how local managers were processing Netflix and Blockbuster return DVD mail and had established an internal study group to review processing methods for such mail. *Id.* at 66 n.17.⁴⁵ The Postal Service also commissioned the Christensen Study to further inform itself regarding the processing of DVD mail.

[4150] Finally, GameFly points to actions taken by Headquarters personnel that affected the processing of Netflix and Blockbuster return mail. GameFly Brief-NP at 74-76. GameFly also introduced into evidence a Headquarters' directive specifying the manner in which Netflix return DVDs were to be trayed and stacked. Tr. 7/1376. GameFly also notes that Headquarters responded to information that a dedicated mail

⁴⁵ This conclusion is supported further by P.O. Ruling No. C2009-1/10 at 5-6. Among other things, that ruling established a presumption that senior Postal Service management was aware (a) that a significant portion of Netflix return DVD mail was being manually culled and condoned such conduct; and (b) that some areas and districts had such standard operating procedures in place and condoned them. The Postal Service never attempted to rebut either of these presumptions within the 2-week time period established by P.O. Ruling C2009-1/10.

slot had been established in more than one post office for Netflix return DVD mail by issuing a directive that appears to have prohibited such slots. ¶ 4135, *supra*.

[4151] On the basis of the forgoing evidence, GameFly argues that the processing of Netflix and Blockbuster mail was either directed or deliberately condoned by Headquarters by acquiescing in processing procedures of which the Postal Service was well aware. GameFly Brief at 24; GameFly Brief-NP at 2-3, 31, 46, 66.

[4152] *Commission analysis.* The basic thrust of the Postal Service's position on this issue is that mail processing decisions are made by local managers. The testimony of Postal Service witnesses supports this proposition. As a general matter, the Commission accepts the Postal Service's assertions that responsibility for processing decisions resides at the local, district, and area levels. As a general matter, the Commission also accepts the Postal Service's assertions regarding many of the factors that limit local processing decisions.

[4153] The issue presented in this case is whether the processing decisions of local managers were guided solely by the generally applicable factors identified by the Postal Service, or whether there was significant Headquarters' involvement in those local processing decisions. The Commission concludes that decisions regarding the processing of Netflix and Blockbuster DVD return mail were not entirely the product of local decision makers.

[4154] The evidence relied upon by GameFly clearly demonstrates that although local managers were making decisions regarding the processing of DVD return mail, those decisions were known and condoned by Postal Service Headquarters. Moreover, there was ongoing communication between local managers and Headquarters personnel regarding DVD processing practices. See ¶ 4133, 4135, *supra*. In addition, Headquarters' involvement manifested itself in the form of the decision made at Headquarters that Netflix's return DVD mail was not subject to a non-machinable surcharge. GameFly Compendium at C7 (OIG Audit Report at 4) (filed under seal). It is

also manifested in specific directives that DVD mail be processed in a specific manner with respect to the traying and stacking of Netflix and Blockbuster return DVD mail and the elimination of dedicated Netflix DVD return mail slots. Tr. 7/1377-78; Postal Service Reply Brief-NP at 67-68. Headquarters' involvement is also evidenced by its participation in the OIG Audit Report and its decision to commission the Christensen Study. The fact that the Postal Service refrained from adopting a national SOP regarding DVD processing does not disprove Headquarters' involvement in the evolution of DVD processing policies that has, over time, consistently provided more favorable treatment to Netflix and, to a lesser extent, Blockbuster.

[4155] The Postal Service's familiarity with field operations, its active involvement in DVD processing decisions, and its involvement in the OIG Audit Report and Christensen Study all support the conclusion that the processing of DVD return mail cannot be considered an exclusively local processing matter. On the contrary, Postal Service Headquarters has either directed or acquiesced in significant DVD processing decisions by local managers.

b. Manual Processing is Implemented by Local Operators to Maximize Mail Processing Efficiency

[4156] *Postal Service's position.* The Postal Service takes issue with witness Glick's assertions that manual DVD mail processing operations are actually driven by Netflix's desire for reduced disc breakage and by the Postal Service's desire to avoid jams and other processing problems. Postal Service Brief at 88-90. Postal Service witnesses testified that one-touch processing of Netflix mail improves efficiency and that manual handling of Netflix mail is more efficient than running such mail through the automated letter processing equipment. *Id.* at 84-93. The Postal Service identifies ballots, tax returns, and census documents as other specific types of mail that is held out in "upstream" operations in order to increase efficiency. *Id.* at 110.

[4157] The Postal Service also seeks to undermine GameFly's claim that "the desire of Netflix for reduced breakage" underlies Postal Service processing decisions by attempting to demonstrate that documents cited in witness Glick's rebuttal testimony do not support such a claim. *Id.* at 90. With respect to the problem of jamming, the Postal Service argues that even if Netflix mail ran on automation equipment without any jams or processing problems, efficiency considerations would still support manual separation and multi-touch processing. *Id.* at 91-92.

[4158] *GameFly's position.* GameFly counters the Postal Service's efficiency argument by asserting that the Postal Service witnesses have presented no data or analyses to support their claims that manual processing of DVD return mail increases processing efficiency. GameFly Brief at 74. GameFly also cites the Postal Service's FY 2009 Comprehensive Statement on Postal Operations to support its claim that standardization, not diversity, in operations, improves service and efficiency. *Id.*

[4159] In its reply brief, GameFly seeks to rebut the Postal Service's criticisms of witness Glick. GameFly Reply Brief-NP at 58-62. GameFly's arguments include its contention that as an expert, witness Glick is entitled to rely upon studies like the Christensen Study, GameFly Reply Brief at 58; that the record demonstrates witness Glick understood certain processing terms used by opposing counsel during his cross-examination, *id.* at 59-60; that the Postal Service failed to establish that witness Glick did not understand the First-Class Mail letter cost avoidance model, *id.* at 60; that witness Glick understood the purpose of the Christensen Study, GameFly Reply Brief at 60-61; and that, contrary to the Postal Service's suggestion, witness Glick was able during cross-examination to demonstrate that the documents cited in his testimony supported his testimony that manual processing was driven by Netflix's desire to avoid breakage of its discs and the Postal Service's desires to avoid equipment jams. *Id.* at 61-62.

[4160] *Commission analysis.* The Postal Service's claim that local managers opt to manually process approximately 80 percent of Netflix's return DVD mail day in and

day out in order to take advantage of opportunities for increased processing efficiencies afforded by Netflix's mail volumes, densities, or other such traditional factors is confronted by a substantial amount of evidence to the contrary.⁴⁶ While the Commission accepts the general proposition advanced by Postal Service witnesses that in some unusual situations manual processing could further processing efficiency, it is not persuaded that such a situation is presented here.

[4161] Historically, manual processing of Netflix DVD return mail was initially driven by two factors: (1) Netflix's concerns about the level of DVD breakage caused by automated letter processing equipment, and (2) Postal Service concerns over the jamming of its automated processing equipment by Netflix mailpieces. These conclusions are supported by documentary evidence that establishes Netflix's attempts to bring to the Postal Service's attention the problem of disc breakage by automated letter processing equipment and have the Postal Service address this problem by means of manual processing of DVD return mail. GameFly Brief-NP at 10-18. Documentary evidence also establishes the Postal Service concerns over the jamming of automated letter processing equipment by Netflix return mailpieces. *Id.* at 18-21.

[4162] Nor is there evidence that this circumstance has changed since the Postal Service began manually processing Netflix's DVD return mail. Despite Netflix's attempts to improve the durability of its DVDs, there is no evidence that it is comfortable with its return mail being handled by automated letter processing equipment. With respect to the problem of jamming, it is significant to note that the Netflix return mailer has not been appreciably redesigned and continues to present automated letter processing equipment with the so-called "leading floppy edge" identified by the Christensen Study as a source of jams. Postal Service Reply Brief at 50.

⁴⁶ In this section, the Commission addresses general claims by the Postal Service that manual processing of Netflix and Blockbuster mail furthers mail processing efficiency. In the section that follows, the Commission addresses the Postal Service's related contention that manual processing reduces Postal Service costs.

[4163] In its brief, the Postal Service appears to acknowledge that the avoidance of equipment jams is a means of enhancing efficiency. (“The Postal Service recognizes that avoidance of jams and other processing problems, to the extent they impact processing efficiency, affect decisions regarding the processing of Netflix mail.”). Postal Service Brief-NP at 91. However, it goes on to assert that the desire to avoid jams is not the “main reason” for Netflix processing decisions. *Id.* Instead, the central reason is cost savings. *Id.* Building on this claim, the Postal Service asserts that “[e]ven if Netflix mail ran on automation without any jams or processing problems, efficiency considerations would still support manual separation of Netflix mail and the avoidance of multi-touch processing.” *Id.* There is, however, no credible evidence in the record to support this sweeping claim. Indeed, the term “one-touch” processing is a misnomer. The record shows that the manual processing afforded Netflix and Blockbuster does not occur at a single stage of mail flow, but occurs at a series of levels within postal processing operations. GameFly Reply Brief-NP at 63.

[4164] The Commission also rejects the suggestion by Postal Service witnesses that the requirement that managers stay within budgets necessarily implies that the hand processing of DVD return mail fosters that objective by minimizing costs. Postal Service Brief at 11, 84, 86, 92; Postal Service Reply Brief at 26, 39. While the requirement that managers stay within budgets could mean that some costs must be reduced, it does not necessarily follow that manual processing of DVD mail will produce needed cost reductions. To the contrary, manual processing could increase costs, or reduce efficiencies, and thereby increase the need for cost reductions elsewhere in the system.

[4165] The Postal Service’s discussion of situations where high density mail to a single recipient is held out in “upstream” operations for efficiency reasons fails to support its claim that manually culling Netflix return mailers improves efficiency. It states that the only difference between other high volume separations (*e.g.*, a local utility) and a high volume DVD mailer cull is the operation in which the mail is held out.

The utility's mail is held out in an automated operation, and the DVD mailer is manually culled. Postal Service Brief-NP at 110. The Postal Service's discussion proceeds as if this difference is not consequential, concluding that "using the GameFly logic, no mailers should ever have a bin on any *machine* dedicated to the isolation of their mail." *Id.* (Emphasis added.) However, it is the fact that manual processes are used instead of machines to separate and process Netflix mail that make it less efficient, not the mere fact that it is separated in an upstream operation. Thus, the Postal Service's claim that GameFly's logic would prohibit machine separation of high volume mailings is a straw man.

[4166] For the forgoing reasons, the Commission is not persuaded by the Postal Service's argument that the principal driver of manual processing of Netflix and Blockbuster mail is the efficiencies of "one-touch" processing. Literal "one-touch" processing appears to apply to only a very small number of return mailers. See GameFly Compendium at C121 (filed under seal).

c. Feasibility of Giving Other Mailers the Same Level of Manual Processing as Netflix and Blockbuster

[4167] *Postal Service's position.* The Postal Service cites a number of differences between GameFly, on the one hand, and Netflix and Blockbuster, on the other, to argue that it would be infeasible to provide GameFly and other DVD mailers with the same level of manual processing of DVD return mail as Netflix and Blockbuster. Postal Service Brief-NP at 4, 67, 118-19, 124 (brightness and visibility of mailpiece design); *id.* at 66-67, 108-09, 119-20, 124-25 (mail volumes and densities); *id.* at 3, 60 (number of mail pickup points). These arguments were previously considered in determining whether GameFly is similarly situated to Netflix and Blockbuster. See section IV.D.2, *supra*.

[4168] *GameFly's position.* In its brief, GameFly cites a Postal Service discovery response in which the Postal Service admits that "[n]o study has been done to

determine the maximum number of parties for which such culling would be feasible. No study [has] been done to identify the operational feasibility of culling return mailpieces for multiple parties at the point of collection, or what the maximum number of such parties may be.” GameFly Brief at 79 (citing Postal Service response to GFL/USPS-162(f)-(g) entered into the record as GameFly Cross-Examination Exhibit GFL-CX-4 (Tr. 9/1653)). GameFly argues further that, as a matter of law, the inability of the Postal Service to provide the same manual processing to all DVD mailers would be insufficient to justify discrimination in favor of Netflix. *Id.* at 80-81.

[4169] Finally, GameFly takes the position that the differences relied upon by the Postal Service are either differences that GameFly is willing and able to eliminate (mail shape and type; and brightness and visibility of mailpiece design); or insignificant (mail volumes and densities; and number of mail pickup points). GameFly Reply Brief at 35-36.

[4170] *Commission analysis.* The Commission is not persuaded by the Postal Service’s arguments that it would be infeasible to provide GameFly similar, even if not the exact same, treatment as Netflix and Blockbuster. While the level of normal processing can be expected to fluctuate among facilities and over periods of time, no insuperable obstacle has been shown on this record to prevent comparable levels of manual processing. This conclusion assumes, of course, that GameFly would make changes to the shape and type of its return mail, and would adopt a more distinctive and visible mailpiece.

[4171] The Commission’s conclusion is based upon several factors. First, as return DVD mail approaches GameFly pickup points, the volumes and densities of that mail rise to levels that facilitate manual processing. USPS-T-3 at 9, 21. Moreover, combined DVD return volumes and densities of different DVD companies can also facilitate manual processing. GameFly Reply Brief at 36; USPS-T-3 at 19. Finally, there is no evidence that places even an estimated limit on the number of mailers for whom it would be operationally feasible to provide manual processing. ¶ 4117, *supra*.

d. Differences in Volume, Density, Length of Haul, and the Number of Mailer Pickup Points Significantly Affect Costs

[4172] *Postal Service's position.* The Postal Service claims that cost differences produced by differences in volume, mail density, length of haul, and the number of mail pickup points provide a rational basis for distinguishing GameFly from Netflix and Blockbuster. Postal Service Brief at 10; Postal Service Brief-NP at 79. In support of its position, the Postal Service cites various court decisions and Commission opinions in which, it asserts, cost differences were recognized as an appropriate basis for determining whether entities are similarly situated or entitled to the same or similar services. Postal Service Brief at 38-58.

[4173] *GameFly's position.* GameFly argues that differences in its volumes and mail densities are not a significant cost factor because its DVD return mail could be combined with the volumes and mail densities of other DVD return mailers. GameFly Reply Brief at 36, 69; GameFly Brief at 77. Similarly, GameFly takes the position that the number of pickup points and the resulting average length of haul have no significant effect on the Postal Service's costs. GameFly Brief at 39-40, 77; GameFly Reply Brief at 36, 68. In that connection, GameFly asserts that the relatively smaller number of Netflix entry and pickup points in 2002 did not prevent the Postal Service from providing Netflix with manual processing. GameFly Brief at 41; GameFly Reply Brief at 68. Finally, GameFly responds to the Postal Service's citation to judicial and Commission precedents by claiming that those decisions apply the legal test set forth in GameFly's brief by engaging in factual inquiries to determine whether alleged discrimination has a rational justification. GameFly Reply Brief at 14.

[4174] *Commission analysis.* The Commission finds that differences among GameFly, Netflix, and Blockbuster with respect to mail volumes and densities have not been shown to produce cost differences that provide a reasonable or legitimate basis for providing GameFly with less favorable service. First, the Postal Service has failed to provide any quantitative data or other specific information to support its claim that cost

differences due to mail volumes or mail densities justify differing treatment of GameFly, Netflix, and Blockbuster. Second, as GameFly has pointed out, the Postal Service willingly provided Netflix manual processing as early as 2002 when Netflix itself had only 12 distribution hubs and its own volumes and mail densities were smaller. *Id.* at 68. Third, as GameFly points out, as a combined mailstream, any cost differences among the DVD mailers would be negligible. *Id.* at 69.

[4175] The Commission also finds that cost differences resulting from differences in the number of mailer pickup points and related transportation distances do not justify less favorable treatment being given to GameFly. First, the Postal Service was willing to offer Netflix manual processing at no extra charge in 2002 when Netflix had only 12 distribution hubs. The Postal Service has presented no evidence that the differences in the number of GameFly, Netflix, and Blockbuster pickup points produce costs differences that justify GameFly's receipt of less favorable processing treatment. See, e.g., Tr. 10/1764 (response to GFL/USPS-T3-28(b)); *id.* at 1774. Indeed, Postal Service witness Seanor acknowledges that the additional transportation costs of the distances in question are very small on a unit basis. Tr. 10/1808-11. Moreover, transportation costs are not affected by the decision to process DVD mail manually or on automation equipment.

[4176] For these reasons, the Commission finds that potential differences in the cost of providing manual culling and processing caused by differences in volume, density, length of haul, and number of pickup points have not been shown to justify the differences in the rates and terms of service offered to GameFly and other DVD mailers.

e. Manual Processing Produces Cost Savings

[4177] *Postal Service's position.* The Postal Service takes the position that the methods used to process Netflix mail are determined by local Postal Service officials based on efficiency and service considerations. It disputes GameFly's claim that manual processing is done in order to accommodate the desire of Netflix to reduce DVD

breakage. Postal Service Brief at 89-90. It argues that the manual handling of Netflix mail that occurs “is done because doing it manually is more efficient than running through the automated letter processing equipment.” *Id.* at 89 (citing Tr. 10/1788).

[4178] The Postal Service’s assertion that manual processing of Netflix DVD return mail reduces costs is supported by the testimony of witnesses Seanor and Belair. These witnesses describe budget and other requirements that constrain local managers, and assert that these constraints ensure that the local operational decisions are efficient and cost effective. *Id.* at 92. In reply to characterizations by GameFly and the Public Representative of witnesses Seanor’s and Belair’s conclusions as unsupported opinions, the Postal Service states that local operational decisions are informed by a variety of data sources, including several that ultimately are used to produce the annual Cost and Revenue Analysis (CRA), and various cost studies. Postal Service Reply Brief at 74.

[4179] The Postal Service also presents several arguments in opposition to GameFly’s assertion that the manual processing afforded to Netflix mail increases Postal Service costs. It states that GameFly witness Glick lacks important fundamental knowledge of how Netflix mail is processed, the full array of assumptions underlying the Christiansen Study, the OIG Audit Report, and the Postal Service’s letter cost models. See Postal Service Brief at 101-03, 111-12; Postal Service Brief-NP at 105-06, 108-10, 112-13. The Postal Service further criticizes witness Glick for failing to properly define the term “manual processing” as it is used in his testimony. Postal Service Brief at 104, 109, 113.

[4180] The Christensen Study is criticized by the Postal Service as failing to provide any realistic understanding of how DVD mail is processed. *Id.* at 101-03. It asserts that the study was never intended to provide a statistically meaningful estimate of nationwide mail processing costs for DVD mailers, nor can it reliably be used for that purpose. *Id.* at 101; Postal Service Brief-NP at 105, 107, 110. It notes that the study does not incorporate methods of processing Netflix mail other than those that the data

collectors observed at the 17 sampled facilities. In particular, the Postal Service argues that the failure to include the one-touch processing described by Postal Service witnesses Belair and Seanor constitutes a fatal flaw in the Christensen Study. Postal Service Brief at 102-03; Postal Service Brief-NP at 102, 105-08.

[4181] The Postal Service also notes that the Christensen Study did not account for the relative prevalence of the different processing methods used throughout the postal system. Postal Service Brief at 102-03. The fact that the study is more than four years old is cited as problematic by the Postal Service. It states that operations have changed as volumes have declined, and notes that the deployment of the new AFCS 200 equipment may have an impact on how DVD mail is processed in the future. *Id.* at 112-13.

[4182] The Postal Service also criticizes several technical aspects of the models in the Christensen Study. Three of the site-specific models are described as anomalous because they seem counterintuitive.⁴⁷ Postal Service Brief-NP at 112, 123-24; Productivities for culling of DVD mailers were unavailable, so the study used proxies. Postal Service Reply Brief at 71; Postal Service Reply Brief-NP at 123. The Postal Service is also critical of the Christensen Study's use of a proxy CRA adjustment factor "borrowed" from the qualified business reply mail (QBRM) model. *Id.* at 71.

[4183] The Postal Service concludes that the Christensen Study is unreliable due to these flaws and that it cannot trump the testimony of Postal Service witnesses, which demonstrate that the budget- and performance-driven operational decision making process ensures efficient processing. *Id.* at 71-72.

[4184] In its reply brief, the Postal Service describes what it sees as shortcomings in the OIG Audit Report. *Id.* at 76-81. The Postal Service asserts that the

⁴⁷ For example, in one model, DVD return mailers that have been culled and trayed are subsequently processed on DBCS equipment, despite this being an apparently unnecessary additional step.

OIG Audit Report imprecisely and incorrectly uses the term “manual processing.” *Id.* at 79. It also argues that the report lacks the documentation normally required of studies relied upon in Commission proceedings, and that it gives only general descriptions of the methodology, assumptions and calculations it uses. *Id.* at 79-80.

[4185] The Postal Service’s reply brief also introduces arguments that data filed with the Commission in previous dockets support its claim that its treatment of Netflix mail improves the overall efficiency of mail processing. The Postal Service asserts that, while the nominal unit cost of single-piece First-Class Mail letters increased between FY 2005 and FY 2009, it has not increased as quickly as has the mail processing hourly labor cost. While conceding that this analysis is not conclusive, the Postal Service states that the decline in “real’ mail processing costs” can be explained by the claims of witnesses Belair and Seanor that one-touch processing of Netflix reduces the cost of DVD mailers. *Id.* at 74-75. The Postal Service states that MODS data do not reflect the hours in collection mail separation operations that would be implied by the high cost scenarios in the Christensen Study. *Id.* at 75. It also asserts that the In-Office Cost System (IOCS) is able to identify the cost of Permit Reply Mail (PRM), and that the cost of this type of mail exhibits a lower average cost per piece than the remainder of (non-PRM) single-piece First-Class Mail letters. *Id.* at 76.

[4186] *GameFly’s position.* GameFly disputes the Postal Service’s claim that cost reductions underlie its extensive manual processing of Netflix DVD return mail and asserts that the true reason is to minimize disc breakage. GameFly Brief at 67-68. Supported by the analysis of witness Glick, GameFly asserts that, rather than reducing costs, the Postal Service’s manual processing of Netflix mail greatly increases costs.⁴⁸ GameFly Brief-NP at 68. It argues that the Postal Service witnesses’ claims of efficiency gains from the use of one-touch processing are not supported by any study or

⁴⁸ Under seal, witness Glick presents an estimated range of how many times more costly manual culling and processing of Netflix DVD return mail is when compared to the cost of processing these pieces on automation letter equipment. See GFL-RT-1 at 30-31 (confidential information redacted).

quantitative analysis, and are not credible. GameFly Brief-NP at 39, 65-67. GameFly asserts that many documents in the record, including the Christensen Study, Postal Service stipulations, and various Postal Service analyses contradict the Postal Service's position. *Id.* at 68, 71-73.

[4187] GameFly argues that the Christensen Study provides the best evidence on the record of the cost of the Postal Service's treatment of Netflix mail. *Id.* at 39-40, 69. It bases this conclusion on several factors, including the reputation of Christensen Associates. GameFly notes that the Postal Service has sponsored approximately 20 pieces of testimony by the consulting firm since 2000. GameFly Reply Brief at 41. GameFly also asserts that knowledgeable Postal Service employees conferred with Christensen and provided input to the study. GameFly Reply Brief-NP at 43-45. GameFly argues that the results of the study are robust. It states that the magnitude of the additional cost of manual processing identified by the study is far larger than any possible effect of the Postal Service's criticisms of the methodology and inputs. *Id.* at 46-47. GameFly also argues that the criticisms of the Christensen Study are undermined by the Postal Service's own use of various parts of it. GameFly Brief-NP at 70; GameFly Reply Brief-NP at 57-58.

[4188] In its reply brief, GameFly responds to the Postal Service's criticisms of the Christensen Study. It asserts that the failure to identify the presence of one-touch processing in the sampled facilities provides strong evidence that it is atypical or nonexistent. GameFly Reply Brief-NP at 48-50. It claims that the modeling of mail flows wherein mail that is culled before the AFCS would subsequently be processed on the outgoing primary Delivery Bar Code Sorter (DBCS) is reasonable in light of concerns that the AFCS is the operation most likely to damage DVDs. *Id.* at 50-51. GameFly also argues that the riffling productivity factor, the greater of the two proxies used in the Christensen Study for the productivity of manual culling, overstates the true productivity of manual culling. *Id.* at 51-52. GameFly points out that many of the inputs to cost models supporting the Postal Service's Annual Compliance Report are

significantly older than the Christensen Study. It notes that the deployment of the AFCS 200 has just begun, and therefore any effects it may have on operations are necessarily prospective and speculative. *Id.* at 54-56.

[4189] GameFly also rejects the Postal Service's criticisms of witness Glick's knowledge of the Christensen models, the Postal Service's letter cost models, and the record. It states that, as an expert witness, he is entitled to evaluate and ultimately rely on the Christensen Study, and argues that a fair reading of the citations that the Postal Service claims demonstrate a lack of understanding do not support such a conclusion. In each situation, GameFly asserts that any lack of understanding is in counsel's question, that the witness was declining to answer an improper line of questioning, or that counsel declined to have the witness expand on his responses. *Id.* at 58-63.

[4190] *Commission analysis.* As with the Postal Service's claim that manual treatment of Netflix DVD return mail improves efficiency, its claim that such treatment reduces costs is not persuasive in light of the extensive evidence to the contrary cited by GameFly. The assertion of witnesses Seanor and Belair that local operations are constrained by budget considerations and therefore all operational decisions necessarily reduce costs is unsupported, and contradicted by the weight of the evidence.

[4191] The Postal Service argues that formal, quantified study or analysis is not necessary to support its witnesses' conclusions that the manual culling and processing of Netflix mail reduces costs. It suggests that the cost implications of many operational decisions are intuitively obvious to local managers. Tr. 10/1788-90. The Commission does not categorically reject this basic premise, but finds that it should be possible to translate this type of intuitive analysis into a more formal calculation that illustrates the logic and assumptions underlying the informal calculus. The Postal Service does not present such an analysis in this case.

[4192] In contrast, the conclusions of GameFly witness Glick are based on modifications to the models used in the Christensen Study. This makes it possible to evaluate the logic and assumptions underlying his conclusions. The Postal Service does just that, and identifies several aspects as questionable. The Commission finds that while some of these criticisms have merit, they do not individually or collectively invalidate the primary conclusion that the manual treatment afforded to Netflix mail increases, rather than decreases, Postal Service costs.

[4193] The Postal Service claims that the Christensen Study's failure to properly reflect the full range of processing methodologies, including one-touch processing, is a fatal flaw. As discussed *supra*, the Commission finds that one-touch processing is a misnomer, and the claims of widespread use of such minimal processing are not supported on the record. The Christensen Study includes a survey to determine the methods used to process Netflix and other DVD mail, and as noted by GameFly, an examination of 17 facilities is very likely to have uncovered such processing if it were as prevalent as the Postal Service claims.

[4194] The Postal Service also claims that the Christensen Study was never intended to provide a meaningful estimate of the cost of processing DVD mail, that it did not gather the data needed to do so, and that the Postal Service has never accepted the study as reliable. The first of these claims is undermined by the Christensen Study's own statements as to its purpose. GameFly Compendium at C101; *see also id.* at C87. And, while not attributed to the Christensen Study by name, the Postal Service responded to the OIG Audit Report in part by stating that it learned through an outside consultant that all Prepaid Reply Mail (PRM) designs (which would include Netflix DVD mail) cover their costs and make a positive contribution. *Id.* at C20 (filed under seal). Since the Postal Service has confirmed that the Christensen Study is the only study that has been performed to evaluate the costs of DVD mailers, and the OIG Audit Report refers to it as the antecedent work of the "outside consultant," it is reasonable to assume that this statement refers to and relies on it.

[4195] The age of the Christensen Study and its failure to incorporate the potential future impact of the ongoing deployment of AFCS 200 equipment are not particularly problematic. As GameFly points out, the Postal Service and the Commission regularly rely on studies with inputs that are older. In the absence of evidence that operations or equipment have changed in ways that would significantly affect the results, age alone does not render such models invalid or unreliable. With the exception of the AFCS 200, the Postal Service does not identify any specific changes that would be necessary to reflect changes in equipment or operations. The effects of the AFCS 200 deployment are described as “possible” and “in the future” by the Postal Service. Postal Service Brief-NP at 122. The possible future effects of equipment changes are not relevant to the issues in this case.

[4196] The use of proxies in the Christensen Study is also not sufficient to invalidate its findings. The Postal Service emphasizes the importance of the proxies for culling, and notes that the Christensen Study discussed the potential for it to be very high or very low, and that it “explicitly considered cases in which culling costs are ‘*de minimis*’ as being within the realm of possibility.” Postal Service Reply Brief at 73. Rather than undermine the validity of the results of the Christensen Study, this actually strengthens it. It is clear that Christensen was aware of the importance of the culling productivity, as it performed a sensitivity analysis to generate upper and lower bounds of unit costs depending on the proxy used. The Postal Service’s position is contradicted by the fact that, even under the high productivity scenario (reflecting the possibility of *de minimis* culling costs), the study results show that manual handling of DVD return mail significantly increases costs.

[4197] Similarly, the use of a proxy CRA adjustment factor “borrowed” from the QBRM model is not necessarily problematic. It is not unusual to apply proxy CRA adjustment factors to modeled costs when there is not a corresponding CRA unit cost available. To wit, the CRA adjustment factor “borrowed” from the QBRM model is itself

“borrowed” from the model of bulk metered mail costs. See Docket No. ACR2010, USPS-FY10-21.

[4198] The mail flow examples that the Postal Service characterizes as “anomalous” may be explained by the reasoning suggested by GameFly. That is, it is conceivable that after circumventing the AFCS to avoid potential damage, some facilities might subsequently use DBCS processing for DVD mail. There is no evidence that the Christensen Study incorrectly translated the activities observed at each sampled facility, and the results of the study reflect a variety of observed mail flows. Moreover, the cost of an additional handling on DBCS equipment, if mistaken, is small enough that it would not invalidate the general findings of the study.

[4199] The analysis of CRA and IOCS cost data presented in the Postal Service’s reply brief is not conclusive.⁴⁹ A decline in the labor cost adjusted unit cost of single-piece First-Class Mail letters could have many explanations, especially given that the volume of this type of mail declined precipitously during the time frame cited by the Postal Service. For example, in addition to the possible explanations posited by the

⁴⁹ GameFly objects to the Postal Service’s attempt in its reply brief to rely upon IOCS data not previously offered into the record to show that the manual processing of Netflix return mailers is less costly than automated processing. Motion of GameFly, Inc., to Strike Portion of the Reply Brief of the United States Postal Service, November 26, 2010. GameFly requests either that two sentences be struck from the Postal Service’s reply brief or that the IOCS information be accorded no weight. *Id.* at 17. The Postal Service has filed an answer in opposition. Reply of the United States Postal Service in Opposition to Motion of GameFly, Inc. to Strike Two Sentences From the Reply Brief of the United States Postal Service, December 3, 2010. In other circumstances, the Commission would be inclined to grant GameFly’s motion. The Postal Service is, in effect, attempting to introduce the disputed IOCS data into the evidentiary record after that record was expressly closed by P.O. Ruling C2009-1/46 and reference to the data is being made for the first time in a reply brief to which no further response is permitted. These factors, by themselves, would support granting the motion to strike. On the other hand, the IOCS information is referred to by the Postal Service as corroborative support for the testimony of witnesses Seanor and Belair. Postal Service Reply Brief-NP at 79. The testimony of those latter witnesses is addressed by the rebuttal testimony of GameFly’s witness Glick. In light of the limited purpose of the Postal Service’s reference to the IOCS data and the nature of the data relied upon, in light of the fact that witness Glick has responded to the testimony of witnesses Seanor and Belair which purports to provide the main support for the Postal Service’s position on the cost of manual processing, and in light of the fact that this costing issue has otherwise been thoroughly litigated, the Commission believes that it can fairly analyze and weigh the probative value of the disputed IOCS data. Accordingly, the Commission hereby denies GameFly’s motion to strike.

Postal Service, it is possible that volume losses have been concentrated among the more costly subsets of single-piece First-Class Mail letters. Similarly, the information provided about the costs of PRM and non-PRM single-piece First-Class Mail letters is not dispositive. Without controlling for the differences in other cost causing characteristics of these types of mail, the average cost difference does not necessarily inform the issue of whether manual culling and processing of Netflix mail increases or reduces Postal Service costs.

[4200] The Postal Service's criticism of the OIG Audit Report for providing only general descriptions of its methodology, assumptions, and calculations is curious in light of the lack of similar support underlying the Postal Service's own analysis in this case. The OIG exists primarily for the purpose of performing these very types of reports, and there is no reason to question its professional qualifications to do so. In any case, while it is consistent with the testimony of witness Glick, the Christensen Study, and internal and external Postal Service communications on the record, the Commission's findings in this case do not turn merely on the contents of the OIG Audit Report.

[4201] In addition to witness Glick's testimony, the Christensen Study, and the OIG Audit Report, the records of the Postal Service's internal and external communications, and other documents produced in discovery provide a wealth of support for the finding that manual culling and processing of Netflix DVD return mail increases Postal Service costs. As noted by GameFly, statements and presentations by Postal Service officials expressing that conclusion are extensive. See, e.g., Tr. 4/158, 179-80, 188, 359-60, 367, 370, 516, 540, 570, 625, 644 (filed under seal).⁵⁰

[4202] In contrast, there is a dearth of statements or suggestions on the record that the Postal Service manually culls and processes Netflix mail to reduce Postal Service costs. The Postal Service does not identify any document, other than its

⁵⁰ Neither the appendix to the Postal Service Brief nor witness Barranca's efforts to place these statements into context change the overall pattern and meaning of the statements. Postal Service Brief, Appendix A; USPS-RT-4. See section IV.D.1.b, *supra*.

witnesses' testimonies in this case, where a Postal Service official suggests this to be the case. See, e.g., Tr. 10/1762. To the contrary, the evidence strongly supports the alternative theory that Netflix DVD return mail is manually culled and processed to address Netflix's desire to reduce DVD damage caused by mail processing equipment. See, e.g., Tr. 4/178-79, 370, 372, 376, 514, 528, 538, 587, 637, 641, 646 (filed under seal).

[4203] In sum, the record in this case strongly supports the conclusion that the Postal Service's manual culling of Netflix DVD return mail increases, rather than decreases, its costs. This finding is consistent with all recent understanding of the behavior of Postal Service costs, that in virtually every instance, processing mail on automation equipment is vastly more efficient and less costly than processing it manually. With programs from the Letter Sorting Machine, DBCS, AFCS, ATHS, FSM881 and AFSM100, to the FSS, the Postal Service has continued to make investments and efforts to reduce costs by automating processes rather than perform them manually.

[4204] While the Commission finds that the evidence is overwhelming that the manual culling and processing of Netflix DVD return mail increases Postal Service costs, the estimates of the difference in the costs of Netflix mail and GameFly mail calculated by witness Glick are not sufficiently reliable to be used to design rates whereby each generates equal contribution. In addition to the imperfections identified by the Postal Service (which have a potential effect far too small in magnitude to reverse the overall findings of the Christensen Study), some of the modifications witness Glick makes to the Christensen models to estimate the cost of processing GameFly pieces are questionable, and could likely only provide a second best point of departure for separate ratemaking purposes.⁵¹

⁵¹ One example is the use of the CRA adjustment factor for Standard Mail Regular flats, whereas GameFly uses First-Class Mail.

f. Discrimination is Necessary to Meet Service Standards

[4205] *Postal Service's position.* In addition to its claim that manual processing of Netflix and Blockbuster return DVD mail produces cost savings, the Postal Service suggests that such manual processing assists in meeting service standards by reducing mail clearance times during mail processing. Postal Service Brief at 84-85, 92; Postal Service Reply Brief at 25; USPS-T-3 at 4. This alleged facilitation of mail processing is presented as a justification for the manual processing of Netflix and Blockbuster DVD return mail.

[4206] *GameFly's position.* GameFly responds to this argument by pointing to Postal Service discovery responses that disclaim any reliance upon the manual processing of Netflix and Blockbuster return DVDs as necessary to meet service standards: "The Postal Service disagrees with [the] statement that [a large portion of Netflix mail must be handled manually to meet service standards]." GameFly Brief at 82 (citing Postal Service response to GFL/USPS-67). GameFly also cites to testimony of Postal Service witness Belair admitting that the Postal Service has no studies that show that culling of Netflix mail helps meet service standards. *Id.* (citing Tr. 9/1691). Finally, GameFly argues that even if it could be demonstrated that manual processing of Netflix and Blockbuster mail assisted in meeting service standards, that would not justify discrimination against GameFly and other DVD mailers. *Id.*

[4207] *Commission analysis.* The Commission agrees with GameFly that the record does not support the conclusion that manual processing of Netflix and Blockbuster DVD return mail is either necessary or appropriate to meet service standards. The testimony and discovery responses presented by the Postal Service is, at best, mixed. While witness Seanor testified that "strategic diversion of mailpieces out of the tighter AFCS window leads to overall benefits in meeting outgoing operational clearance times," he does not tie that general statement to the specific effects of manually processing Netflix or Blockbuster DVD return mail. USPS-T-3 at 4. Nor does

his testimony state that such manual processing of Netflix or Blockbuster DVD return mail is necessary in order to meet operational clearance times.

[4208] For his part, witness Belair testified that he was unaware of any studies showing that culling Netflix mail helps meet service standards. Tr. 9/1691. Finally, the Postal Service expressly stated its disagreement with the statement that manual processing of Netflix or Blockbuster mail was necessary to meet service standards. Postal Service response to GFL/USPS-67.⁵² Finally, even if it could be demonstrated, which it has not, that discriminatory manual processing facilitated the Postal Service's ability to meet service standards, the Commission could not approve of any such unduly discriminatory conduct.

g. Decision Not to Impose a Non-machinable Surcharge on Netflix's DVD Mail Does Not Constitute Discrimination

[4209] The Postal Service's decision not to impose a non-machinable surcharge on Netflix's DVD return mail was communicated to Netflix on June 24, 2002, by the Mail Preparation and Standards group. Tr. 4/303 (filed under seal). Two weeks earlier, on June 11, 2002, the Postal Service's Department had advised Netflix that its DVD return mailer was not automation compatible. *Id.* at 302 (filed under seal). Consistent with the determination announced by the Mail Preparation and Standards group June 24, 2002 letter, the Postal Service has never collected the non-machinable surcharge from Netflix. See Joint Statement ¶ 82.

[4210] In 2007, the OIG Audit Report was issued as part of an investigation of whether the Postal Service was processing Permit Reply Mail, which included DVD mail, in accordance with approved mail classification and pricing criteria. The OIG Audit Report concluded that although the Postal Service had generally processed PRM mail in accordance with DMM classification, the DMM classification criteria for non-

⁵² Received in evidence at Tr. 10/1848, appearing as the sixth unnumbered page following Tr. 10/1890.

machinability was incomplete, inaccurate, and problematic, if not misleading. It indicated that the Postal Service should revise the DMM's machinability standards "to identify additional non-machinable characteristics and physical standards for First-Class letter-size mail." GameFly Compendium at C12-C13 (OIG Audit Report at 9-10) (filed under seal). To date, the Postal Service has neither revised the DMM's machinability standards nor imposed a non-machinability surcharge on Netflix. See Postal Service Reply Brief at 46.

[4211] *Postal Service's position.* The Postal Service argues that GameFly has failed to establish that the Postal Service's decision not to impose a non-machinability surcharge and its decision not to revise its machinability standards constitute undue discrimination in mail processing operations. *Id.* at 45-54. More specifically, the Postal Service asserts that (1) GameFly has failed to explain how the failure to impose the surcharge or the failure to revise the machinability standards relate to GameFly's claim that it has been denied equal processing treatment (*id.* at 47); (2) GameFly has failed to explain how the imposition of a non-machinability surcharge or a change in machinability standards would address GameFly's alleged circumstance (*id.* at 48); (3) GameFly has failed to establish a link between the failure to impose a non-machinable surcharge on Netflix and the alleged unreasonableness of the Postal Service's processing decisions (*id.*); (4) GameFly has failed to cite any evidence that the Postal Service's decision not to impose a non-machinable surcharge on Netflix represents discrimination against any other mailer (*id.* at 49-50); and (5) the OIG Audit Report, while critical of the Postal Service's machinability criteria and the inconsistent application of those criteria to mailers, did not find the Postal Service's actions to be unlawful (*id.* at 51-54).

[4212] *GameFly's position.* In its brief, GameFly expressly declines to take a position on whether a non-machinable surcharge should be imposed on DVD mailers. GameFly Brief-NP at 88 n.23. GameFly does, however, state that if a non-machinable surcharge is imposed, it must be imposed on all non-machinable DVD mailpieces,

including those of Netflix. *Id.* Notwithstanding these positions, GameFly argues that the Postal Service's decision not to impose a non-machinable surcharge on Netflix's return DVD mail "compound[s] the disparity in treatment" accorded Netflix by the Postal Service and is a further example of Postal Service discrimination against other DVD mailers, including GameFly. *Id.* at 42. In its reply brief, GameFly asserts that the classification of Netflix's mailpiece as machinable is one of several "additional forms of discrimination [that] preclude any claim that the discriminatorily high levels of manual culling and diversion offered to Netflix have anything to do with cost minimization." GameFly Reply Brief at 33.

[4213] GameFly supports its claims with evidence which, it asserts, demonstrates that (1) the original decision not to impose the non-machinable surcharge was inconsistent with the actual machinability capabilities of Netflix's DVD return mailer (GameFly Brief-NP at 42); (2) the Postal Service violated applicable procedures in reaching its original decision not to impose the surcharge on Netflix's DVD return mailers (*id.* at 42-43); (3) that the non-machinability of Netflix's DVD return mailers has been widely known and accepted by Postal Service employees, including operational personnel responsible for processing Netflix's DVD return mailers (*id.* at 46-47); (4) Postal Service employees have recognized for some time that the decision to treat Netflix's DVD return mail as machinable could at some point trigger the filing of a discrimination complaint (*id.* at 47-49); (5) since the 2002 decision that Netflix's DVD return mailer was machinable, the Postal Service has routinely and consistently rejected requests by other DVD mailers with mailpieces similar to Netflix to have their mailers declared machinable (*id.* at 44-45); (6) in 2007, the Postal Service's Engineering Department tested 11 Netflix DVD mailers, all of which were variations of the original mailer, and concluded that the new mailers were unacceptable for long term utilization (*id.* at 44); (7) the 2007 OIG Audit Report, *supra*, confirmed the non-machinability of Netflix's DVD return mailer and the irregularity of the procedures used in making the original determination that the mailer was machinable (*id.* at 43); and (8) the Postal

Service has failed to respond to the recommendation in the 2007 OIG Audit Report that the machinability criteria in the DMM be revised to identify additional non-machinable characteristics and physical standards for First-Class letter-size mail (*id.* at 43).

[4214] *Commission analysis.* The decision by the Postal Service not to impose the non-machinable surcharge on Netflix and its subsequent failure to revise its machinability standards raises a number of important issues. These issues can be grouped into several categories. At the threshold are issues regarding the relevance of the non-machinability surcharge to the GameFly's claims of undue discrimination. Assuming the non-machinability surcharge and its application are relevant, further issues are presented. First, are issues regarding the propriety of both the Postal Service's original decision not to impose the surcharge and the procedures used in reaching that decision. Second, are issues regarding whether the Netflix return mailpiece is in fact automation compatible and/or machinable. Third, are issues regarding the alleged inconsistent application of the machinability standards to different DVD mailers. Fourth, are issues regarding the Postal Service's failure to implement the recommendations in the OIG Audit Report.

[4215] As a threshold matter, the Postal Service questions whether the DMM standards for determining mailpiece machinability and their application are relevant to a determination in this case of whether GameFly has been harmed by undue discrimination. Postal Service Reply Brief at 45-54. The Postal Service argues that GameFly (1) has failed to explain how the Postal Service's failure to impose a surcharge on Netflix or to revise the DMM's machinable standards relates to its claims of unequal mail processing treatment; (2) has failed to explain how the imposition of a non-machinable surcharge on Netflix would relate to GameFly's circumstances; and (3) has failed to demonstrate a link between the failure to impose a non-machinable surcharge on Netflix and the alleged unreasonableness of the Postal Service's processing decisions. GameFly responds by arguing that the failure to impose a non-machinable surcharge on Netflix is evidence of discrimination that is undue, and

evidence that the discriminatory preferences shown to Netflix have nothing to do with cost minimization. GameFly Brief-NP at 42; GameFly Reply Brief at 33.

[4216] The Commission is persuaded that both the Postal Service's determination to treat Netflix's DVD return mail as machinable and its failure, to date, to take steps to revise the DMM standards for machinability of DVD mail are relevant to a determination of whether the Postal Service unduly discriminates in its rates or processing practices. The Postal Service actions cited by GameFly can, if proven, be deemed part of a pattern of discrimination that is unduly favorable to Netflix. Accordingly, the Commission will review the Postal Service's decision not to impose the non-machinable surcharge on Netflix, and the Postal Service's failure to review the DMM's machinability standards as recommended in the OIG Audit Report.

[4217] The OIG Audit Report concluded that the original decision to treat the Netflix DVD return mailer as machinable comported with the DMM machinability criteria as they existed in 2002. This conclusion is used by the Postal Service to argue that the OIG Audit Report did not find the Postal Service determinations to have involved unlawful discrimination. Postal Service Reply Brief-NP at 51.⁵³

[4218] GameFly seeks to raise questions regarding the propriety of the Postal Service's original decision. GameFly points to the fact, discussed in the OIG Audit Report, that the Postal Service's Engineering Department had initially concluded that Netflix's return mailpiece was "not automation compatible." Tr. 4/302 (filed under seal). That unqualified conclusion was subsequently mischaracterized by the Mail Preparation and Standards group as the Postal Service's Engineering Department having found that

⁵³ While the Postal Service is correct in stating that the OIG Audit Report did not find the Postal Service's actions to constitute unlawful discrimination, it is important to bear in mind that the purpose of the report was not to rule on the issue of discrimination, but to determine whether PRM mailpieces were being processed in accordance with the classification and pricing criteria that existed at the time. November 8, 2007 Transmittal Letter from Ms. Tammy L. Whitcomb to Mr. Michael K. Plunkett, *et al.* re: Report No. MS-AR-08-001. GameFly Compendium at C2 (filed under seal). The issue of discrimination in this proceeding involves consideration of events both in, and since, the 2002 determination regarding machinability and processing treatment.

the Netflix mailpieces “although not completely automation-compatible, were machinable.” *Id.* at 303 (filed under seal).

[4219] This unexplained inconsistency between the Postal Service’s Engineering Department’s actual finding and its finding as characterized by the Mail Processing and Standards group casts potentially serious doubt on the reliability of the Mail Preparation and Standards group’s determination that the Netflix mailpiece was machinable. This doubt is reinforced by the fact that the Postal Service had failed to follow appropriate procedures in making the determination of machinability. GameFly Compendium at C10 (OIG Audit Report at 7) (filed under seal).⁵⁴

[4220] Furthermore, the OIG Audit Report estimated that 70 percent of Netflix DVD return mail was being manually processed. *Id.* at C7 (OIG Audit Report at 4) (filed under seal). Together, these facts strongly suggest that the Netflix return mailpiece was not, in reality, machinable.

[4221] While questions remain regarding how and why the inconsistent decisions of the Postal Service’s Engineering Department and the Mail Processing and Standards group regarding machinability were resolved, the Commission cannot, without a more complete record, reach any definitive conclusions regarding whether the initial machinability determination was lawful or unlawful.

[4222] However, since the initial determination that the Netflix return mailpiece was machinable, a significant amount of additional information has accumulated which conflicts with the initial determination that the Netflix return mailpiece was machinable.

⁵⁴ In its response to the OIG Audit Report, the Postal Service attempted to explain this failure as a consequence of the fact that use of First Class Mail by DVD mailers was relatively new in 2002. OIG Audit Report, Appendix C, Management’s Comments (Management’s Comments), October 25, 2007, at 2. GameFly Compendium at C20 (filed under seal). While this may explain why Netflix received notification regarding the non-machinability surcharge from the Mail Processing and Standards group, it does not adequately explain the inconsistent conclusions reached by the Postal Service’s Engineering Department and Mail Processing and Standards group regarding the automation compatibility of Netflix mailpieces.

GameFly has cited numerous internal Postal Service e-mails and documents supporting GameFly's contention that, in reality, the Netflix mailpiece is neither automation compatible nor machinable. GameFly Brief-NP at 19-21. GameFly's position is further reinforced by tests conducted during 2007 of "improved" Netflix mailpieces that led the Postal Service's Engineering Department to conclude that the new mailpieces, which were variants of the earlier Netflix mailpiece, were unacceptable for long-term utilization. *Id.* at 44. No evidence has been submitted in the current proceeding to suggest that the Netflix DVD return mailpiece is, in fact, any more automation compatible or machinable today than it was in 2007, or, for that matter, in 2002.

[4223] Evidence regarding whether machinability standards have been applied consistently to all DVD mailers is mixed. On the one hand, while GameFly points to evidence showing that subsequent to the determination in 2002 that Netflix's DVD return mailer was machinable, the Postal Service consistently found very similar DVD mailpieces of other mailers to be non-machinable. *Id.* at 44-45. GameFly relies upon this evidence to suggest that the Postal Service has systematically discriminated against DVD mailers other than Netflix. The Postal Service responds by arguing that the record does not demonstrate that the mailpieces of these other mailers are the same as, or comparable to, Netflix's DVD return mailer. Postal Service Reply Brief at 49.

[4224] The Commission is not persuaded by the Postal Service's argument. Tests of the mailpieces of other mailers were all conducted by the same Postal Service Engineering Department group. In rejecting those mailpieces, the Postal Service's Engineering Department referred to them as similar to the Netflix mailpiece and found them to have the same automation and machinability problems. In addition, in its 2007 analysis of improved Netflix mailpieces, the Postal Service's Engineering Department referred to the mailpieces of those other mailers as "a typical Netflix clone." Tr. 4/485. This evidence clearly supports GameFly's contention that the Postal Service has been

inconsistent in determining Netflix's mailpiece to be machinable, while finding the same, or comparable, mailpieces of other DVD mailers to be non-machinable.

[4225] Notwithstanding the inconsistent determinations of machinability, it appears that the Postal Service did not impose the non-machinability surcharge on any of the mailers using a "Netflix clone" mailpiece. Postal Service Reply Brief-NP at 49-50 (citing Postal Service response to GFL/USPS-9).⁵⁵ The Postal Service fails to explain why the non-machinability surcharge has not been imposed on these other mailpieces previously determined to be non-machinable.

[4226] The Postal Service offers no explanation for its failure to impose non-machinable surcharges on DVD mailpieces that have been determined by the Postal Service's Engineering Department to be non-machinable. One possible explanation might be found in the Postal Service's response to the OIG Audit Report. It would appear from that response that decisions on whether to impose the surcharge on DVD mailers has been determined on the basis of the Postal Service's reading of the DMM standard that has remained unchanged since before Netflix return mailpieces were determined not to be subject to the non-machinable surcharge. If so, this would mean that determinations by the Postal Service's Engineering Department that mailpieces of other DVD mailers are, in fact, non-machinable are being ignored.⁵⁶

⁵⁵ To support this same contention, the Postal Service cites to a portion of a training guide used by Postal Service retail associates and attached to the Postal Service's reply brief. The date of this training guide and the cited section are not provided. Nor have other portions of the guide been provided, such as the section in which the quoted selection appears. In P.O. Ruling C2009-1/42, the Presiding Officer directed that documents cited in the briefs of the parties that are not readily accessible to the parties or to the Commission should be provided in a supplemental appendix. The Postal Service has failed to make the training guide, or the section of the training guide in which the quoted selection appears, available, either by citation or by inclusion in a supplemental appendix. Accordingly, the Commission will not rely upon the cited portion of the training guide.

⁵⁶ Such an interpretation would be consistent with what may have happened in 2002 when Netflix's mailpiece was determined to be machinable by the Mail Preparation and Standards group. See *supra*.

[4227] By relying on the discovery response stating that other DVD mailers, whose Netflix clone mailpieces were determined to be non-machinable, have not been required to pay the non-machinability surcharge, the Postal Service seems to invite the Commission to conclude that the inconsistency in the machinability determinations has been remedied by the fact that those other DVD mailers have been treated the same as Netflix, *i.e.*, all of these DVD mailers have been spared the burden of paying the non-machinability surcharge. The Commission is not prepared to conclude that the potential for discriminatory treatment has been eliminated. The mailpieces of other DVD mailers with Netflix-clone mailpieces have been determined by the Postal Service's Engineering Department to be non-machinable. While, to date, it appears that these machinability determinations have had no practical impact on other DVD mailers, neither the Commission nor affected DVD mailers can rule out the possibility that at a future date the Postal Service will seek to collect the non-machinability surcharge as back postage due from those other mailers.

[4228] Based on conclusions by the Postal Service's Engineering Department that Netflix-type mailpieces were not machinable, the OIG Audit Report recommended that the Postal Service should revise the DMM's machinability standards "to identify additional non-machinable characteristics and physical standards for First-Class letter-size mail." OIG Audit Report at 9-10. Since the issuance of the OIG Audit Report in 2007, the Postal Service has not taken any actions to implement this recommendation. Tr. 10/1883-86. Nor, for that matter, has the Postal Service rescinded the favorable machinability determination given to Netflix in 2002. The Postal Service admits that its decision not to act on the recommendation of the OIG Audit Report "remains controversial," but cites Management's Comments on the report and the testimony of witness Barranca to support the reasonableness of its inaction. Postal Service Reply Brief at 52-54. The Postal Service argues that even if the Commission were to conclude that the failure to act on the OIG Audit Report's recommendations was a

matter of “incorrect judgment,” that would not constitute undue discrimination. *See id.* at 53-54.

[4229] The Postal Service’s decision not to implement changes in the DMM’s machinability criteria is one of several examples of inaction which GameFly argues have benefited Netflix. In the section that follows, the Commission will evaluate this alleged pattern of behavior. As part of that evaluation, the Commission will examine the Postal Service’s decision not to implement the OIG Audit Report’s recommendation that the machinability criteria be reviewed and revised.

h. Decision Not to Reclassify First-Class Mail Does Not
Constitute Discrimination

[4230] *GameFly’s position.* In addition to its arguments regarding the Postal Service’s failure to impose a non-machinable surcharge on Netflix’s DVD return mail, GameFly cites the Postal Service’s repeated failures to address the alleged operational and rate favoritism shown to Netflix as additional examples of undue discrimination. GameFly Brief-NP at 45-53. GameFly bases its claims on numerous e-mails in which Postal Service employees question the failure to impose a non-machinable surcharge or to develop a mailpiece design that is compatible with automated processing equipment and on PowerPoint presentations used at Postal Service meetings to consider possible changes to DVD mailing policies and rates. *Id.* at 46-50.

[4231] GameFly also cites examples of Postal Service proposals that were dropped when opposed by Netflix. *Id.* at 50-53. Those proposals included a possible NSA and the establishment of an experimental or permanent classification for Round-Trip Disc Mail. *Id.* at 50-51. The goal of this latter proposal was to address operational problems with DVD return mailers, the lack of national standards for the design and preparation of such mail, and the inconsistent treatment of DVD mailers. *Id.* Citing statements by Postal Service employees contained in documents produced during discovery, GameFly asserts that Netflix opposed these proposals either because they

would increase Netflix's mailing costs or because they would increase the exposure of Netflix's DVD return mail to automated processing and an increase in disc breakage. *Id.* at 51-52.

[4232] *Postal Service's position.* The Postal Service presents several responses to GameFly's allegations. First, it challenges GameFly's interpretation of Postal Service e-mails and documents produced during discovery. The Postal Service asserts that GameFly has taken statements and other materials out of context and has misrepresented the meaning or significance of those statements and materials. Postal Service Reply Brief-NP at 55-59. Second, the Postal Service cites certain responses to GameFly discovery requests and testimony by Postal Service witness Barranca which, it alleges, explain why the failure to create a separate rate category for First-Class DVD mail is not discriminatory. *Id.* at 59-63. Third, the Postal Service argues that GameFly has not explained how the Postal Service's failure to reclassify First-Class Mail is related to GameFly's claim that the Postal Service's operational practices discriminate against it. *Id.* at 60, 63.

[4233] In this latter connection, the Postal Service asserts that if GameFly's argument is that the failure by the Postal Service to consider reclassification is by itself discrimination (apart from any effect on operational decisions), such a claim "should be evaluated independently." *Id.* at 60. Similarly, the Postal Service argues that if GameFly is alleging that Postal Service pricing policies, or specific rates, are unduly discriminatory, such an allegation "must be evaluated on its own terms." *Id.* The Postal Service argues further that if these are GameFly's intended allegations, they require an "intense," "highly technical," "systematic" review. *Id.* at 64. The Postal Service concludes by asserting that GameFly "has not begun to establish that First-Class Mail needs to be reclassified and repriced...[n]or has it developed a record on which such reclassification could be responsibly accomplished." *Id.*

[4234] *Commission analysis.* The Commission is not persuaded by the Postal Service's argument that GameFly has misconstrued or misrepresented the significance

of e-mails or PowerPoint presentations. The Postal Service asserts that “GameFly strongly implies, if not states, that the fact that certain issues that might be construed as involving references to the possibility of discrimination claims in internal discussions of DVD mail constitutes an *acknowledgment* by the Postal Service that it does discriminate unlawfully.” (Emphasis added.) Postal Service Reply Brief at 54, 56. In fact, GameFly has cited the e-mails and PowerPoint presentations at issue for the proposition that “[m]any knowledgeable [Postal Service] employees have worried about the Postal Service’s disparate treatment of Netflix and other DVD rental companies....” GameFly Brief-NP at 45. As such, GameFly has fairly cited these documents as evidence that the Postal Service was aware of the possibility that the differing treatment of the two mailers could not be justified. GameFly has not misconstrued or mischaracterized the subject documents as a Postal Service *acknowledgment* that it was unlawfully discriminating.

[4235] Nor is the Commission persuaded by the Postal Service’s argument that GameFly has misconstrued or misrepresented two other Postal Service employee e-mails cited by GameFly in its brief. *Id.* at 48-49. GameFly asserts that the statement made by the Postal Service employee in one of the e-mails makes “essentially the same point” as a statement made by a different employee in another e-mail. *Id.* The Postal Service argues that the two e-mails address not only different points, but different topics. Postal Service Reply Brief-NP at 59. Based upon its comparison of the two e-mails at issue, the Commission notes the distinction between those e-mails identified by the Postal Service, but concludes that it is within acceptable limits of advocacy for GameFly to argue that the two e-mails are consistent in that they both address rate implications of the manual processing of Netflix mail. In the Commission’s view, GameFly has neither misconstrued nor misrepresented the significance of the two e-mails at issue.

[4236] The Postal Service cites to a discovery response that purports to explain why it did not pursue the establishment of an experimental or permanent classification

for round-trip First-Class DVD mail. *Id.* at 56-57, 60. In that response, the Postal Service states, without explanation, that there were concerns about how such proposals would affect the second-ounce rate for First-Class Mail and how such proposals would impact volume growth in the DVD industry. *Id.* at 57, 60. The Postal Service states further that there was “a belief that existing processes were an efficient way to handle Netflix, and other DVD mail...” Postal Service Reply Brief at 57 (citing Postal Service response to GFL/USPS-145). In providing these responses, the Postal Service admitted that “[t]he lack of clear support by the largest customer in the two-way DVD industry [*i.e.*, Netflix] was a consideration.” *Id.*

[4237] In a further attempt to justify its failure to create a separate category for First-Class DVD mail, the Postal Service cites testimony of witness Barranca. *Id.* at 58-59, 61-62. In that testimony, the witness disclaims any purpose of either critiquing or defending First-Class Mail rates or Postal Service pricing policy, but proceeds to do just that by discussing considerations traditionally taken into account in establishing First-Class Mail rates. *Id.* at 52, 59. Witness Barranca asserts that “First-Class Mail rates reflect important choices of pricing policy that lie squarely within the Postal Service’ management prerogatives, and its pricing discretion and flexibility under the current statutory scheme...[and that]...[f]ailure to choose a First-Class Mail rate structure that benefits a particular mailer...[or]...disfavors any other mailer, cannot be reliably evaluated in the highly biased and incomplete context that GameFly describes.” *Id.* at 59.

[4238] These assertions by witness Barranca are true and, absent any challenge, Postal Service pricing choices will be assumed to be reasonable. However, these explanations fall short of what is needed to justify the Postal Service’s failure to pursue classification or rate changes that could eliminate the disparity in treatment of different DVD mailers when such disparities are identified in an OIG audit and are the subject of a formal complaint alleging discrimination.

[4239] The Postal Service fails to explain why a redesign of DVD letter mailers was either impossible or otherwise inappropriate. While the Commission understands that the development of rates for First-Class Mail involves consideration of numerous factors, the Postal Service offers no explanation of why the establishment of a special classification for DVD mail was impossible or otherwise undesirable. The broad generalities offered by the Postal Service fail to provide the level of specificity needed to justify either the rejection of a special classification or the decision to abandon the exploration of that possibility. In this connection, the Postal Service appears simply to have ignored the OIG Audit Report recommendation that the standards for the non-machinable surcharge be revised.

[4240] Responding to the Postal Service's argument that GameFly has failed to explain how the Postal Service's alleged failure to reclassify First-Class DVD mail or take other responsive action is related to claims of operational discrimination, GameFly asserts that these failures are part of a pattern of discrimination favoring Netflix. See GameFly Brief-NP at 42; GameFly Reply Brief at 33. While the Postal Service acknowledges that "GameFly seems to argue that the Postal Service's failures in this area establish a pattern of favoritism that supports its operations claims", it goes on to assert that each of these claims must be evaluated independently. Postal Service Reply Brief-NP at 59-60.

[4241] The Commission is not persuaded by the Postal Service's arguments. The examples relied upon by GameFly are connected and their alleged relationship bears directly on the ultimate issue of whether there has been undue discrimination. While each example requires separate examination, the implications of their combined effect cannot be ignored by accepting the Postal Service's apparent suggestion that they be strictly compartmentalized and their interconnectedness overlooked.

[4242] Similarly, the Commission does not interpret GameFly's allegations contesting specific pricing policies or rates, *per se*. Rather, GameFly is alleging that the Postal Service has discriminated against it unduly because of the combined effect on it

of the service it has received and the rates it has paid when compared to the service afforded to, and rates paid by, Netflix.

[4243] The Commission concludes that the Postal Service has failed to adequately explain why it has yet to address the operational and rate issues raised by DVD mail. The evidence cited by GameFly shows that significant issues regarding the processing and rate preferences afforded Netflix were well known within the Postal Service at both the operational and higher management levels and that several attempts were made to resolve those issues. The evidence shows further that the efforts to address those issues were ultimately abandoned in the face of Netflix opposition and without clear reasons given for the decision not to pursue a reasoned resolution. General assertions by the Postal Service in its discovery responses and the testimony of witness Barranca fail to provide a satisfactory explanation for perpetuating the then-existing processing methods and rate policies that were affording Netflix, and to a lesser extent Blockbuster, processing and rate preferences. These delays in addressing long-standing issues first formally raised by the OIG Audit Report have continued without adequate justification. This failure to act supports GameFly's contention that Netflix, and to a lesser extent Blockbuster, have been the beneficiaries of preferences which have not been extended to GameFly and other DVD mailers.

i. Netflix and Blockbuster Have Not Been Given Preferential Access to Postal Service Facilities, Employees, or Management

[4244] *Postal Service's position.* Responding to allegations by GameFly that the Postal Service has given Netflix preferential access to Postal Service facilities, employees, and management, the Postal Service asserts that Netflix's activities "are neither unique nor unusual in the postal businesses." Postal Service Reply Brief at 61. The Postal Service supports its position with the testimony of witness Seanor that "[n]either Blockbuster nor Netflix is afforded any special accommodations." Tr. 10/1738; USPS-T-3 at 16.

[4245] *GameFly's position.* GameFly's allegations of preferential access are supported by e-mails obtained from the Postal Service during discovery in which Postal Service employees refer to visits by Netflix representatives to Postal Service processing plants to observe operations; meetings between Netflix representatives and Postal Service officials; and attempts by Netflix representatives to keep Netflix mailpieces off automated processing equipment. GameFly Brief-NP at 53 n.14.

[4246] *Commission analysis.* The record reflects that Netflix is not the only mailer that attempts to influence Postal Service processing decisions. Postal Service Reply Brief at 65-66. Indeed, GameFly has, itself, sought to do the same thing. Joint Statement ¶¶ 113-15, 118, 120-21, 123. The pursuit by any mailer of its objectives by lawful means is not prohibited. Based on the record developed in this proceeding, the issue of whether the Postal Service has unlawfully discriminated against GameFly or in favor of Netflix depends upon factors other than Netflix's attempts to convince the Postal Service that it should provide manual processing of Netflix DVD return mail at the one-ounce First-Class Mail rate without imposition of a non-machinable surcharge.

V. FINDINGS AND CONCLUSIONS

A. GameFly's Allegations of Unlawful Discrimination and Preferences

[5001] *Evidentiary rulings.* In its briefs, the Postal Service challenges evidentiary rulings made by the Presiding Officer during the course of the hearings in this proceeding. For the reasons set forth in section IV.D.1. *supra*, the Commission finds those rulings to have been correct and rejects renewed challenges by the Postal Service.

[5002] *GameFly's claim that it is similarly situated to Netflix.* For the reasons set forth in section IV.D.2. *supra*, the Commission finds that GameFly is similarly situated to Netflix, Inc.

[5003] *GameFly's claim that it has received less favorable treatment.* For the reasons set forth in section IV.D.3. *supra*, the Commission finds that GameFly has received less favorable rates and terms and conditions of service than Netflix, Inc., a similarly situated customer of the Postal Service.

[5004] *Reasons offered by the Postal Service for providing GameFly less favorable treatment.* For the reasons set forth in section IV.D.4. *supra*, the Commission finds that the Postal Service has failed to establish reasonable and legitimate reasons for providing GameFly less favorable treatment than Netflix, a similarly situated customer of the Postal Service.

[5005] *GameFly's claims of discrimination.* Based upon the findings set forth in paragraphs 5001, 5002, 5003, and 5004 *supra*, the Commission finds that the Complaint of GameFly is justified and that the Postal Service has unduly discriminated against GameFly in violation of 39 U.S.C. 403(c).

[5006] *Remedy.* On the basis of its finding of undue discrimination and the record developed in this proceeding, the Commission finds that the remedy described in section V.B., *infra*, is appropriate to achieve compliance with the non-discrimination

requirements of section 403(c) and to remedy the effects of the Postal Service's non-compliance with the section.

[5007] *Filed rate doctrine.* In light of the Commission's ruling that GameFly has been discriminated against unduly and the remedy discussed below, the Commission finds no need to address GameFly's additional contention that the Postal Service has violated the filed rate doctrine.

B. Remedy

[5008] Having found GameFly's Complaint to be justified, the Commission is both required and authorized to impose an appropriate remedy:

If the Postal Regulatory Commission finds the complaint to be justified, it shall order that the Postal Service take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance (such as ordering unlawful rates to be adjusted to lawful levels, ordering the cancellation of market tests, ordering the Postal Service to discontinue providing loss-making products, or requiring the Postal Service to make up for revenue shortfalls in competitive products).

39 U.S.C. 3662(c).

[5009] The requirement that the Commission adopt a remedy is found in the statutory command that the Commission "shall" order the Postal Service to take action. The Commission's authority to impose a remedy is broadly formulated. Thus, section 3662(c) empowers the Commission to order the Postal Service to "take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any non-compliance...." Examples of possible remedies are expressly set forth in section 3662(c). That the examples are intended to be illustrative and not exclusive can be inferred from the introductory phrase "such as" which precedes the series of examples set forth in section

3662(c). This broad remedial power is consistent with, and reinforced by, 39 U.S.C. 503, the enabling provision which authorizes the Commission to “take any other action they [the Commissioners] deem necessary and proper to carry out their functions and obligations to the Government of the United States and the people as prescribed under this title.” In commenting on what became new section 3662(c), the House Committee on Government Reform stated that the new subsection “gives the Commission broad authority to correct violations by ordering the Postal Service to take whatever steps the Commission considers appropriate.” H.R. Rep. No. 109-66 at 52 (2005).

[5010] Nor is the broad remedial power bestowed upon the Commission by section 3662(c) at all uncommon. See *Exxon Mobil Corp. v. FERC*, 571 F.3d 1208, 1216 (D.C. Cir. 2009) citing *Niagra Mohawk Power Corporation v. Federal Power Commission*, 379 F. 2d 153, 159 (D.C. Cir. 1966) (“[T]he breadth of agency discretion is, if anything, at zenith when the action assailed relates primarily...to the fashioning of policies, remedies and sanctions....”).

[5011] While the Commission is broadly empowered to fashion a remedy, it is also mindful that the remedy it selects must be responsive to “the effects of any noncompliance.” In this case, the noncompliance consisted of undue discrimination against GameFly with respect to its DVD return mailers. The remedy chosen by the Commission must, therefore, address this undue discrimination and be supported by, and consistent with, the record. With the forgoing considerations in mind, the Commission turns to consideration of an appropriate remedy.

[5012] *Remedies proposed by GameFly.* To resolve the discrimination, GameFly asks the Commission to order the Postal Service to implement one or both of two remedies. The first of these would be an operational remedy, whereby the Postal Service would offer every DVD rental company a measureable and enforceable level of manual culling and processing of DVD mailers sent at machinable letter rates. The extent of manual culling and processing would be equal to that currently achieved for Netflix. Further, GameFly states that the remedy must be implemented through a

directive of national scope and effectiveness, and that the Commission should require sufficient data reporting by the Postal Service to measure and ensure compliance with the ordered remedy. GameFly Brief at 4-5.

[5013] The second remedy sought by GameFly is rate-based. The Postal Service would be required to publish a reduced rate for flat-shaped DVD mailers sent and received by GameFly and other DVD rental companies. The rate sought by GameFly is one designed to produce the same average contribution per piece as that generated by Netflix letter-shaped DVD mailers. *Id.* at 5-6.

[5014] GameFly's proposed operational remedy would require the Postal Service to achieve very high percentages of manual culling and processing of DVD mailers from a variety of companies.⁵⁷ Such a remedy has at least two potentially serious drawbacks. First, it necessarily requires the Commission to involve itself in operational matters which have, to date, been almost exclusively the prerogative of the Postal Service. The Commission is reluctant to assume responsibility for the kind of day-to-day oversight of mail processing operations envisioned by GameFly's proposed operational remedy. This is not to suggest that an operational remedy may never be warranted. On this record, however, the Commission will not impose it.

[5015] Second, in addition to requiring the collection and reporting of a significant amount of data on the extent to which Netflix, GameFly, and other DVD mailers' return mail is processed on the various types of letter processing equipment, and manually, it is unclear how an operational remedy could reasonably be enforced. Thus, that remedy could cause the Postal Service to incur potentially significant administrative costs.

⁵⁷ The operational relief sought by GameFly would impose manual culling and processing to "the same extent that Netflix receives." *Id.* at 4. The manual culling and processing afforded to Netflix occurs principally, if not exclusively, for return pieces inbound from subscribers to Netflix. Therefore, the Commission's analysis of this remedy focuses on the treatment of return pieces.

[5016] For these reasons, the Commission does not find it appropriate to impose the operational remedy proposed by GameFly, nor is it able to develop modifications to protect against the imposition of potentially large costs on the Postal Service, mailers, and the Commission itself.

[5017] GameFly's proposed alternative price-based remedy would preserve the Postal Service's discretion to manage its operational treatment of each mailer's DVD mailers. Rather than creating operational parity with Netflix, the proposed rate-based remedy seeks parity of rate treatment.

[5018] The testimony and supporting workpapers of witness Glick develop an estimate of the cost difference between Netflix and GameFly round-trip DVD mailers. The difference between the round-trip postage paid by a GameFly piece and a Netflix piece is much greater than the estimated cost difference. GFL-T-1 at 2 (nonpublic). GameFly's remedy is intended to reduce the round-trip price paid by GameFly (and other DVD rental companies that use flat-shaped mailers) to the point where the rate difference would equal the cost difference, and DVD flats and DVD letter mailers would generate the same contribution per piece. GameFly Brief at 5-6.

[5019] The Commission has examined the models used by witness Glick to estimate the cost differences between Netflix and GameFly round-trip mailers. Even if the Commission were to accept GameFly's contention that the cost differences do not justify the extent of the difference in rates paid by the mailers, such estimates are not sufficiently accurate to be used to design a rate for flat-shaped round-trip DVD mailers in the manner suggested by GameFly's rate-based remedy.

[5020] Moreover, there are pricing differences that exist between First-Class letters and flats. Pricing products to fairly balance the multiple policies, objectives, and factors of title 39 is, in the first instance, a responsibility of the Postal Service. The Commission prefers to allow the Postal Service to exercise statutory flexibility in this area. A given mailer is not necessarily entitled to pay the same contribution as another

mailer when they enter mail with different characteristics.⁵⁸ Significantly, in this regard, GameFly's alternate remedy fails to directly address the consequences of the preferential treatment afforded Netflix. Thus, the Commission will not adopt Netflix's alternate remedy.

[5021] *Separate rates for round-trip DVD mail.* Nevertheless, there is sufficient basis to justify, and information to quantify, a rate-based remedy that is based on the relationship between the mailpiece design used by each mailer to avoid automated letter processing of return pieces, and how the Postal Service has applied the existing rate schedule. As discussed below, the remedy chosen by the Commission, in fact, creates a niche classification for round-trip letter and flats DVD mailers. The Postal Service has previously created niche classifications for mailpieces with unique characteristics. See PRC Op. MC99-1, *Classification and Fees for Weight-Averaged Nonletter Size Business Reply Mail*.

[5022] The Commission finds that the appropriate remedy is for the Postal Service to offer a reduced rate for round-trip flat-shaped DVD mailers weighing up to two ounces. The rate is designed to ameliorate the disparate treatment in the Postal Service's current application of the rate schedule to Netflix's and GameFly's mailpiece designs. Each of these mailers has taken steps to ensure that its return pieces avoid automated letter processing, but to date the Postal Service's application of its rate schedule to the mailer's pieces has resulted in undue preferences for Netflix, *vis-a-vis* GameFly and other DVD mailers.

[5023] GameFly wants its pieces to avoid automated letter processing, but the Postal Service is unable to promise a reasonable likelihood that will happen even if GameFly return pieces are letters that bear postage, including the non-machinable surcharge and instructions to avoid processing on automated equipment. Therefore, to

⁵⁸ It also is not inappropriate for mailers of items with different characteristics to make identical contributions. Rates that are established within broad classes and products will often result in such a circumstance.

achieve this result, GameFly mailpieces are sent as flats. Even then, GameFly flats were too often processed on automation letter machines. GameFly was advised that to avoid automated letter processing, its pieces had to be thick enough to be automatically culled. Mailing GameFly pieces that thick resulted in additional weight that required them to pay additional postage.

[5024] Netflix also prefers its return mail to avoid processing on automated equipment likely to damage its DVDs. Netflix return mail is effectively non-machinable. However, in contrast to GameFly, which is required to pay the additional postage associated with the extra weight it adds to assure manual processing, Netflix does not pay the additional postage that would ordinarily be associated with the additional costs of non-machinability. This disparate treatment is totally apart from any local processing decisions made by local employees, and establishes the disparity between the treatment that each mailer receives from the Postal Service and the prices that it pays.

[5025] With these relationships between costs and rates in mind, the Commission has developed a remedial rate that provides GameFly with relief from the increased postage associated with its efforts to ensure that it avoids automation letter equipment (additional ounce charge), similar to the relief that the Postal Service has granted Netflix from the increased postage that would be associated with its efforts to ensure that it avoids automation letter equipment (non-machinable surcharge).

[5026] For the forgoing reasons, the Commission instructs the Postal Service to offer a rate for First-Class Mail round-trip letter-shaped DVD mailers sent to and from subscribers that weigh up to one ounce. The outbound to subscriber rate shall be the applicable presort First-Class one-ounce letter rate. The inbound from subscriber rate shall be the applicable single-piece First-Class one-ounce letter rate. These pieces will not be subject to the non-machinable surcharge.

[5027] The Commission also instructs the Postal Service to offer a rate for First-Class Mail round-trip flat-shaped DVD mailers sent to and from subscribers that

weigh up to two ounces. The base rate for each leg (outbound to subscriber or inbound from subscriber) shall be the one-ounce single-piece First-Class Mail flat rate. Flat-shaped DVD mail may qualify for presort discounts on the outbound leg. The return leg, by its nature, does not lend itself to presorting. These pieces will not be subject to additional ounce charges.

[5028] To qualify for either the letter- or flat-shaped round-trip DVD rate, the pieces must be sent to and from subscribers. Mailers will be required to pay the postage for the return leg using either Business Reply Mail (BRM) or Permit Reply Mail (PRM). Qualifying pieces will also be required to contain a standard 12 centimeter or smaller optical disc, and the return pieces must be picked up by the mailer at designated Postal Service facilities.

[5029] The difference in the rates that will be paid by Netflix and GameFly under the remedy is justified by cost differences and by general pricing differences between the First-Class Mail flat and letter products.⁵⁹ Additional rate differences may arise between users depending on whether a given mailer presorts its outbound pieces. Such differences are the result of reasonable pricing differences that exist between the various single-piece and presort rates applicable to First-Class Mail letters and flats.

[5030] The price granted by the remedy is not as low as the alternative remedy sought by GameFly, and even at this rate, GameFly mail may continue to generate more than double the contribution per piece than Netflix mail. However, the remaining rate disparity is reasonable in light of the differences between letter-shaped and flat-shaped round-trip DVD mailers. By making the letter-shaped and flat-shaped round-trip DVD mailer rates available to all qualifying mailers, any potential discrimination against other similarly situated mailers is also remedied.

⁵⁹ The term “pricing” as used here refers to the cost coverage or contribution for a given product, which is often expressed either as a percentage or per-piece amount, respectively.

[5031] *Implementation of the remedy.* As noted at the beginning of this section, the Commission has broad authority under section 3662(d) to fashion an appropriate remedy when it finds a complaint to have been justified. Since this is the first proceeding under section 3662 in which the Commission will impose a remedy, it is appropriate not only to specify the content of the remedy as discussed above, but to give the Postal Service both adequate direction regarding the form of the remedy and adequate time to implement the remedy.

[5032] Attached to this Order as Appendix B is Mail Classification Schedule language that sets forth the terms of the pricing remedy established by this Order for round-trip DVD letter and flats mailers.

[5033] Within 15 days of the date of issuance of this Order, the Postal Service shall file with the Commission a notice stating the date upon which Appendix B and the rates and terms and conditions contained therein shall be implemented. Such implementation date shall not be more than 60 days following the date of issuance of this Order. For good cause shown, the Commission may extend the implementation date by up to 30 days.

[5034] Not later than 45 days prior to the implementation date of Appendix B, the Postal Service shall provide public notice of rates and terms and conditions contained in Appendix B.

[5035] In directing the Postal Service to implement the forgoing remedy, the Commission does not intend to preclude the Postal Service from exercising its statutory rights to propose future changes to the rates and terms and conditions of service for DVD mailers. The Postal Service remains free to propose any such changes in accordance with applicable regulatory requirements and subject to Commission review.

VI. ORDERING PARAGRAPHS

It is ordered:

1. The Mail Classification Schedule language designed to remedy the undue discrimination is set forth in Appendix B and is hereby adopted. The Postal Service shall implement the remedy within 60 days of the date of issuance of this Order.
2. Within 15 days of the date of issuance of this Order, the Postal Service shall file with the Commission a notice stating the date upon which the provisions of the Mail Classification Schedule contained in Appendix B shall be implemented.
3. Not later than 45 days prior to the implementation date of Appendix B, the Postal Service shall provide public notice of the rates and terms and conditions set forth in the Mail Classification Schedule language contained in Appendix B.
4. All motions not otherwise acted upon in this Order are hereby denied.

By the Commission.

Ruth Ann Abrams
Acting Secretary

Concurring Opinion of Commissioner Hammond

I reluctantly join with the majority in this decision. My reluctance stems from concern that the Postal Service and its current and potential customers may misinterpret the Commission's finding.

The Postal Service worked with a customer, Netflix, to help its business thrive through the use of the mail. The Postal Service should work with current and potential customers. Netflix explained to the Postal Service what treatment would be most helpful to it. There is nothing wrong with that. In fact, the Postal Service should encourage this type of communication. I hope this decision does not discourage the Postal Service from helping businesses to use the mail.

This was a lengthy and complex case. The Postal Service offered multiple defenses, many of which struck me as, at best, strained. For instance, I am not convinced that management is powerless to stop local officials from following unnecessarily expensive operating practices. As our decision rightly points out, the Postal Service cannot insulate itself from local postal operations. There was also substantial time devoted to procedural controversies. Some may argue that delays for these reasons are an inescapable part of major litigation, but these essentially peripheral issues may have distracted the Postal Service from presenting convincing evidence on the merits of the case.

Tony L. Hammond, Commissioner

Complaint of GameFly, Inc., Docket No. C2009-1
Rulings by the Presiding Officer

1. Presiding Officer's Ruling C2009-1/1, Presiding Officer's Ruling Establishing Procedural Schedule, July 30, 2009
2. Presiding Officer's Ruling C2009-1/2, Presiding Officer's Ruling Certifying Joint Motion for Establishing Protective Conditions to the Commission, August 21, 2009
3. Presiding Officer's Ruling C2009-1/3, Presiding Officer's Ruling Granting Extension of Time, September 4, 2009
4. Presiding Officer's Ruling C2009-1/4, Presiding Officer's Ruling Granting Conditional Limited Access to Discovery Material Filed Under Seal, September 25, 2009
5. Presiding Officer's Ruling C2009-1/5, Presiding Officer's Ruling Granting, in Part, GameFly's Motion to Compel Responses to Discovery Requests GFL/USPS-3(e), 4(e), 6(a)-(e), (g)-(h), 7, 8, 14(e), 15, 16(f)-(g), 20(a)-(d), 21, 28, 29, 31, 40, and 41(c), September 28, 2009
6. Presiding Officer's Ruling C2009-1/6, Presiding Officer's Ruling Granting GameFly's Motion to Compel Responses to Discovery Requests GFL/USPS-79 and 80, October 1, 2009
7. Presiding Officer's Ruling C2009-1/7, Presiding Officer's Ruling Granting Motion of the United States Postal Service for Extension of Time in Which to Reply to the Motion of GameFly, Inc. to Unseal Certain Documents Produced in Discovery, October 7, 2009
8. Presiding Officer's Ruling C2009-1/8, Presiding Officer's Ruling Denying GameFly's Motion to Compel Production of Three Documents Withheld by the United States Postal Service, October 13, 2009
9. Presiding Officer's Ruling C2009-1/9, Presiding Officer's Ruling Granting Motion for Late Acceptance, October 16, 2009

10. Presiding Officer's Ruling C2009-1/10, Presiding Officer's Ruling Granting, in Part, GameFly's Motion to Compel Responses to Discovery Requests GFL/USPS-84, 85, 99, 100, 109, 151 and 152(d); and 117, 122 and 129 Filed Under Seal, November 4, 2009
11. Presiding Officer's Ruling C2009-1/11, Presiding Officer's Ruling Concerning Procedural Schedule, November 9, 2009
12. Presiding Officer's Ruling C2009-1/12, Presiding Officer's Ruling on Motion to Show Cause Why Certain Documents Should Not Be Unsealed, November 18, 2009
13. Presiding Officer's Ruling C2009-1/13, Presiding Officer's Ruling on Motions to Unseal, December 7, 2009
14. Presiding Officer's Ruling C2009-1/14, Presiding Officer's Ruling Granting Motions for Late Acceptance, December 7, 2009
15. Presiding Officer's Ruling C2009-1/15, Presiding Officer's Ruling on Motion of GameFly, Inc. to Schedule Status Conference, January 13, 2010
16. Presiding Officer's Ruling C2009-1/16, Presiding Officer's Ruling Regarding Outstanding Motions for Late Acceptance, March 19, 2010
17. Presiding Officer's Ruling C2009-1/17, Presiding Officer's Ruling on Postal Service Claims of Confidentiality and Privilege, April 15, 2010
18. Presiding Officer's Ruling C2009-1/18, Presiding Officer's Ruling Establishing Scheduling Conference, April 27, 2010
19. Presiding Officer's Ruling C2009-1/19, Presiding Officer's Ruling Clarifying Effective Dates, April 29, 2010
20. Presiding Officer's Ruling C2009-1/20, Presiding Officer's Ruling Establishing Procedural Schedule, May 7, 2010

21. Presiding Officer's Ruling C2009-1/21, Presiding Officer's Ruling Establishing Procedural Deadlines for Presenting Unresolved Discovery Disputes to the Presiding Officer, May 21, 2010
22. Presiding Officer's Ruling C2009-1/22, Presiding Officer's Ruling Modifying Procedural Schedule, June 9, 2010
23. Presiding Officer's Ruling C2009-1/23, Presiding Officer's Ruling Granting, in Part, Postal Service's Motion to Compel Responses to Discovery Requests USPS/GFL-5, 8, 16, 26, 28, 38, 39, 46, 49, 50, 51, 52(e), 54, and 60, June 10, 2010
24. Presiding Officer's Ruling C2009-1/24, Presiding Officer's Ruling Granting, in Part, Postal Service Motion for Institutional Witness, July 6, 2010
25. Presiding Officer's Ruling C2009-1/25, Presiding Officer's Ruling Correcting Transcripts Volumes 3 and 4 and Other Procedural Matters, July 8, 2010
26. Presiding Officer's Ruling C2009-1/26, Presiding Officer's Ruling Establishing Date for Cross-Examination of GameFly's Institutional Witnesses, July 15, 2010
27. Presiding Officer's Ruling C2009-1/27, Presiding Officer's Ruling Granting, in Part, Postal Service's Motion to Maintain Its Direct Testimony Under Seal, July 16, 2010
28. Presiding Officer's Ruling C2009-1/28, Presiding Officer's Ruling Granting Motion of the Public Representative for Access, July 20, 2010
29. Presiding Officer's Ruling C2009-1/29, Presiding Officer's Ruling Granting Motion of the Public Representative for Access, July 20, 2010
30. Presiding Officer's Ruling C2009-1/30, Presiding Officer's Ruling Regarding Oral Cross-Examination of GameFly Institutional Witnesses, July 20, 2010
31. Presiding Officer's Ruling C2009-1/31, Presiding Officer's Ruling on Procedures for Oral Cross-Examination of GameFly's Institutional Witnesses, July 23, 2010

32. Presiding Officer's Ruling C2009-1/32, Presiding Officer's Ruling on Postal Service's Motion for Reconsideration or Clarification, July 27, 2010
33. Presiding Officer's Ruling C2009-1/33, Presiding Officer's Ruling on the Order of Witnesses Appearances and Related Matters, August 25, 2010
34. Presiding Officer's Ruling C2009-1/34, Presiding Officer's Ruling Shortening Time for Responses, August 26, 2010
35. Presiding Officer's Ruling C2009-1/35, Presiding Officer's Ruling Granting GameFly's Motion to Postpone Hearing, August 31, 2010
36. Presiding Officer's Ruling C2009-1/36, Presiding Officer's Ruling Modifying the Witness Order, September 1, 2010
37. Presiding Officer's Ruling C2009-1/37, Presiding Officer's Ruling Correcting Transcript Volumes 5 and 6, September 14, 2010
38. Presiding Officer's Ruling C2009-1/38, Presiding Officer's Ruling Rescheduling the Rebuttal Hearings and Related Matters, September 16, 2010
39. Presiding Officer's Ruling C2009-1/39, Presiding Officer's Ruling on the Treatment of Netflix Comments, September 24, 2010
40. Presiding Officer's Ruling C2009-1/40, Presiding Officer's Ruling Granting, in Part, and Denying, in Part, GameFly's Motion to Compel, October 1, 2010
41. Presiding Officer's Ruling C2009-1/41, Presiding Officer's Ruling on Objections to Admission of GFL-CX-1, October 18, 2010
42. Presiding Officer's Ruling C2009-1/42, Presiding Officer's Ruling Concerning Briefing, October 27, 2010

43. Presiding Officer's Ruling C2009-1/43, Presiding Officer's Ruling Granting, in Part, and Denying, in Part, GameFly's Motion on GFL-CX-5, November 4, 2010
44. Presiding Officer's Ruling C2009-1/44, Presiding Officer's Ruling Granting GameFly's Motion to Extend Date for Filing Appendices, November 5, 2010
45. Presiding Officer's Ruling C2009-1/45, Presiding Officer's Ruling Granting the October 29, 2010 Motions of GameFly and the Public Representative, November 8, 2010
46. Presiding Officer's Ruling C2009-1/46, Presiding Officer's Ruling Denying Motion to Strike, Resolving Remaining Motions, and Closing the Record, November 8, 2010

**Complaint of GameFly, Inc., Docket No. C2009-1
Mail Classification Schedule Language**

1100 First-Class Mail

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1110 Presorted Letters/Postcards

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1110.3 Price Categories

The following price categories are available for the product specified in this section:

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- Letter Round-Trip Mailer

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Letter Round-Trip Mailer

- a. Letter Round-Trip Mailer service allows a mailer to send a letter-shaped mailpiece to a subscriber at the applicable Presorted Letters/Postcards price and pay postage for the return of the contents of that mailpiece at the Single-Piece Machinable Letters price.
- b. A mailer may either prepay postage for the return mailpiece by using Permit Reply Mail or only pay for mailpieces actually returned by using Business Reply Mail.
- c. Qualifying pieces must contain a standard 12 cm or smaller optical disc.
- d. Qualifying pieces must weigh no more than one (1) ounce.
- e. Returned pieces must be picked up by the mailer at designated Postal Service facilities.
- f. Letter Round-Trip Mailers are not subject to prices for:
 - (i) the Nonmachinable Letters price category of Presorted Letters/Postcards, or
 - (ii) the Single-Piece Nonmachinable Letters price category of Single-Piece Letters/Postcards.

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1115 Flats

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1115.3 Price Categories

The following price categories are available for the product specified in this section:

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- Flat Round-Trip Mailer

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Flat Round-Trip Mailer

- a. Flat Round-Trip Mailer service allows a mailer to send a flat-shaped mailpiece to a subscriber at the applicable one (1) ounce Flats price and pay postage for the return of the contents of that mailpiece at the one (1) ounce Single-Piece Flats price.
- b. A mailer may either prepay postage for the return mailpiece by using Permit Reply Mail or only pay for mailpieces actually returned by using Business Reply Mail.
- c. Qualifying pieces must contain a standard 12 cm or smaller optical disc.
- d. Pieces weighing no more than two (2) ounces qualify for the one (1) ounce rate.
- e. Returned pieces must be picked up by the mailer at designated Postal Service facilities.