

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

COMPLAINT OF GAMEFLY, INC.

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Docket No. C2009-1

COMPLAINT OF GAMEFLY, INC.

1. Pursuant to 39 U.S.C. § 3662, GameFly, Inc. ("GameFly") respectfully submits this complaint against the United States Postal Service ("Postal Service").

2. The complaint involves the rates and service provided by the Postal Service to customers who use First-Class Mail to send and receive DVDs. The rates and service offered to DVD mailers 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.

3. The Commission has jurisdiction over this complaint pursuant to 39 U.S.C. § 3662.

4. Notices and communications about this matter should be sent to:

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I. FACTUAL ALLEGATIONS

A. GameFly's Business

5. GameFly is a company incorporated in Delaware and headquartered in Los Angeles, California.

6. Founded in 2002, GameFly has become the leading online video game rental service. With a choice of more than 6,000 titles, GameFly offers a wide selection of games for the Playstation 3, Playstation 2, PSP, Xbox 360, Xbox, Wii, GameCube, Nintendo DS and GameBoy Advance.

7. GameFly charges subscribers by the month, not by the game. For a flat monthly fee, a GameFly subscriber may rent as many games as desired, and play them as long as desired, with free shipping, no due dates and no late fees. A monthly subscription price of \$15.95 a month (plus any applicable state or local tax) allows a subscriber to rent one game at a time. A monthly subscription price of \$22.95 a month (plus tax) allows a subscriber to rent two games at a time. A monthly subscription price of \$36.95 (plus tax) allows a subscriber to rent four games at a time. When the subscriber returns the game(s) to GameFly, GameFly mails to the subscriber the next game(s) previously chosen by the subscriber. Subscribers also have the option of buying games rather than returning them.

8. Consumers subscribe to GameFly, and maintain and update lists of desired games, through the company's web site, www.gamefly.com.

9. GameFly also sells used video games.

10. The games rented and sold by GameFly are recorded on DVDs. GameFly distributes its video game DVDs to subscribers via First-Class Mail. GameFly currently enters these mailings at Postal Service facilities in Los Angeles, Pittsburgh, Tampa, and Austin, the four cities where GameFly has shipping centers. GameFly prepays the postage for these mailings.

11. Subscribers return the video game DVDs to GameFly in preaddressed reply mailers via First-Class Mail Business Reply Mail ("BRM"). GameFly pays the postage and fees for these return mailings through a BRM account with the Postal Service.

12. GameFly, like many other businesses that rent DVDs to consumers, uses a two-way DVD mailer. The outer face of the mailer is addressed to the subscriber. To use the mailer for the return trip, the subscriber tears off the outer face to reveal an inner face with the BRM indicia and a GameFly mailing address. Attached as Attachments A and B are images of the outer and inner faces of the mailers currently used by GameFly.

13. GameFly currently mails approximately 590,000 DVDs to its subscribers per month, and receives approximately 510,000 DVDs in return mail from its subscribers per month.

14. GameFly's monthly mail volume has increased by approximately 140 percent since February 2006, a compounded annual growth rate of 34 percent.

15. In July 2008, shortly after GameFly opened its distribution center in Austin, Texas, the Postal Service issued a news release noting the opening of the facility and touting the role of the Postal Service in helping GameFly grow:

LET THE GAMES BEGIN

Austin's service lures company

GameFly may be a relatively new company, but it's using an old idea—getting USPS to help it grow.

Company founders modeled the video game rental company on Netflix, the movie rental-by-mail mogul. Like Netflix, pre-paid postage on all GameFly's rentals is included with membership.

GameFly just opened its fourth distribution center – this one in Austin, TX. Why Austin? One of the company's co-founders recently told a reporter that “the city's excellent U.S. Postal Service facility” was a big factor.

Los Angeles-based GameFly stocks and mails about 6,000 game titles from distribution centers in L.A., Pittsburgh, PA, Tampa, FL, and – now – Austin. *Grand Theft Auto IV*, *Mario Kart Wii*, *Call of Duty 4* and *Halo 3* are currently the most-requested games.

USPS News Link (July 2, 2008).

B. GameFly's Problems with Mail Service

16. A DVD is small and light enough so that, when mailed in a lightweight mailer, the combined mailpiece can qualify as a one-ounce letter. Since the beginning of GameFly's operations, however, the company has experienced breakage of DVDs in the mail, particularly when the DVDs are enclosed in lightweight mailers without protective inserts.

17. Testing by GameFly and Postal Service personnel has revealed that breakage occurs during the processing of DVD mailers on Postal Service automated mail processing equipment.

18. A new video game DVD costs GameFly as much as \$50 to purchase.

19. In an effort to reduce the breakage of DVDs in transit, GameFly began inserting cardboard protectors into its DVD mailers in November 2002, about one month after the company began operations. The protectors reduced, but did not eliminate, the breakage. Moreover, the protectors increased the size and weight of the mailpieces enough to require their mailing as two-ounce flats.

20. In July 2007, in response to the rate increases on flat-shaped First-Class Mail in Docket No. R2006-1, GameFly began working with the Postal Service to test a variety of designs of mailers without a protective insert. The tests, which continued until July 2008, involved four progressively larger designs. While increasing the external dimensions of the mailer tended to reduce the breakage rate, even the largest of the test mailers had a breakage rate of almost two percent (approximately double the breakage rate the GameFly currently experiences with a protective insert).

21. The test results persuaded GameFly to continue using a mailer with a cardboard protective insert, despite the added weight and postage.

22. Moreover, the Postal Service failed to stop breaking GameFly DVDs despite collecting the higher rates charged for flat-shaped First-Class Mail, and even after GameFly began marking its mailers with warnings such as **"FIRST-CLASS MAIL FLAT"** and **"PROCESS ON AFSM-100"**.

23. On the advice of Postal Service operating personnel, GameFly tested a variety of alternative mailer and insert designs in 2007 and 2008. The only design that significantly reduced the breakage rate was a mailer with a protective insert for the DVD. Adding the protective insert, however, increases the total weight of the mailer and contents above one ounce, thereby requiring the payment of postage for a two-ounce First-Class flat. Moreover, even with this added level of protection, GameFly still experiences a DVD breakage rate of approximately one percent per mailing.

24. In addition to breakage, GameFly DVD mailers have also experienced substantial rates of loss in transit. The Office of Inspector General and the Postal Inspection Service have made vigorous efforts to control the problem. OIG/Postal Inspection Service investigations have led to the arrest of 19 Postal Service employees for alleged theft of GameFly DVDs at a number of Postal Service facilities. Fourteen of the arrests have occurred since the beginning of 2007. These enforcement initiatives have reduced, but not eliminated, the losses.

25. The problems described above have greatly increased mailing costs. The postage for a DVD mailer entered as a one-ounce letter is \$0.42. The postage for the same mailpiece entered as a flat is \$0.83. The postage for a DVD mailer entered as a two-ounce flat with a protective insert is \$1.00.¹ Loss or theft in transit costs an additional \$0.22 or so per trip. Even with a protective sleeve heavy enough to require the payment of second-ounce postage, the breakage rate still costs GameFly approximately \$0.08 in DVD breakage per trip. The cumulative result is that an average

¹ On May 11, 2009, when the rate changes adopted in Docket No. R2009-2 take effect, the \$0.42, \$0.83 and \$1.00 rates will become \$0.44, \$0.88 and \$1.05, respectively.

DVD mailing costs GameFly approximately \$1.30 in postage and damaged and lost merchandise—almost 88 cents per piece more than the postage for a one-ounce letter.

C. GameFly's Efforts to Find a Solution in Cooperation with the Postal Service

26. GameFly has had multiple meetings and telephone calls with the Postal Service since late 2007 in an effort to find a mutual solution for the problems described above.

27. In October 2007, GameFly met with the Postal Service Operations and Engineering groups.

28. In December 2007, GameFly again met with the Postal Service Operations and Engineering groups as well as the Pricing Group.

29. Also in December 2007, GameFly tested a variety of mailer configurations at the USPS facility in Merrifield, Virginia, in an effort to design a mail piece that would be mechanically culled by USPS equipment out of the letter mailstream and into the flats mailstream.

30. In September 2008, GameFly again met with the Postal Service Operations, Engineering, and Pricing groups.

31. From July 2007 to July 2008, GameFly performed "live mail" tests of multiple mailer configurations.

32. Beginning in December 2007, when it became evident that an operational solution was not forthcoming, GameFly asked the Postal Service to offer in the

alternative 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. GameFly made these requests at meetings with the Postal Service's current Manager, Pricing Strategy; the previous Manager, Pricing Strategy; and the Postal Service's then-Senior Vice President, Mailing Services.

33. The Postal Service, however, declined to include any such relief in the price and classification changes implemented in May 2008 in Docket No. R2008-1, the changes proposed in Docket No. R2009-2 (and approved by the Commission on March 16, 2009), or in any separate docket.

34. To date, apart from enforcement actions against pilferage in transit, the Postal Service has not provided relief from the problems described above.

D. Preferential Treatment for Other DVD Mailers

35. GameFly is not the only mailer to experience significant DVD breakage rates on automated mail processing equipment. In response to this phenomenon, the Postal Service has adopted a practice of manually culling out the DVD mailers of two high-volume shippers of DVDs, Netflix and Blockbuster, for special processing.

36. A report by the Postal Service's Office of Inspector General in November 2007 found that 70 percent of the two-way DVD mailers from one unnamed DVD rental company received manual processing for this reason. USPS Office of Inspector General, Audit Report No. MS-AR-08-001, Review of Postal Service First-Class Permit Reply Mail (November 8, 2007).

37. The Postal Service's practice of giving manual processing to DVDs from certain large mailers has continued since the OIG report. On routine visits to multiple Postal Service facilities, GameFly's employees have observed that a large percentage of mail pieces from Netflix and Blockbuster are culled from the automated letter processing stream.

38. GameFly has asked the Postal Service to give GameFly's DVD mailers processing on terms and conditions comparable to the terms and conditions offered to two larger DVD mailers, Blockbuster and Netflix. The Postal Service has not done so.

39. Until recently, none of the larger-volume DVD rental companies offered video games. On February 11, 2009, however, Blockbuster, which hitherto had offered only movie DVDs (which GameFly does not offer), announced that Blockbuster was expanding its DVD rental service to include video games in the second quarter of 2009. As a result of this initiative, GameFly now faces direct competition from a rival that is larger and longer established—and which, because of the preferential treatment given by the Postal Service, enjoys a substantial cost advantage in the distribution of its DVDs to consumers.

E. Nature of the Evidence that GameFly Has or Expects To Obtain During Discovery To Support the Facts Alleged in the Complaint (Rule 3030.10(a)(5))

40. GameFly intends to support paragraphs 5-39, *supra*, with documentary evidence possessed by GameFly and the testimony of GameFly employees.

41. GameFly expects to seek additional documentary evidence in the following categories from the Postal Service in discovery:

- Formal or informal directives from Postal Service headquarters concerning the processing that should be given to DVDs mailed to or from Netflix, Blockbuster, GameFly and similarly situated mailers.
- Formal or informal directives from local or district employees of the Postal Service concerning the processing that should be given to DVDs mailed to or from Netflix, Blockbuster, GameFly and similarly situated mailers.
- Confirm scan data and other business records regarding the extent to which DVD of Netflix, Blockbuster, GameFly and similarly situated mailers have been processed on letter sorting equipment, flats sorting equipment, or manually.
- Documents regarding the processing actually given to DVDs.
- Documents regarding DVD breakage and potential solutions.
- Documents regarding the actions (if any) taken by the Postal Service in response to OIG Audit Report No. MS-AR-08-001, *Review of Postal Service First-Class Permit Reply Mail* (November 8, 2007).
- Internal Postal Service electronic and paper communications regarding the treatment of GameFly's DVD mail pieces.
- Internal Postal Service electronic and paper communications regarding the treatment of Netflix and Blockbuster's DVD mail pieces.

42. GameFly reserves the right to seek additional discovery as justified by the Postal Service's pleadings and evidence.

F. Related Proceedings (Rule 3030.10(a)(7))

43. None of the issues raised in this Complaint are pending in or have been resolved by an existing Commission proceeding or a proceeding in any other forum in which GameFly is a party.

G. Certification Regarding Attempts To Meet or Confer To Resolve or Settle Complaint (Rule 3030.10(a)(9))

44. As stated in paragraphs 26-34, GameFly had multiple meetings and telephone calls with members of the Postal Service's Operations, Engineering, Pricing and Mailing Services groups from late 2007 through the end of 2008 in an effort to find a mutual solution for the problems described above. These communications did not result in any proposed solution or settlement offer from the Postal Service.

45. Beginning in January 2009, counsel for GameFly sent several requests to legal counsel for the Postal Service for a settlement proposal from the Postal Service. These communications did not produce any response from the Postal Service.

46. On March 23, 2009, Gamefly sent an email to Daniel J. Foucheaux, Jr., Chief Counsel, Pricing and Product Support, for the Postal Service, requesting a meeting by April 22, 2009 to resolve or settle the issues stated in this complaint. A draft of this Complaint was attached to the email. Mr. Foucheaux confirmed on March 26, 2009, that he had received the email. The Postal Service did not further respond to the email.

47. On March 26, 2009, GameFly sent a letter to Mary Ann Gibbons, the Postal Service's General Counsel, requesting a meeting by April 22, 2009 to resolve or settle the issues stated in this complaint. A draft of this Complaint was attached to the letter. Neither Ms. Gibbons nor any other employee of the Postal Service has responded to the letter.

II. CAUSES OF ACTION

A. Count I: Unlawful Discrimination Among DVD Mailers

48. GameFly incorporates paragraphs 1-39 by reference.

49. The Postal Service's practice of manually processing the DVDs entered by certain large DVD mailers as one-ounce letters, while failing to offer similar treatment to the DVDs of GameFly and other similarly situated mailers, violates 39 U.S.C. § 403(c), which prohibits undue or unreasonable discrimination and undue preferences and prejudices among users of the mail.

B. Count II: Unlawful Discrimination Among Flats Mailers

50. GameFly incorporates paragraphs 1-39 by reference.

51. The Postal Service's practice of providing flats processing to most mail matter entered at the higher rates for flat-shaped First-Class Mail, while providing letter processing to DVDs entered at rates for flats by GameFly and similarly situated mailers unless they also pay the second-ounce rate, violates 39 U.S.C. § 403(c), which prohibits undue or unreasonable discrimination and undue preferences and prejudices among users of the mail.

C. Count III: Failure To Provide Reasonable And Equitable Rates and For DVDs Entered At First-Class Rates For One-Ounce Flats

52. GameFly incorporates paragraphs 1-39 by reference.

53. The Postal Service's practice of collecting flats rates for DVDs entered by GameFly and similarly situated mailers as First-Class flats, but processing the same DVDs on letter-sorting equipment unless the mailer also pays second-ounce postage, is an unreasonable practice in violation of 39 U.S.C. § 404(b).

D. Count IV: Failure To Provide Reasonable And Equitable Rates and For DVDs Entered At First-Class Rates For Flats

54. GameFly incorporates paragraphs 1-39 by reference.

55. The Postal Service's practice of collecting flats rates for DVDs entered by GameFly and similarly situated mailers as First-Class flats, but failing to process the DVDs on flats-sorting equipment, is an unreasonable practice in violation of 39 U.S.C. § 404(b).

III. RELIEF REQUESTED

56. In light of the foregoing, GameFly respectfully requests that the Commission (1) promptly hold hearings on this complaint and (2) on the basis of the resulting record, prescribe reasonable and nondiscriminatory rates and terms of service for GameFly.

57. This relief should include, *inter alia*, an order prescribing the same prices and terms of service for GameFly, including the same degree of manual processing,

that the Postal Service provides to Netflix and Blockbuster. GameFly reserves the right to propose additional forms of relief as the evidentiary record justifies.

Respectfully submitted,

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Counsel for GameFly, Inc.

April 23, 2009

CERTIFICATE OF SERVICE

I hereby certify that a copy of this Complaint has been served today in compliance with Rule 3030.11 by email addressed to sandra.t.broadus@usps.gov.

April 23, 2009

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Image of Outer Face of GameFly Mailer
(for outbound mailing to subscriber)



Image of Inner Face of GameFly Mailer
(for return mailing to GameFly)

