

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Robert G. Taub, Vice Chairman;
Mark Acton;
Tony Hammond; and
Nanci E. Langley

Competitive Product List
Adding Round-Trip Mailer

Docket No. MC2013-57

COMMENTS OF NETFLIX, INC.

(August 15, 2013)

Netflix, Inc. (Netflix) submits these Comments pursuant to Order No. 1794,¹ which opened this docket to consider the Postal Service's Request to create a new Competitive Product to replace existing Market-Dominant mailer options for DVD mail.² Netflix is the mailer with the greatest volume of mail that would be affected by this proposal.³

¹ Order No. 1794, Docket No. MC2013-57, Notice and Order on Request to Add Round-Trip Mailer Product to Competitive Product List, July 30, 2013 (Order No. 1794).

² Docket No. C2009-1R, Request of the United States Postal Service under Section 3642 to Create Round-Trip Mailer Product, July 26, 2013 (Request).

³ Netflix was not a party in Docket No. C2009-1, and these Comments are not intended to address issues already decided in that proceeding.

INTRODUCTION

Netflix is the world's leading DVD and Internet subscription service for enjoying movies and TV shows. Founded in 1997, Netflix has been a force for change in the way people watch movies and television shows. In 2007, Netflix added to its DVD-by-mail service a streaming service, which allows members to instantly watch movies and television shows on personal computers and related devices.

Netflix's DVD-by-mail service remains extremely popular due to the breadth of video titles it offers and its quick-turnaround delivery service. To provide quick delivery, Netflix has invested heavily in developing a nationwide network of distribution centers, which enable Netflix to offer more than 95% of its members delivery within one business day. Netflix is also committed to providing its subscribers playable discs and has worked closely with DVD replicators and consultants to develop new replication and handling processes to reduce damage.⁴

Netflix currently mails DVDs as First-Class Automated Presort for the outbound portion and as First-Class Single-Piece for the return portion. Netflix mail benefits the Postal Service in ways beyond the financial benefit derived from the high cost coverage

⁴ "Such steps include limiting ultraviolet light exposure (when labels are printed), picking the best polycarbonates, avoiding moisture, and changing cutter speed, cutter sharpness, specification for the cut, service life of the cutter, how hot the disc is when cut, mold temperature, amount of moisture in the polycarbonate mixture, thickness of the DVD (within tolerance), use of reinforcement rings, minimizing distance traveled through the mail, a new Blu-Ray coating, distance of ground transportation, use of label application machines, modified in-plant operations, and the impact of freezing temperatures. See, e.g., PRC Docket No. C2009-1, Tr. VII/1297-1303; 1306-07; 1326; 1332; 1334; 1361-62; 1366-74; Tr. VIII/1537-40; 1545-46, 1550; 1554-55." Docket No. C2009-1R, USPS Motion for Reconsideration and Clarification of Order No. 1763, July 25, 2013, at 5 n.8.

of its First-Class mail—Netflix mail increases the value and relevance of mail, enhances the “Mail Moment,” and highlights the Postal Service’s quick service and reliability.

I. CREATION OF A NEW COMPETITIVE PRODUCT FOR DVD MAIL IS UNNECESSARY NOW THAT ORDER NO. 1807 HAS CLARIFIED THE APPLICATION OF THE CAP RULES.

In its Request, the Postal Service explained that its concern about how price cap rules would apply was a key reason for its proposal of a new *Competitive Product* for Round Trip Mail. It declared, “if the Commission clarifies that the creation of such a product would not have price cap implications,” it would “consider a ... proposal for the equalization of rates on the Market-Dominant product list. This equalization could either take place as part of the upcoming annual price adjustment, or through a standalone price adjustment that the Commission determines would not have price cap implications.” Request at 4-6. On August 13, 2013, the Commission issued Order No. 1807,⁵ which clarifies that implementation of Order No. 1763⁶ in a Market-Dominant category need not trigger recalculation of the cap at this time. This clarification removes the driving motivation for the Competitive Product Request and renders the Request unnecessary. However, because the Postal Service has not yet withdrawn its Request, these Comments discuss below some of the problems presented by the creation of a Competitive Product.

⁵ Order No. 1807, Docket No. C2009-1R, Order on Reconsideration and Clarification, August 13, 2013 (Order No. 1807).

⁶ Order No. 1763, Docket No. C2009-1R, Order on Remand, June 26, 2103 (Order No. 1763). See *also* Order No. 1794 at 4.

II THE PROPOSED ROUND-TRIP MAILER DOES NOT MEET THE STATUORY REQUIREMENTS FOR A COMPETITIVE PRODUCT AND SHOULD REMAIN A RATE CATEGORY WITHIN MARKET-DOMINANT FIRST-CLASS MAIL.

- A. Cobbled together from four distinct products, the Round-Trip Mailer does not meet the Section 102(6) definition of a “product” with a “distinct cost or market characteristic.”

The proposed Round-Trip Mailer does not fit the definition of a “product” under 39 U.S.C. § 102(6): “a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied.” In fact, the Round-Trip Mailer is an amalgamation of four products, each with its own distinct cost and market characteristic. Previously, the Postal Service and the Commission established four separate products: Presort Letters (a bulk category containing Netflix’s outgoing mail), Presort Flats (a bulk category containing GameFly’s outgoing mail), Single-Piece Letters (a category containing mail being returned to Netflix), and Single-Piece Flats (a category containing mail being returned to GameFly). Now, due to concerns about the price cap, the Postal Service has cobbled together mail from what is essentially one mailer of each product to concoct a new “product” not subject to the cap. If the original four products are meaningfully coherent categories, (and they are),⁷ it makes no sense to say now that the aggregation of all four results in a product with distinct cost and market characteristics.

⁷ Cf. USPS Petition for Rehearing *en banc*, *USPS v. PRC*, in the D.C. Circuit Court of Appeals, No. 12-1221 (July 26, 2013), at 13 (the Postal Service’s recently argued for a limit on how a “product” may be delineated: “[T]here is no basis for the panel’s evident assumption that Presort First-Class Mail is not really a product with its own market or cost characteristics.... Even the PRC concluded otherwise, finding that Presort and Single-Piece had distinct market or cost characteristics and thus are separate products.”) Here, the Postal Service would combine the two products referred to and add Presort Flats and Single-Piece Flats to concoct an entirely new “product”.

Moreover, the “market” for the proposed Competitive Product consists essentially of one very large mailer and one very small mailer, each with a bulk outbound leg and a single-piece inbound leg. Instead of the traditional market that is generally composed of a substantial number of participants (*i.e.*, mailers) grouped in a way that allows costs and demand to be recognized, the proposed Competitive Product singles out a few mailers with widely varying costs and characteristics.

- B. The proposed Round-Trip Mailer fails to meet the criteria of Section 3642(b) for a “competitive product” because the Postal Service continues to have market power over the delivery of DVDs.

Even greater difficulties—both legal and practical—face the Postal Service in its attempt to classify its questionable “product” as a “competitive product” under Section 3642(b).

1. Unusually high cost coverages are evidence that the Postal Service “can effectively set the price of the product substantially above costs.”

Section 3642(b)(1) provides that “[t]he market-dominant category of products shall consist of each product in the sale of which the Postal Service exercises sufficient market power that it can effectively *set the price of such product substantially above costs*. The competitive category of products shall consist of all other products.” 39 U.S.C. § 3642(b)(1) (emphasis added). Examination of the cost coverages currently reported for the product categories involved shows that the Postal Service has and exerts market power in this area: For example, one of the four customer-legs of the proposed product, Netflix’s outbound automated bulk letters, currently falls under the existing Market-Dominant product Presort Letters. In the most recent Annual

Compliance Determination, the cost coverage for Presort Letters was 293.8 percent.⁸ By any measure, a cost coverage this high indicates substantial “market power” under the statutory language that “the price of such product [is] substantially above costs.”

The usual presumption is that competition tends to drive prices (usually down) toward marginal costs. But there are no competitors offering to deliver Netflix discs at prices below those of the Postal Service, whatever the marginal costs might be. In fact, the Postal Service has conceded that it “does not know of another shipping company that provides door-to-door delivery of optical discs such as DVDs (DVD-by-mail).”⁹

2. If the Round-Trip Mailer becomes a Competitive Product, ensuring full compliance with the costing requirements of Section 3633(a)(2) will be extremely difficult, if not impossible.

Section 3633(a)(2) requires the Commission to “ensure that each competitive product covers its costs attributable.” To estimate costs, the Postal Service and the Commission have developed sophisticated costing systems. However, these systems are incapable of estimating costs for products with very small volumes, and here the volumes of the proposed product are split into four legs that are even smaller. In this case, the Postal Service must borrow costs from other, much larger categories, but this approach provides only ballpark estimates and fails to recognize the specific characteristics of the proposed product. While this approach may be used as a last resort in rare circumstances, the Commission should avoid creating a competitive

⁸ Postal Regulatory Commission, *Annual Compliance Determination Report FY2012*, March 28, 2013, at 81 (ACD Report).

⁹ Request, Attachment A, at 3. Note that the cost coverage on Single-Piece Letters of 168.8 percent is also high. The coverage on Presort Flats is only 110.0 percent, indicating that GameFly’s outbound mail is already receiving a rate that is quite favorable, and the coverage on Single-Piece Flats is 164.7 percent. ACD Report at 81.

product that would require it to rely regularly on ballpark estimates to measure compliance with the statute.¹⁰

3. The Postal Service's assertion of competition rests on a strained and superficial definition of the relevant market, a complex legal issue that should not be glossed over.

In order to portray the proposed product as competitive, the Postal Service asserts that other forms of "digital content delivery compete against the Postal Service's Round-Trip Mailer product." Citing "alternatives" such as Amazon®, Blockbuster, iTunes®, Netflix and other physical DVD rental services such as Redbox®, the Postal Service would have the Commission define the relevant product market as the delivery of digital video content through virtually all physical and electronic means. In reality, assessing relevant market definitions in the constantly evolving media and communications industries is a complicated process normally subject to lengthy (and often contentious) administrative proceedings, including extensive comments and expert testimony.¹¹ The fact that multiple media forms deliver video content is not sufficient to render them all part of a single product market. The question is whether different media are substitutable. For example, the FCC has determined that broadcast television service is not part of the same product market as cable and satellite television

¹⁰ In addition, Congress enacted the requirement of Section 3633(a)(2) that competitive products cover their costs so that the Postal Service would not compete unfairly with the private sector, e.g., through hidden subsidies. One portion (the GameFly portion) of the proposed Competitive Product appears to be subsidized, and another portion (the Netflix portion) appears to have a price well above cost. To ignore the subsidy problem by combining the two portions, and assuming that the second portion will be substantially larger than the first, runs counter to the Congressional intent for transparency with respect to subsidies in Competitive Products.

¹¹ The only support offered by the Postal Service on this complex question is a three-paragraph argument, which cites a news report and Netflix's 10-K. Request at 4 nn. 11, 12.

services, even though all deliver video programming.¹² Similarly, given the nascent market for online video, the FCC has recently determined that there is not sufficient evidence or marketplace development to decide whether online video is a substitute for cable television even though both deliver video programming.¹³

In that regard, there are significant differences between physical DVD and Internet-delivered services which suggest that they may not be substitutable. DVD distribution and Internet distribution of movies and TV shows are distinct rights for which companies like Netflix must obtain licenses separately. Due to industry-wide practices known as “windowing,”¹⁴ as well as the copyright principle known as the “first sale doctrine,”¹⁵ the content available to consumers via DVD services frequently differs from what is available via Internet-delivered video services. Even within Netflix, the content available via DVD is not identical to that available via streaming. Because DVD content is not necessarily interchangeable with content available through Internet video services

¹² See General Motors Corporation and Hughes Electronics Corporation, Transferors, and The News Corporation Limited, Transferee, *Memorandum Opinion and Order*, 19 FCC Rcd. 473, ¶ 75 (2004); see also Application of EchoStar Communications Corporation, General Motors Corporation, and Hughes Electronics Corporation (Transferors) and EchoStar Communications Corporation (Transferee), *Hearing Designation Order*, 17 FCC Rcd. 20559, ¶¶ 109-115 (2002).

¹³ Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc. for Consent to Assign Licenses and Transfer Control of Licensees, *Memorandum Opinion and Order*, 26 FCC Rcd. 4238, ¶ 41 (January 20, 2011).

¹⁴ Windowing refers to the content industry practice of reserving time periods or “windows” of exclusivity for different types of video delivery, such as theatrical distribution, home video, and cable and broadcast distribution. For example, movie content is generally available via DVD within six months of theatrical release, but it can take much longer to reach other media platforms such as streaming video or premium cable services.

¹⁵ The first sale doctrine enables the distribution chain of physical copyrighted products such as library lending, gifting, and video rentals. As practical matter, it means that Netflix can provide its DVD service members lawful access to virtually any copyrighted content that has been fixed and distributed by the copyright holder in DVD form.

such as Netflix, Hulu, Amazon, or YouTube, many consumers avail themselves of more than one of these services.

It is not at all clear that physical DVD and Internet video services are interchangeable, as the Postal Service maintains. This is an extremely complex, fact-based question, and Netflix is not suggesting that the Commission reach a conclusion one way or the other at this time. Rather, the issue at the first instance may fall more appropriately within the core competencies of agencies with expertise in media and antitrust, such as the FCC or the FTC. For the Commission to decide this contentious issue in the context of a time-sensitive Section 3642 proceeding would require an unnecessary expenditure of Commission resources and could result in unintended consequences. This is particularly inadvisable since the Commission has now clarified that a GameFly price adjustment in the Market-Dominant category need not trigger recalculation of the cap.

CONCLUSION

Netflix has strong reservations about the Postal Service's Request to create a new Round-Trip Mailer Product that is a Competitive Product. Driven by price cap concerns that the Commission has recently addressed, the proposal raises complex problems that could unnecessarily occupy the Commission as it strives to ensure timely implementation of a GameFly remedy. Netflix accordingly requests that the Commission deny the Postal Service's Request.

Respectfully submitted,

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