

ORDER NO. 235

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

Before Commissioners:

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

Complaint of GameFly, Inc.

Docket No. C2009-1

ORDER DENYING MOTION OF UNITED STATES POSTAL SERVICE
FOR PARTIAL DISMISSAL OF COMPLAINT AND NOTICE OF FORMAL
PROCEEDINGS

(Issued July 1, 2009)

The Complaint of GameFly, Inc. (Complaint) was filed on April 23, 2009. The Complaint asserts several claims that concern unreasonable discrimination and other undue preferences allowed by the United States Postal Service in violation of the law. In support of its Complaint, GameFly, Inc. (GameFly) alleges that the Postal Service extended preferential services and inequitable rates to certain high volume rival mailers who similarly use First-Class Mail to send and receive DVDs.

GameFly specifically contends its pieces are being processed through the automated letter mail processing equipment that continues to cause damage, and that the favored high volume DVD mailers are not suffering the high level of broken DVDs. It further alleges that ever since it resorted to higher cost flat rates and inserts to reduce

breakage, it is still suffering more damage than these other mailers, while it is also paying the additional ounce postage charges and more for the flats shape of its pieces.

The Answer of the United States Postal Service (Answer) in response to the Complaint was filed on May 26, 2009, together with a Motion of the United States Postal Service for Partial Dismissal of Complaint (Motion for Partial Dismissal). The Answer denied that the Postal Service's updated policy favors special handling by hand for inbound pieces, even though some exceptions arise in the field. The Motion for Partial Dismissal asserts that GameFly's reliance upon 39 U.S.C. 404(b) for jurisdiction appears misplaced. On June 2, 2009, GameFly, under a Motion of Gamefly, Inc. for Leave to File Reply to Requests of the USPS for Disposition of Complaint (Motion for Leave), filed a Reply of Gamefly, Inc. to Requests of the USPS for Disposition of Complaint (Reply).

For the reasons explained below, the Commission concludes it has jurisdiction over the dispute, grants GameFly's Motion for Leave, and, upon a review of the pleadings, denies the Postal Service's Motion for Partial Dismissal. The Commission also concludes that the Complaint raises material issues of fact and law, and shall begin proceedings to hear the issues involved. 39 U.S.C. 3662(b).

I. THE GAMEFLY COMPLAINT

GameFly claims that the rates and services extended to some high volume DVD mailers violate 39 U.S.C. 101(d), 403(c), 404(b) and 3622(b)(8), which prohibit undue discrimination. Complaint at 1. It explains that it, like many other businesses that rent DVDs to consumers, uses a two-way DVD mailer. *Id.* at 3. It distributes game DVDs to subscribers via First-Class Mail, and subscribers usually return the DVDs to GameFly in prepaid mailers via First-Class Mail Business Reply Mail (BRM). *Id.*

The Complaint alleges that the DVD is small enough so that when it is mailed in a lightweight mailer, the combined mailpiece can qualify as a one-ounce letter. *Id.* at 4. However, when the DVDs were enclosed in lightweight mailers without protective inserts, the company experienced breakage of DVDs in the mail. *Id.* GameFly alleges

that the “breakage occurs during the processing of DVD mailers on Postal Service automated mail processing equipment” for letters. *Id.* at 5. To reduce breakage, GameFly began to insert cardboard protectors into its DVD mailers in 2002. *Id.*

While reducing breakage, the protectors “increased the size and weight of the mailpieces...to...two-ounce flats.” *Id.* This raised GameFly’s postal rates for this higher total weight. *Id.* at 6. In 2007, the rising postal rates on flats led GameFly to test other mailpiece designs without a protector to reduce breakage at less cost, but these tests did not succeed. *Id.* The Postal Service also declined GameFly’s request to reduce rates as to the second ounce. *Id.* at 7.

GameFly contends that “the Postal Service failed to stop breaking GameFly DVDs” despite charging the higher rates for flats. *Id.* at 5. On account of the higher postage for flats, surcharges for the extra ounce, and certain other losses for theft, GameFly claims that it has incurred “greatly increased mailing costs,” that on average are almost 88 cents per piece more than the postage for a one-ounce letter. *Id.* at 6-7.

GameFly alleges that the Postal Service gave preferential treatment for certain high volume movie DVD mailers who also faced significant DVD breakage.¹ It claims that “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.”²

GameFly asserts that the Postal Service’s practice of giving manual processing to DVDs from certain high volume mailers has continued since the OIG report. Complaint at 9. It alleges that, despite its requests, the Postal Service has declined to give GameFly’s DVD mailers processing on terms and conditions comparable to those offered to the two high volume mailers. *Id.* It alleges that Blockbuster is a rival that is entering the market for game DVD mailpieces. *Id.*

¹ *Id.* at 8-9. GameFly cites a report from 2007 that allegedly found that most of the two-way DVD mailpieces from one unnamed high volume DVD rental company received manual processing. See Complaint at 8, ¶ 36, *citing* USPS Office of Inspector General, Audit Report No. MS-AR-08-001, Review of Postal Service First-Class Permit Reply Mail (November 8, 2007) (OIG Report).

² *Id.* at 8; see also OIG Report at 5, n.9. The term “culling” usually refers to removing, by hand, nonletter mail from letter mail, and nonmachinable mailpieces from automation rate pieces.

Counts I and II assert undue discrimination under sections 3662(a) and 403(c).³ Under counts III and IV, GameFly contests postal rates charged for DVDs entered by GameFly as First-Class flats as inequitable, in violation of 39 U.S.C. 404(b).⁴ Each of the counts includes the first 39 paragraphs of the Complaint. GameFly requests relief, following a hearing, in an order that prescribes the same rates and terms of service that the Postal Service provides to Netflix and Blockbuster. *Id.* at 13.

II. THE POSTAL SERVICE'S ANSWER AND MOTION FOR PARTIAL DISMISSAL

The Postal Service responds to the Complaint with a timely answer, which denies most of the material allegations directly, and adds certain affirmative allegations. The Postal Service also denies any preferential practices of unfair rules, inequitable rates, or processing standards, as well as any liability, losses, causation, and injury. See, e.g., Answer at ¶¶ 2, 12, 16, and 19. It separately submits a Motion for Partial Dismissal to assert that the Commission lacks jurisdiction to hear counts that assert violations of 39 U.S.C. 404(b). Motion for Partial Dismissal at 1.

Aside from its Motion for Partial Dismissal, addressed below, the Postal Service alleges that it does not have a “policy” of manually processing mail entered by other high volume DVD mailers for delivery to or from its customers. Answer at ¶ 49. The Postal Service explains that while it has no current practice of manually culling incoming DVDs, it admits that “some culling of the incoming DVDs (returns from customers) may ...occur despite the change in policy.” *Id.* at ¶ 37. It also denies that “any significant volume of outgoing DVD mail pieces (from the mailer to the customer) are processed manually.” *Id.*; see also, ¶ 38.

³ The Postal Service's Motion for Partial Dismissal, discussed below, does not separately challenge GameFly's first two counts, raised under section 403(c), either based upon any defect of pleading or jurisdiction.

⁴ Count III asserts the rates are unfair because the Postal Service processes the same DVDs on letter-sorting equipment, unless the mailer also pays second-ounce postage. Count IV asserts that they are unfair because the Postal Service fails to process the DVDs on flats-sorting equipment.

The Postal Service urges that its procedures for letter sorting streams and flat sorting streams are justifiably different. *Id.* at ¶ 39. It asserts that mailpieces very close to the size of the envelopes that complainant currently uses would typically not be extracted as a flat. *Id.* at ¶ 22. It explains that each mailer's mailpiece design controls the processing of the mailpiece. *See, e.g.,* Answer at ¶¶ 12, 17, 23.

The Motion for Partial Dismissal explains that the Commission's jurisdiction to hear complaints is "narrowly specified" in a quoted portion of 39 U.S.C. 3662(a). The Postal Service mainly assails paragraphs 53 and 55 of the Complaint. It observes that the Complaint improperly alleges that the Postal Service practices have violated 39 U.S.C. 404(b). Motion for Partial Dismissal at 2. The Postal Service submits that "subsection [404(b)] is not one of the specific provisions...that are identified in subsection 3662(a)." *Id.* Nor is the cited statute in chapter 36. *Id.* On these grounds, it contends that a "complaint filed under subsection 3662(a) alleging a violation of subsection 404(b) fails to state a cause of action for which the Commission may grant relief." *Id.*

III. COMMISSION ANALYSIS

The Postal Service's Motion for Partial Dismissal aims at eliminating allegations by GameFly under 39 U.S.C. 404(b), and particularly defeating counts III and IV. *See Id.* at 2. Section 404(b) mainly empowers the Governors "to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage" consistently with chapter 36. 39 U.S.C. 404(b). Section 404(b) is not included in the grounds for complaints listed in section 3662.

GameFly asserts, by its Reply, that section 3662(a) incorporates section 101(d). Reply at 5-6. It adds that "[b]y operation of Sections 401(2) and 101(d), the substantive standard of Section 404(b) thus is clearly justifiable in a complaint filed under Section 3662(a)." *Id.* at 6. Section 101(d) is included in the grounds for complaints listed in section 3662(a).

In view of these contentions, it is appropriate to explore whether the counts are properly based upon statutory authority that satisfies the usual notice pleading requirements. Each count includes by reference the first 39 paragraphs of the Complaint. See Complaint at ¶¶ 52 and 54. Thus, each count properly may be read to assert a violation under sections 101(d) and 403(c), unless the allegations otherwise fail to state a colorable claim.⁵

The Postal Service's dismissal motion overlooks that the contested counts expressly include other allegations based upon section 101(d). Each count plainly has at least one clear statutory basis upon which to seek recourse. Thus, despite its apparent reliance on section 404(b) at the very end of the counts, GameFly still satisfies the standards of pleading statutory authority at this juncture. See Complaint at 1, *citing* 39 U.S.C. 101(d), and 403(c). The Commission has determined that the Postal Service's Motion for Partial Dismissal must therefore be denied.

The Commission finds 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).

IV. PREHEARING CONFERENCE AND PUBLIC REPRESENTATION

A prehearing conference is scheduled for July 23, 2009 at 10:00 A.M. in the Commission's hearing room.

⁵ See, Complaint at ¶ 2 (the rates and services offered to high volume DVD mailers violate sections 101(d) and 403(c), which prohibit undue discrimination, and inequitable rates and practices.); see *also* Answer at ¶ 2; and *see generally* Docket No. C2001-1, Order Partially Denying Motion of United States Postal Service to Dismiss Complaint and Notice of Formal Proceedings, March 20, 2001, at 9 n.11.

GameFly and the Postal Service must meet and confer at least two weeks before the conference date to consider the appropriate scope and timeframes for discovery. Discussion should separately address each of the categories mentioned in the Complaint. See Complaint at ¶ 41. They shall jointly prepare a prehearing conference memorandum that identifies relevant undisputed facts. They shall offer suggestions, and be prepared to discuss the proper scope of discovery and the dates to complete discovery and to present their cases. They are urged to stipulate to an orderly process that streamlines the discovery schedule so as to reduce the need for motions on any special challenges. Where a mutually acceptable process can not be agreed to, Gamefly and the Postal Service shall fashion a joint statement clarifying areas of contention. The joint prehearing conference memorandum, with any related proposed stipulations, must be filed no later than July 20, 2009.

V. OPPORTUNITY FOR INTERVENTION

Except as otherwise specified above, any interested person may file a notice of intervention, consistent with the Commission's rules of practice, as a full or limited participant. See 39 CFR 3001.20 and 3001.20a. The notice of intervention shall be filed using the Internet (filing online) at the Commission's website (www.prc.gov) unless a waiver is obtained for hard-copy filing. See 39 CFR 3001.9(a) and 3001.10(a). Notices of intervention are due no later than July 22, 2009.

Pursuant to 39 U.S.C. 505, E. Rand Costich and John Klingenberg are appointed to serve as officer of the Commission (Public Representative) to represent the interests of the general public in the above-captioned docket.

It is Ordered:

1. The Commission finds that the Complaint by GameFly, Inc., filed April 23, 2009, regarding violations of law by the Postal Service, raises material issues of fact and shall begin proceedings in this Complaint

2. The Motion of GameFly, Inc. for Leave to File Reply to Request of the United States Postal Service for Disposition of Complaint, filed June 2, 2009, is granted.
3. The Motion of the United States Postal Service for Partial Dismissal of Complaint, filed May 26, 2009, is denied.
4. The Commission will sit *en banc* in this proceeding.
5. The deadline for filing any notices of intervention is July 22, 2009. Notices shall indicate whether the intervening party intends to participate in the hearing and the nature of that participation.
6. A prehearing conference will be held in the Commission's hearing room on July 23, 2009 at 10:00 A.M. At least two weeks before the conference, the parties shall meet and confer on discovery. They shall prepare a joint prehearing conference memorandum that must be filed no later than July 20, 2009.
7. The Commission appoints E. Rand Costich and John Klingenberg as Public Representative to represent the interests of the general public in this proceeding.
8. The Secretary shall arrange for publication of this Order in the *Federal Register*.

By the Commission.

Judith M. Grady
Acting Secretary