

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

Complaint of GameFly, Inc.

Docket No. C2009-1

PUBLIC REPRESENTATIVE
INITIAL BRIEF
(November 8, 2010)

I. INTRODUCTION

On April 23, 2009, pursuant to 39 U.S.C. § 3662, GameFly, Inc. (GameFly) filed a Complaint against the United States Postal Service (Postal Service).¹ The Postal Service responded with its Answer on May 26, 2009.² At that juncture, the Postal Service also filed a Motion for Partial Dismissal of the Complaint, which stated that the Commission lacks jurisdiction to hear complaints asserting violations concerning section 404(b) of title 39.³ On July 1, 2009, the Commission issued Order No. 235, finding that the Complaint raises material issues of fact and law and began proceedings in the Complaint. Further, Order No. 235 appointed the undersigned Public Representative. Pursuant to POR No. 38, the undersigned respectfully submit the following comments.

II. COMPLAINT CASE BACKGROUND

As stated in Order No. 235, the Complaint raises material issues of both fact and law. Section III will discuss issues of fact; section IV will discuss issues of law. Section V will discuss potential remedies. Before the material issues of the current docket are discussed, it is necessary to comment on the difficulties experienced in litigating this case. The complaint mechanism is an important tool to provide accountability and

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

²Answer of the United States Postal Service, May 26, 2009 (Answer).

³Motion of the United States Postal Service for Partial Dismissal of Complaint, May 26, 2009 (Motion to Dismiss).

transparency as envisioned by the PAEA. This case has revealed that the Postal Service does not yet have the capability to quickly perform tasks critical to the complaint mechanism, such as document review. Further, the unreasonably broad claims of privilege asserted by the Postal Service have had an effect of causing significant delay in the resolution of the current docket. While the Postal Service has the right to litigate a complaint case in the method that it considers best, the Commission needs to send a clear message to parties considering future cases that the Postal Service will not be allowed to employ delaying tactics ad infinitum. For the Commission to resolve complaint dockets in a swift fashion, both the Commission and the Postal Service may need to revisit the procedures used to litigate such cases.

III. ISSUES OF FACT

The Complaint lists 57 enumerated statements, which, collectively, GameFly contends amount to discrimination. The Joint Statement of Undisputed and Disputed Facts lists 133 statements by GameFly and the Postal Service concerning issues in this case.⁴ The Joint Statement describes the essential issues of the complaint. The following summarizes statements declared by GameFly and the Postal Service as “undisputed”:

- GameFly distributes its video game DVDs to subscribers via a two-ounce First-Class flat in a pre-addressed two-way reply mailer through a Business Reply Mail account.⁵
- GameFly currently distributes and collects its mail via four shipping centers.⁶
- GameFly paid postage on approximately 14.4 Million Pieces in 2009.⁷
- GameFly began testing mailer designs to reduce DVD breakage in 2002, with the goal of diverting mailpieces away from the automation letter mailstream.⁸
- Netflix distributes its video DVDs to subscribers via a one-ounce First-Class letter in a pre-addressed two-way reply mailer through a Permit Reply Mail account.⁹

⁴ Joint Statement of Undisputed and Disputed Facts, July 20, 2009 (Joint Statement).

⁵ Joint Statement Paragraphs 15, 18, 19, 20, 60, 61, 62.

⁶ Joint Statement Paragraph 16.

⁷ See Joint Statement Paragraph 21 (sum of mailed and received in June times 12).

⁸ Joint Statement Paragraphs 38, 39, 41, 48, 50.

⁹ Joint Statement Paragraphs 65, 66, 69, 70, 71.

- Blockbuster distributes its video and video game DVDs to subscribers via a one-ounce First-Class letter in a pre-addressed two-way reply mailer through Qualified Business Reply Mail (QBRM).¹⁰
- DVDs, when processed on Postal Service automation processing equipment, can experience breakage.¹¹
- Netflix submitted a DVD mailpiece design in 2002 that was deemed “machinable” although “not completely automation-compatible.”¹²
- Postal Service processing operations “often” manually cull Netflix return DVD mailers, removing them from the automated letters mailstream. Netflix does not pay a nonmachinable surcharge for its return mailers.¹³
- Since 2007, the Postal Service has determined that at least seven mailers similar to the Netflix Mailer are operationally nonmachinable.¹⁴
- Blockbuster has requested manual culling of inbound mailpieces.¹⁵
- The Postal Service has manually processed inbound Blockbuster mailpieces in many instances.¹⁶
- GameFly has worked with the Postal Service in attempts to remove its mailpieces from the automation letter processing mailstream. These attempts have not led to a mutually amicable solution.¹⁷

The following statements were “disputed” in the Joint Statement:

- Video Game DVDs can be mailed as one-ounce letters in lightweight mailers.¹⁸
- DVD breakage from processing on automated letter processing equipment, can be as high as five percent.¹⁹

¹⁰Joint Statement Paragraphs 93, 94, 95, 96, 98, 100.

¹¹Joint Statement Paragraph 27.

¹²Joint Statement Paragraphs 73, 74, 78.

¹³Joint Statement Paragraphs 79, 82, 83, 84, 87, 88.

¹⁴Joint Statement Paragraph 92.

¹⁵Joint Statement Paragraphs 102, 103.

¹⁶Joint Statement Paragraph 107.

¹⁷Joint Statement Paragraphs 113, 114, 115, 116, 117, 118, 119, 120, 121, 122, 123, 126, 127.

¹⁸Joint Statement Paragraph 26.

¹⁹Joint Statement Paragraph 28

- DVD thickness, weight, and flexibility differences can lead to differences in DVD breakage due to automation letter processing.²⁰
- The Postal Service contends GameFly has previously expressed a preference for automation flats processing.²¹
- GameFly contends that automation flats processing is a second-best option, since manual handling has not been offered, and automation flats processing has not led to acceptable breakage.²²
- The Postal Service contends that the GameFly mailpiece is a “fletter.”²³
- The Postal Service contends that the Netflix inbound mailpiece was determined not to be automation-compatible.²⁴
- GameFly contends that since 2002, the Postal Service has had an understanding with Netflix that Netflix DVD mailers will receive manual culling at the point of induction.²⁵
- The Postal Service contends that mail processing decisions concerning manual handling of DVD return mail are made locally to ensure the overall efficiency of mail processing operations.²⁶
- GameFly and the Postal Service disagree over the reasons for manual culling of Blockbuster mailpieces.²⁷

As described in the Joint Statement, it is undisputed that GameFly mails its videogame DVDs via First-Class flats so they will be processed in the automation flats mailstream. There is also agreement that research has shown that Netflix (and, to a lesser extent, Blockbuster) return DVDs are manually culled before reaching the automation letter processing mailstream. There is agreement that the Postal Service has not made this manual processing option available to GameFly, which is the basis for GameFly’s contention of discrimination.

²⁰Joint Statement Paragraphs 33, 34,35, 36, 37

²¹Joint Statement Paragraph 44

²²Joint Statement Paragraphs 40,45,46,47, 49, 51, 53, 54, 124, 125

²³Joint Statement Paragraph 55

²⁴Joint Statement Paragraph 75,

²⁵Joint Statement Paragraphs 80, 85, 89

²⁶Joint Statement Paragraphs 81, 86

²⁷Joint Statement Paragraphs 104, 105, 106

The Joint Statement also provides guidance on the issues of fact that were discussed in discovery throughout the case. The Postal Service contends that the manual culling of Netflix return DVD mailers is locally-made decision based on realizing processing efficiencies. The Postal Service contends that factors other than automation letter processing could be the primary cause of DVD breakage. As a further issue of contention, the Postal Service contended in in the course of litigation that GameFly would need to meet certain conditions if it were to receive manual culling, as described in the May 17, 2010, Letter from Andrew German to David Levy. As such, there are three key issues of fact that must be resolved in this case before considering issues of law.

Issue of Fact #1: Does the Postal Service have a policy of manually culling Netflix return DVDs?

Issue of Fact #2: Does the Postal Service manually cull Netflix return DVDs to realize efficiencies in mail processing, *i.e.*, reduce processing cost?

Issue of Fact #3: Is GameFly similarly situated to Netflix?

A. Issue of Fact #1: Does the Postal Service Manually Cull Netflix Return DVDs Systematically?

That the Postal Service chooses to manually processing some Netflix return DVDs is undisputed. However, GameFly and the Postal Service disagree as to both the extent and intent of the Postal Service's manual processing procedure. The record is straightforward concerning the extent of manual processing by the Postal Service. In the Joint Statement, the Postal Service did not dispute that "often" Netflix return DVDs are manually culled. In 2007, the USPS OIG issued report MS-AR-08-001, which estimated that 70 percent of such mail was manually processed.²⁸ The Postal Service has not offered a meaningful alternative to that estimate.²⁹ While the 70-percent estimate does not represent census or universal data, and does not reflect a recently conducted study, it is the best estimate currently available. The Postal Service's lack of visibility into processing decisions and lack of desire to undertake a comprehensive study of how often manual processing occurs further suggests the Postal Service is

²⁸ USPS OIG Audit Report No. MS-AR-08-001 at 4.

²⁹ See USPS Response to GFL/USPS-67, September 11, 2009.

satisfied with the accuracy of the OIG's estimate. Thus, as the record currently stands, the extent of manual processing of Netflix return mail is 70 percent or more.

While the record is clear regarding the extent of manual processing, determining the intent of the Postal Service in developing and implementing such a policy is less straightforward. The record contains voluminous evidence of the Postal Service's responding to the quick and widespread increase in Netflix volume, but much of the evidence is varied and local in origin. At the national (Headquarters) level, nearly as much can be discerned from the lack of action on the part of the Postal Service as from decisions and comments available on the record. The Postal Service has stated that no SOP directing all postal facilities to manual process Netflix return mail has been issued. As described in the April 21 Memorandum of GameFly, the preponderance of local SOPs suggests that headquarters was aware of the number of areas and districts requiring manual culling.³⁰ In 2006, the Postal Service contracted a report from the well-respected consulting firm, Christensen Associates, to measure the methods and costs of DVD-by-mail processing. That analysis showed that manual processing was widespread, especially among facilities near Netflix processing hubs. The 2007 OIG report reiterated to upper USPS management that widespread manual processing of Netflix return mail was occurring. No action was taken to change processing procedures in response to this report.

The record in this docket contains a plethora of emails from USPS headquarters staff analyzing the "Netflix issue." These emails report on the common theme that Netflix mail is handled manually, in almost every operation.³¹ Witness Seanor (USPS-T-3) states, "Headquarters issues SOPs only if national issues are identified."³² In 2006, Headquarters considered issuing an SOP directing facilities to put Netflix mailers on automation. The Postal Service did not issue that directive. In 2006, the Postal Service developed a proposal to streamline DVD by mail rate offerings and mailpieces to automate Netflix mail. That proposal was not enacted. Given the multitude of

³⁰ Memorandum of Gamefly, Inc., Summarizing Documentary Evidence, April 12, 2010, at 20-24 (under seal) (Roadmap Memo).

³¹ See Tr.4/161-163.

³² USPS-T-3 at 8.

information, it is clear that the Postal Service has made a conscious decision to allow its local facilities to continue a pattern of processing Netflix return mailpieces manually.

The interaction between Netflix management and the Postal Service cannot be ignored. USPS witness Lundhahl (USPS-T-4) was employed by Netflix to determine how to reduce disk breakage. His conclusion was that the number-one method to reduce the damage incurred by automation processing was to avoid it. The Postal Service should be commended for working with Netflix to deliver the service necessary to allow Netflix to prosper. The record is clear that the Postal Service has implemented manual processing to reduce disk breakage in response to Netflix concerns.³³

Thus, the record shows that the Postal Service has a national policy of manually processing Netflix return DVDs, one that was initially implemented locally beginning in at least 2002 and continues with both knowledge and consent from Postal Service Headquarters.

B. Issue of Fact #2: Does the Postal Service Manually Cull Netflix Return DVDs to Realize Efficiencies in Mail Processing, *i.e.*, to Reduce Processing Cost?

Both GameFly and the Postal Service have sponsored witnesses to testify to this issue. GameFly sponsored Sander Glick as GFL-T-1 and GFL-RT-1. The USPS sponsored Seanor (USPS-T-3) and Belair (USPS-T-2). The record in this case contains two estimates of the cost of manually processing Netflix return DVDs. In 2006, the Postal Service contracted with Christensen Associates to estimate the costs of return DVDs by mail. GameFly witness Glick updated this study and added a range of productivity assumptions to develop a cost model in the form and substance of the cost models generally presented to the Commission. Witnesses Seanor and Belair testified that, in their expert opinions, manually processing Netflix mail was less expensive than the normal automation process, and that manual culling possibly had a marginal cost of 0.³⁴ There were no cost studies or analysis to back up this claim.

In addition to the Christensen study, transcript volume four contains numerous statements of Postal Service Headquarters employees commenting on how expensive

³³ See Roadmap Memo at 57-59; Tr.4/376.

³⁴ See USPS Response to GFL/USPS 162, 201, October 14, 2009.

manually processing Netflix return mail is.³⁵ Further, in its 2007 report, the USPS OIG used the 2006 Christensen study to estimate the additional cost of manual processing. On the balance of the record, it is clear that the Postal Service does not realize cost savings by manually processing return trip DVDs. Further, the record shows that the Postal Service implemented manual processing of Netflix DVDs not to reduce costs, but to reduce damage to the contents of Netflix mailpieces.³⁶ The Postal Service is to be commended for working with this customer to provide the necessary service.

C. Issue of Fact #3: Is GameFly Similarly Situated to Netflix?

The May 17th Letter from Andrew German to David Levy laid out the conditions which the Postal Service would be willing to offer “unguaranteed” manual processing of GameFly return mailers. This agreement would be similar to the understanding the Postal Service currently has with both Blockbuster and Netflix. By adding this letter to the record, and having Postal Service witnesses testify to its accuracy and meaning, the Postal Service has added a “similarly situated” argument to this case. The term “similarly situated” has a very specific meaning in the Postal context. PAEA requires that, when the Postal Service enters into a “Special Classification” with a mailer, the same deal should be available to all other “similarly situated” mailers. The Postal Service seems to be admitting it has some sort of agreement with Netflix, and argues that GameFly can have the same agreement, but first GameFly has to have similar characteristics (beyond the content of their mail). This offer is effectively null, because GameFly has much lower volume, fewer pickup sites, and other unique characteristics. What the Postal Service has offered cannot be accepted by GameFly, as GameFly has stated. The record also contains interesting insights into the reality of this offer.

Witness Seanor makes it clear that that Postal Service would have to issue an SOP to force local plants to manually cull pieces that will run on the AFSM without problems. Thus, the fact that GameFly’s mailpiece actually meets machinability standards works against it. Further, the Postal Service did not make a similar offer to Netflix. This is not an example of the Postal Service creating a niche classification and legally allowing any mailer to use a publicly available rate. This offer creates the illusion

³⁵ Roadmap Memo at 54.

³⁶ See Tr. 4/179, 301, 311.

of rhyme and or reason behind the Postal Service's intent in manually processing Netflix inbound mail pieces. As discussed in closed session on October 28 with witness Glick, Netflix has not always had the number of caller service pickup sites that it does today. Netflix has not always had the volume per facility per day that it currently does. For the Postal Service to argue that a processing service it has provided to Netflix for over eight years is only available to mailers that meet the operational and mail characteristics of Netflix in 2010 is an obvious farce. Netflix could not meet these conditions for much of *its* history, yet the service was provided. There is scant evidence in the record of the Postal Service carefully considering what qualifications a DVD mailer must meet in order to qualify for manual processing of inbound pieces.

This issue highlights the overall theme of the record evidence in this case. The Postal Service was confronted with a new problem as DVD mail entered the mailstream. The decision to offer machinable rates to a mailpiece that local plants would not run on a machine was a decision with clear repercussions. The DBCS and AFCS were not built to handle rigid pieces, but rigidity is hard to define, and even harder to measure. The first major entrant into this field (Netflix) understood how to work with the Postal Service, and the Postal Service understood the importance of the new, possibly high-volume, entrant.³⁷ The Postal Service is to be commended for working with Netflix to achieve a solution that supported innovation and reduced disk breakage. However, future DVD mailers were not allowed to use the Netflix mailer design, or receive the same level of service (breakage).³⁸ The record clearly shows the difficulty of processing Netflix mail, and the Postal Service's realization that the ad-hoc process was unsustainable and could not be adapted for multiple mailers. However, in over eight years, the Postal Service has not implemented any universal solution. As such, GameFly claims discrimination, and asks the regulator for fair relief.

³⁷ Tr. 4/516-517 ("innovation").

³⁸ Tr. 4/579 "the usual response."

IV. Legal Issues

The record establishes as fact that Netflix and Blockbuster receive better service than other DVD return mailers. Is this treatment justifiable? The answer boils down to an issue of credibility: given that Netflix initially received special treatment *at the request of Netflix*,³⁹ is it plausible that Netflix now receives special treatment because such treatment is cheaper? The question almost answers itself. The only quantitative evidence on the record shows that manual handling of Netflix return pieces is more expensive than automated handling. The evidence to the contrary consists of the unsupported opinions of witnesses Belair and Seanor. Mere unsupported opinion cannot rebut quantitative studies such as witness Glick's direct testimony and the Christensen report. And the opinions of Belair and Seanor are contradicted by internal Postal Service documents.⁴⁰ By whatever standard of evidence the Commission decides to apply (substantial, preponderance, or clear and convincing), the Postal Service is granting an undue preference to Netflix in violation of 39 U.S.C. 403(c).

³⁹ See Roadmap Memo at 53-54.

⁴⁰ Roadmap Memo at 58-59 (especially paragraph 148, stating that manually processing was at mailer's request in 2009).

V. REMEDY

The remedy for an undue preference is removal of the preference. The Postal Service has realized the importance, value, and growth potential of the DVD-by-mail industry. The Postal Service has implemented manual processing procedures for some DVD-by-mail costumers to provide the necessary service to encourage use of the mail (reduced breakage). The Postal Service should offer the same service provided to Netflix to all other DVD return mailers. If the remedy is granted, the service should be codified in the MCS, pursuant to the filed rate doctrine.⁴¹ GameFly should be asked to submit proposed classification language.

Respectfully submitted,

Emmett Rand Costich
Public Representative

John Klingenberg
Public Representative

901 New York Ave. NW
Washington, DC
202-789-6833
FAX: 202-789-6861
rand.costich@prc.gov

⁴¹ See Roadmap Memo at 63-65.