Postal Regulatory Commission
Submitted 11/18/2010 4:03:40 PM
Filing ID: 70936
Accepted 11/18/2010

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

COMPLAINT OF GAMEFLY, INC.	)	Docket No. C2009-1

**APPLICATION OF GAMEFLY, INC.,
FOR NON-PUBLIC TREATMENT OF PORTIONS OF
REPLY POST-HEARING BRIEF
(November 18, 2010)**

Pursuant to Rule 3007.22, 39 C.F.R. § 3007.22, GameFly, Inc. ("GameFly") applies for nonpublic treatment of certain portions of the Reply Post-Hearing Brief that GameFly is filing separately today.

The portions that GameFly is filing under seal are documents (or portions of documents) that were designated as confidential pursuant to Presiding Officer's Ruling No. C2009-1/17, or have been designated as confidential by the Postal Service and have not yet been subject to a motion to unseal.

GameFly has today filed two copies of the proprietary version of the motion under seal with the Commission (along with two CDs containing electronic versions of the documents) and served copies of the same documents upon counsel for the Postal Service, Netflix, and the Public Representative. GameFly will also file a public version of this document with the confidential information redacted.

Respectfully submitted,

/s/

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November 18, 2010

PUBLIC (REDACTED) VERSION

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[to be added after filing of deferred document appendix]

REPLY POST-HEARING BRIEF OF GAMEFLY, INC.

GameFly, Inc., respectfully submits its reply post-hearing brief. This brief replies to the initial briefs of the Postal Service and the Public Representative.

I. INTRODUCTION AND SUMMARY

The 222-page jumble of arguments, assertions and ad hominem attacks in the Postal Service's initial brief cannot obscure how few are the material issues that still remain in dispute. The Postal Service can no longer seriously dispute that automated letter processing breaks DVDs at high rates; that the Postal Service gives special manual processing to about 80 percent of Netflix DVDs at no extra charge to Netflix; that the Postal Service has not offered similar terms of service to other DVD rental companies; and that this discrimination has occurred with the knowledge and acquiescence of senior management at Postal Service headquarters.

The Postal Service's defense has collapsed to little more than the proposition that the discrimination saves the Postal Service money. But this theory is a pretext concocted after the fact for this litigation. The most credible evidence on the cost consequences of the Postal Service's special treatment of Netflix is the 2006 study by the Postal Service's own consultant, Christensen Associates. The Christensen data show that the special manual treatment given to Netflix returns costs the Postal Service approximately **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** the cost of processing the same mailpieces on automated letter equipment. The Postal Service's attempts to discredit Christensen Associates and GameFly's cost witness, Sander Glick, are baseless and unfounded. Even the Postal Service has conceded that

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[END PROPRIETARY] By contrast, the testimony of Postal Service witnesses Belair, Seanor and Barranca, the three employees drafted by the Postal Service to support its current party line, is unsupported by any data, studies or analyses. To the contrary, the record overwhelmingly refutes the notion that the costly manual intervention received by Netflix DVDs is limited to "one touch" of manual culling upon induction.

The remaining arguments in the Postal Service's initial brief are makeweights. First, the Postal Service has misstated the governing legal standards. GameFly has standing to pursue its complaint without sending its DVDs at letter rates during the pendency of the case. Nor does the Federal Tort Claims Act bar GameFly's claim, which is A complaint for relief from unlawful discrimination under 39 U.S.C. §§ 403(c) and 3662, a completely distinct cause of action from a tort suit. Section 403(c) does not give the Postal Service unfettered discretion to discriminate without a rational basis. And the Postal Service has offered no reason to reconsider the multiple Commission rulings in this case that GameFly is entitled to rely on the 2006 Christensen reports, the 2007 OIG report, and other adverse admissions by Postal Service employees and agents without a sponsoring witness.

GameFly and Netflix are clearly similarly situated within the meaning of Section 403(c). The governing legal standards do not require that GameFly and Netflix be identical, and the differences between the two companies and their mail are mutable, insignificant or completely irrelevant.

Finally, the Postal Service has failed to establish any other rational basis for discriminating in favor of Netflix and against GameFly. None of the differences in the mail characteristics of the two companies has a significant effect on costs. Moreover, and in any event, the Postal Service's failure to publish the terms and conditions of service offered to Netflix as required by the filed rate doctrine bars the Postal Service from asserting that operational differences between Netflix and other mailers justify the preferences that Netflix receives.

II. THE POSTAL SERVICE HAS MISSTATED THE LEGAL STANDARDS FOR RESOLVING GAMEFLY'S DISCRIMINATION CLAIMS.

A. GameFly Has Standing.

The Postal Service contends that GameFly's discrimination claim is merely "hypothetical"—and, indeed, that GameFly does not even have standing to pursue a discrimination complaint at all—because GameFly does not currently mail its DVDs at letter rates, does not use mailers that are small enough to qualify for letter rates, and has never requested manual processing for DVD mailers entered at letter rates. USPS Br. 10-11, 16, 27, 35-36, 52, 63-65, 77, 82-83, 85, 115-118. The Postal Service misstates both the law and the facts.

(1) Nothing in Section 39 U.S.C. §§ 403(c) and 3662 conditions standing on a complainant's actual use of the service at issue before the defendant carrier eliminates the discriminatory terms and conditions that make the service unusable or uneconomic for potential users of the service. The zone of interests protected by 39 U.S.C. § 403(c) encompasses any "potential user" of a service who is "willing to meet the same [nondiscriminatory] conditions of service" that another user enjoys. *Experimental Rate*

and Service Changes to Implement Negotiated Service Agreement with Capital One, Docket No. MC2002-2 ("Capital One NSA"), PRC Op. & Rec. Decis. (May 15, 2003) at ¶ 3013. *Accord*, *Sporhase v. Nebraska*, 458 U.S. 941, 945 (1982) (explaining that as "appellants would not have been granted a permit had they applied for one. . . . [t]heir failure to submit an application therefore does not deprive them of standing to challenge the [regulation at issue]."); *Am. Trucking Ass'n v. United States*, 364 U.S. 1, 18 (1960) (holding that competing carriers had standing to challenge the grant of a trucking certificate to another carrier under the "party in interest" standard of the ICA; it was not necessary to show that the carriers challenging the action would have received the business sought by the carrier granted the permit).[1]

(2) 39 U.S.C. § 3622 confers standing to file a complaint upon "*any interested person* (including an officer of the . . . Commission representing the interests of the general public) who believes that the Postal Service is not operating in conformance with the requirements of," *inter alia*, 39 U.S.C. ¶ 403(c). 39 U.S.C. § 3662(a) (emphasis added). Courts and regulatory commissions have held repeatedly that provisions authorizing "any interested person" or "any person" to seek relief do not require that

[1] *See also Mitchell v. United States*, 313 U.S. 80, 93 (1941) (holding that the plaintiff had standing to challenge discriminatory railroad practices under the Interstate Commerce Act even though there was no evidence he intended to use the railroad's services in the future); *Am. Warehousemen's Ass'n v. Ill. Central R.R. Co.*, 7 I.C.C. 556, 590 (1898) (allowing a discrimination claim to proceed even though "the evidence taken discloses few instances where a transportation privilege has been granted to one shipper or consignee and actually denied to another" because "manner of providing these exceptional facilities indicates that there must be resulting discriminations and that unlawful abuses are not merely practicable, but that their perpetration is thereby actually invited."); *California Comm. Ass'n v. Wells, Fargo & Co.*, 14 I.C.C. 422, 425 (1908) (dismissing defendant's contention that plaintiff, because it had no legal status and could not demand service from the carrier, lacked standing to bring a discrimination claim under ICA § 13, which allowed for a complaint by "any person, firm, corporation, or association, or any mercantile, agricultural, or manufacturing society.").

person to have used the service at issue, or even be capable of using the service. *See FERC v. Mississippi*, 456 U.S. 742 (1982) (noting broad standing conferred by statute authorizing "any interested person" to seek relief from state public service commission); *American Message Centers v. Sprint Coms. Co. L.P.*, 8 FCC Rcd 5522 (1993) at ¶ 6 (the "fact that AMC [the complainant] was not a customer of Sprint [the defendant] does not negate AMC's standing to file this complaint [under 47 U.S.C. § 208, the complaint provision of the Communications Act] challenging the lawfulness of Sprint's common carrier practices, even in the absence of direct or indirect injury"); *accord*, *APCC Services, Inc. v. Radiant Telecom, Inc.*, 23 FCC Rcd 8962 (2008) at ¶¶ 14-15.

(3) Even (contrary to fact) Sections 403(c) and 3622 authorized the Commission to adopt a more onerous standing requirement, limiting use of the complaint remedy to persons who were actually using the service at issue would effectively bar the door to relief when, as here, the discriminatory practice is so costly or destructive as to make use of the service impractical or economically ruinous. If the law required GameFly to needlessly run up its damages while this case was pending, merely to preserve GameFly's standing—particularly given the lack of any retroactive monetary remedy for damages—the law would be, to paraphrase Charles Dickens, an ass and an idiot.[2] Nothing in the language or legislative history of Sections 403(c) and

[2] For similar reasons, GameFly's standing does not require that GameFly use letter-sized mailpieces while this complaint case remains pending. If GameFly prevails in this case, and the Postal Service complies with a favorable decision by offering Netflix-like rates of manual processing to pieces entered at letters, GameFly will readily comply with the mailpiece height and thickness limits for letter rates.

3662(a) suggests that its drafters were as wrongheaded as the Postal Service suggests. *Accord*, *Sporhase v. Nebraska*, *supra*.[3]

(4) In any event, some of GameFly *have* been processed by the Postal Service as letters. In each instance, the results were devastating. When GameFly CEO Dave Hodess joined the company in 2003, the "first thing" that GameFly employees told him about mail processing was "don't let the DVDs go on letter machines because they break them." Tr. 5/890. Mr. Hodess later witnessed first-hand the destructive power of automated letter processing when he personally observed automated letter processing equipment in the Los Angeles P&DC break a "substantial portion" of 100-200 GameFly DVDs in a test run of one-ounce letter-sized mailers in 2007. Tr. 5/890-891. GameFly mails its DVDs at two-ounce flats rates, not one-ounce letter rates, not because GameFly likes paying an extra $1.22 in postage per round trip, but because this is the least costly and destructive alternative available to GameFly given the Postal Service's refusal to offer Netflix-like rates of manual processing to GameFly pieces entered at letter rates. Tr. 3/107-108 (Glick); Tr. 5/888 (Hodess).

(5) GameFly *has* requested nondiscriminatory processing of mailpieces entered at letter rates. The Commission need not delve into the 18 months of disheartening and fruitless negotiations that preceded the filing of this complaint in April

[3] The Postal Service gains nothing from *UPS Worldwide Forwarding Inc. v. USPS*, 66 F.3d 621 (3d Cir. 1995) (USPS Br. 35). The additional $700,000 per year in postage that GameFly must pay to approximate the breakage rates that Netflix enjoys from free manual processing clearly constitutes "injury in fact." The causal connection between the discrimination and the injury is equally clear: if the Postal Service offered GameFly Netflix levels of manual processing for mail entered at letters, or a flats rates that made the same contribution that the Postal Service receives from the letter rates paid by Netflix, GameFly could avoid paying the extra postage. And the two remedies proposed by GameFly in this case would redress the injury suffered by GameFly.

2009. It is sufficient to note the demand letter that GameFly sent to the Postal Service's general counsel on March 28, 2009, in a last-ditch effort to avoid litigation. The letter stated that the complaint would be filed on April 23, 2009 unless the Postal Service submitted to GameFly by April 22 a "concrete proposal for processing GameFly DVDs on terms and conditions offered to two large DVD mailers, Netflix and Blockbuster." A draft of the Complaint was attached to the letter. Paragraphs 2, 35-39, 41 and 47 of the draft complaint stated that, unless GameFly's grievances were resolved, GameFly intended to challenge as unduly discriminatory the Postal Service's practice of offering Netflix and Blockbuster, but not GameFly, manual culling and processing DVD mailers entered at letter rates. Joint Statement of Undisputed and Disputed Facts (July 20, 2010) ¶ 129.

(6) The very existence of this costly and time-consuming litigation amounts to a continuing request by GameFly for Netflix-like processing of DVD mailers entered at letter rates. GameFly has explicitly stipulated in this case that it would use letter rates if USPS provided letter service on nondiscriminatory terms. GFL Br. 62-63 and 87-88; Tr. 11/1963 (Glick); USPS Br. 81-82 (admitting that "GameFly has maintained repeatedly that it would prefer to mail at letter rates"). Likewise, the Postal Service has made clear by *its* actions in this case that it would rather litigate indefinitely than offer service on these terms. Under these circumstances, the notion that GameFly lacks standing because it failed to use the right formulation of "Open Sesame" to request Netflix-like processing of letters adds insult to injury.[4]

[4] The Postal Service speculates that GameFly is unwilling to give up automated flats processing because doing so would deprive GameFly of Confirm scans. USPS Br. 36. As Mr. Hodess made clear during cross-examination, however, the value of Confirm to GameFly as a means of tracking mail is worth much less to GameFly than the value of

B. The Federal Tort Claims Act Does Not Bar Relief From Unlawful Discrimination Under 39 U.S.C. § 3662

The Postal Service also contends that a provision of the Federal Tort Claims Act ("FTCA"), 28 U.S.C. § 2680(b), bars any relief for GameFly by immunizing the Postal Service "completely from financial responsibility for damage to DVDs incurred in the mail." USPS Br. 67-68, 71. If the Commission fails to dismiss GameFly's claims on this ground, "the D.C. Circuit Court of Appeals [sic] certainly will." *Id*. at 68. The "breakage rate is [GameFly's] own legal responsibility anyway." USPS Br. 71.

The Commission may wonder why, if the FTCA provides such a clear and complete defense, the Postal Service did not assert it until after 19 months of costly and time-consuming litigation. The obvious reason is that the FTCA is completely irrelevant to this case. The FTCA, codified generally at 28 U.S.C. §§ 1346 and 2671-1680, waives the sovereign immunity of the United States from suit for certain specified kinds of tort and other claims arising from the actions or omissions of the United States or its employees. *FDIC v. Myer*, 510 U.S. 471, 475-476 (1994). As the Postal Service correctly notes, Section 2680(b) exempts tort claims "arising out of the loss, miscarriage, or negligent transmission of letters or postal matter" from the waiver of sovereign immunity otherwise effected by the FTCA.

The FTCA, however, is not the only statute that waives the sovereign immunity of the Postal Service. 39 U.S.C. § 401(1), which authorizes the Postal Service to "sue and be sued in its official name," generally "waives the immunity of the Postal Service from suit." *USPS v. Flamingo Indus. Ltd.*, 540 U.S. 736, 744 (2004); *Gómez-Pérez v. Potter*,

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the opportunity to bypass automated letter processing while paying letter rates. Tr. 5/936.

476 F.3d 54, 57 (1st Cir. 2007), *rev'd* on other grounds, 553 U.S. 474 (2008). Except for "tort" claims that are "cognizable" under 28 U.S.C. §§ 1346(b), the limitations on suit against the Postal Service preserved by the FTCA, including 28 U.S.C. § 2680(b), do not apply to claims authorized by 39 U.S.C. § 401(1). 28 U.S.C. § 2679(a); 39 U.S.C. § 409(c). The courts have held that the only tort claims "cognizable" under 28 U.S.C. § 1346(b), and thus subject to the reservation of sovereign immunity codified in 28 U.S.C. § 2679(a), are tort claims arising under state common law. *FDIC v. Meyer*, 510 U.S. 471, 476-78 (1994); *Global Mail Ltd. v. USPS*, 142 F.3d 208, 211-215 (4th Cir. 1998).

More immediately, the United States has specifically consented to discrimination complaints against the Postal Service at the Commission. 39 U.S.C. § 3662(a) specifically authorizes any interested person to "lodge a complaint" against the Postal Service at the Commission for alleged violations of certain enumerated provisions of Title 39. One of those provisions is Section 403(c), the antidiscrimination provision of Title 39.

This case thus falls squarely within the waiver of sovereign immunity effected by 39 U.S.C. § 3662. GameFly is pursuing its claim the Postal Service at the Commission, not in court; bases its claim on 39 U.S.C. § 403(c) and other substantive provisions of federal law, not state tort law; and seeks a remedial order from the Commission under 39 U.S.C. § 3662(c), not monetary damages or an injunction. Hence, GameFly's claim against the United States is one to which Congress has explicitly consented. it is irrelevant whether 28 U.S.C. § 2680(b), or any other provision of the FTCA, would

authorize suit against the Postal Service on a common law tort theory based on some or all of the same facts.

C. 39 U.S.C. § 403(c) Does Not Give The Postal Service Unlimited Discretion To Discriminate.

The Postal Service's discussion of the legal standards of discrimination runs for nearly 50 pages. USPS Br. 13-63. Most of this discussion is pointless, however, as the Postal Service and GameFly are in essential agreement on the basic tenets of a discrimination claim. As GameFly stated in its initial brief, a discrimination claim consists of three elements:

(1) Is the Postal Service offering better processing or terms of service to some ratepayers than others?

(2) Are the favored and disfavored ratepayers similarly situated to each other?

(3) If the Postal Service is engaging in discrimination, is it "undue or unreasonable"—that is, lacking a rational and legitimate basis?

See GameFly Initial Brief at 54-60. The cases cited and discussed by the Postal Service fully support GameFly's reading of the law. Further, GameFly agrees with the Postal Service 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. *See Sea-Land Service, Inc.*, 38 F.2d at 1317 n.10 (D.C. Cir. 1984) (quoting *Change of Policy, Railroad Contract Rates*, 361 I.C.C. 205, 209-10 (1979)).[5]

The Postal Service errs, however, in suggesting that its discretion to discriminate among its customers is unlimited, and that the discretion to decide whether a particular act of discrimination is reasonable under Section 403(c) rests primarily with the Postal Service rather than its regulator, the Commission. Rather, the cases cited by both parties require that the *Commission* find that a rational justification exists for the discrimination—i.e., that the discrimination either reduces the costs to the Postal Service of handling the mail in question, promotes the efficiency of delivery (which amounts to the same thing), or directly advances one of the Postal Service's statutorily-

[5] The Postal Service contends that decisions from agencies such as the ICC carry no weight in proceedings before the Commission. This is incorrect. The Commission has repeatedly looked to decisions from sister regulatory agencies to inform its interpretation of postal laws. *See, e.g.*, *Experimental Rate and Service Changes to Implement Negotiated Service Agreement With Capital One*, MC2002-2 PRC Op. & Rec. Decis. (May 15, 2003) ("*Capital One NSA*") at ¶ 7013-15 (citing discrimination standards from other regulatory commissions); *Rate and Service Changes to Implement Baseline Negotiated Service Agreement with Bookspan*, Opinion and Recommended Decision, Docket No. MC2005-3 at 38-41 (May 10, 2006) (discussing precedent construing the Interstate Commerce Act and decisions from the Federal Energy Regulatory Commission and Federal Communications Commission and explaining that the Commission must actually adhere "to a higher level of scrutiny for individualized rates than the ICC, the FCC, and the FERC" because of the Postal Service's status as a regulated monopoly without equity shareholders). *See also* Docket No. R77-1, PRC Op. R77-1, Vol. 1, at 193-195 (May 12, 1978) (drawing on decisions of the Civil Aeronautics Board and general principles of public utility regulation to determine whether discrimination was reasonable). The Commission's attention to FCC, FERC, ICC and similarly regulatory precedent is entirely logical, since all of these regulatory commissions deal with network industries characterized by substantial fixed and common costs, wide variations in competition and market power among the markets served by each firm, and statutory mandates to safeguard ratepayers from "undue" or "unjust" discrimination or preferences.

imposed goals.[6] These principles are manifest in every case cited by the Postal Service, even those that are more concerned with Constitutional issues than discrimination under the postal statutes.[7] We discuss court and Commission decisions in turn.

1. Court decisions

For instance, in *UPS Worldwide Forwarding*, 66 F.3d 621, 635 (3d Cir. 1995), the court explained that "[t]he goal sought by the Postal Service in the instant case by their discrimination is the efficient and economical delivery of the mail. The goal is legitimate and the only question before the court is whether the distinctions between the three groups [of customers] are rationally related to the achievement of the goal." (internal quotations omitted).

While the discussion in *Currier v. Henderson*, 190 F. Supp. 2d 1221 (W.D. Wa. 2002), was focused on the constitutionality of the regulation in question, the court upheld the Postal Service's actions based primarily on the Postal Service's showing that

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[6] The notion that *any* discrimination between GameFly and Netflix would be *per se* illegal, regardless of any rational justification, is a caricature of GameFly's position. Rather, in line with Commission and other regulatory precedent, GameFly has shown that its disparate treatment vis-à-vis Netflix is illegal precisely because the discrimination is *not* rationally justified.

[7] Two of the cases cited by the Postal Service, *General Motors Corp. v. Tracy*, 519 U.S. 278, 298-303 (1997), and *Nation's Choice Vitamin Co. v. General Mills, Inc.*, 526 F. Supp. 1014, 1018-1019 (S.D.N.Y. 1981), have no bearing on the instant case. *General Motors* turned on the applicability of the dormant commerce clause. As the parties did not serve the same markets, the Court understandably held that the law in question, which restricted the activity of one of the parties, did not unfairly burden interstate commerce. The foundation for the holding in *Nation's Choice Vitamin*—that a discrimination claim must involve like purchasers and like commodities—is applicable only in the context of the lawsuit, a price discrimination claim under the Robinson-Patman act.

the service, as provided, was more economical. ("The Postal Service could reasonably determine, as it states it has, that it cannot provide no-fee postal boxes in certain areas economically or that General Delivery by zip code in large cities does not justify the cost or the operational problems it creates.") *Id.* at 1230.

In *Currier v. Potter*, notwithstanding that this appeal also turned on constitutional considerations rather than § 403(c), the court upheld the Postal Service's restrictions because they were "a rational response to the inefficiencies and increased costs that would result from expanding general delivery to branch offices." 379 F.3d 716, 732 (9th Cir. 2004).

Likewise, *Eggers v. USPS*, 436 F. Supp. 138, 142 (W.D. Va. 1977), held that "the Postal Service may provide different levels of delivery service to different groups of mail users so long as the distinctions are reasonable."

Grover City v. USPS, 391 F. Supp. 982, 986 (C.D. Cal. 1975), held that delivery regulations were not unduly discriminatory "because the distinctions made by the regulations are reasonably related to the effectuation of the pertinent objectives of the Postal Reorganization Act, which are provision of efficient mail delivery services at reasonable costs."

A change in delivery schedule was upheld in *Bovard v. U.S. Post Office*, 1995 U.S. App. LEXIS 3846 at *2 (10th Cir. 1995), for the same reason—conflict between the customer and the mail carrier inhibited the efficient delivery of the mail.

The renumbering of a rural route in *Ludwig v. Wulff*, 492 F. Supp. 1048, 1049 (S.D. Tex. 1980), was not discriminatory because it reduced the time it takes to sort and deliver mail, thereby saving the Postal Service money.

The court in *Mail Order Ass'n of America v. USPS*, 2 F.3d 408, 436 (D.C. Cir. 1993), looked to whether the distinctions drawn to justify an unzoned rate were arbitrary, as "[a]ny such arbitrariness would presumably violate 39 U.S.C. § 403(c)'s prohibition of 'undue or unreasonable preferences.'" The court held that the unzoned rate was not discriminatory, even though it was not cost-justified, because it was rationally related to furthering the separate statutory goal of binding the nation together. *Id.* at 436-37.

In sum, all of these cases apply the test set forth in GameFly's initial brief, then engage in a factual inquiry to determine whether the discrimination has a rational justification grounded in the statute.

2. Commission decisions

The Commission decisions cited by the Postal Service stand for the same principle, but even more forcefully—as demonstrated by the passages from those cases that the Postal Service relies on.

In considering the Capitol One NSA, the Commission explained that § 403(c) "requires that any identified user preference have a reasonable justification" and found that the distinction in question did not violate § 403(c) "in light of the significant cost-saving opportunities" it provided. *Capital One NSA*, PRC Opinion MC2002-2, Docket No. MC2002-2 at 29 (May 15, 2003) (quoted in Postal Service Brief at 25). The

Commission went on to explain that the determination of whether a preference is undue or unreasonable "depends on whether there is a rational basis for treating a single mailer differently than others." *Id*. (quoted in USPS Br. 26). As the Postal Service notes in its brief, the Commission then explained that differences in treatment may be justified by differences in cost of service or other empirical justification. But the proposition that discrimination may be justified by reasons other than cost differences does not mean that the discretion to discriminate is unbounded. By focusing on the possibility of "other empirical justification," the Postal Service overlooks the central holding of this case—that any discrimination must have a rational basis.

Likewise, the Commission declined to recommend the proposed Citizens Rate Mail ("CRM") category in Docket No. R77-1 because there was no real service distinction between CRM and First Class Mail that could rationally justify a price differential. PRC Op. R77-1, Vol. 1, at 193-199 (May 12, 1978). The Commission explained that, while charging different rates to customers of the same class was not *per se* unlawful, a lawful differential must be justified by "some material distinguishing characteristic exist[ing] either in the segment of customers constituting the class or subclass, or in the form of the service to be provided such segment, so as to warrant the differential." *Id*. at 195. Finding no meaningful distinction between CRM and First Class Mail, or between household and business users of First Class Mail, the Commission determined that the preferences and discrimination that the CRM category would create were not rationally justified and were in violation of § 403(c).

The *Red Tag* Opinion, too, relied on a lack of rational justification for distinguishing between mailers who were eligible for Red Tag service and those who

were not. The Commission ruled that it was a violation of § 403(c) "for non-red tag mailers to pay the same rate that red-tag mailers pay, and receive a lesser quality of service." Docket No. MC79-3, PRC Op. & Rec. Decis. (May 16, 1980) at 11. The Commission also found that this "serious and illegal discrimination" had resulted in part because "there [was] no rational relationship between the present eligibility requirements for red-tag service, and a mailer's need for the expedited delivery that red-tag offers." *Id.* at 12. While the Postal Service attempts to discredit GameFly's reliance on this opinion by pointing out superficial differences between *Red Tag* and the present case, the essential holdings of that opinion are undeniable. The *Red Tag* opinion still stands for the proposition that any discrimination between mailers must rest on a rational justification.

* * *

The issues that remain before the Commission are largely factual. Is the Postal Service's discrimination in favor of Netflix justified? Does it reduce mail processing costs? Does it aid the Postal Service in meeting its statutory goals? And would offering the same service to GameFly frustrate the Postal Service's ability to meet these goals?

As we explain in Sections V and VI, the weight of the *factual* evidence shows that the Postal Service's discrimination has no rational justification. Manual processing of Netflix DVD mailers increases, rather than decreases, the cost of processing DVD mail. The real reasons for this manual processing are to protect the product of a single large mailer, and to minimize the jamming of Postal Service equipment that the Postal Service has brought upon itself by accepting as machinable a Netflix mailpiece design that is effectively nonmachinable. These goals would be served just as well by

manually culling the DVD mailers of other companies too. And the Postal Service has provided no evidence that offering the same treatment to GameFly would increase Postal Service costs or inhibit its ability to meet its goals. Consequently, in line with the cases the Postal Service relies on in its brief, the Postal Service's discrimination in favor of Netflix is not rationally justified and thus violates section 403(c).

D. The 2006 Christensen Reports, The 2007 OIG Report, And Other Admissions By Postal Service Employees And Agents Are Entitled To Full Evidentiary Weight Without A Sponsoring Witness.

In its initial brief, the Postal Service tries—yet again—to resurrect its tired claim that the 2006 Christensen Associates reports, the 2007 OIG report, and other documentary admissions obtained by GameFly in discovery should not be admitted, let alone given evidentiary weight, without a "sponsoring" witness from GameFly. USPS Br. 12-13, 27, 94-101, 113, 122, 125-127.[8] The Commission has rejected this claim in six separate rulings in this case.[9] The Postal Service has offered no reason for a different outcome this time.

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[8] For the Postal Service's previous requests, *see* Tr. 3/72-73 (argument of Postal Service counsel); Tr. 4/155-156 (same); Motion of USPS to Compel GameFly to Designate A Witness To Sponsor Interrogatory Answers And Interpretations Of Postal Service Documents (June 16, 2010) at 8; USPS Response to GameFly Motion to Compel (Sept. 21, 2010) at 5; Tr. 7/1374-1376 (hearing on Oct. 5, 2010); Reply Of The USPS In Opposition To Motion Of GameFly, Inc. To Retain Cross Examination Exhibit GFL-CX-5 In Evidence And To Preclude The Postal Service From Denying The Truth And Effectiveness Of Its Contents (Oct. 28, 2010); Reply of the USPS in Opposition to Motion of GameFly, Inc., to Admit Certain Postal Service Documents Into The Record (Nov. 1, 2010); Reply of the USPS In Opposition to Motion of the Public Representative to Admit Christensen Spreadsheets into Evidentiary Record (Nov. 1, 2010); Motion of the USPS to Strike the Rebuttal Testimony of Sander Glick for GameFly, Inc. (Nov. 1, 2010).

[9] Tr. 4/156-157, 666 (oral rulings by Commissioner Blair); Presiding Officer's Rulings No. C2009-1/24, 40, 41, 45 and 46.

1. The Commission repeatedly has considered and rejected the Postal Service's position on this issue.

During the hearing on June 16, 2010, the Postal Service objected to admission of these Postal Service documents on the ground that GameFly had not offered a sponsoring witness for them. Tr. 3/72-73 (argument of Mr. Hollies); Tr. 4/155-156 (argument of Mr. Mecone); *cf*. Tr. 3/73-76 and 4/155-156 (responsive argument of GameFly counsel). The Presiding Officer, after considering the arguments, provisionally admitted the documents, subject to reconsideration if the Postal Service moved within one week (i.e., by June 23) to strike the documents from the record. Tr. 4/156-157, 666.

On June 16, the Postal Service also filed a written motion asking that GameFly be compelled to designate a witness to stand cross-examination on, *inter alia*, the "Postal Service documents whose content GameFly does not sponsor."[10] GameFly filed an opposition on June 23.[11] The Postal Service did not, however, seek reconsideration of the Presiding Officer's June 16 ruling on or before the June 23 deadline set by him.

In Presiding Officer's Ruling No. C2009-1/24 (July 6, 2010), Commissioner Blair ordered GameFly to submit an institutional witness to stand cross-examination on how GameFly *interpreted* the Postal Service documents, *but not on the authenticity or credibility of the documents themselves.* POR 24 at 12. He explained:

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[10] Motion of USPS to Compel GameFly to Designate A Witness To Sponsor Interrogatory Answers And Interpretations Of Postal Service Documents (June 16, 2010) at 8.

[11] Answer of GameFly to Motion of the USPS For Another Opportunity To Cross-Examine An Institutional GameFly Witness (June 23, 2010).

> No due process basis for oral cross-examination arises to test the authenticity of documentary evidence produced by the party seeking cross-examination. The GameFly Answer [of June 23] rebuts the risks that concern a lack of authenticity, and asserts the documents are independently credible in view of Federal Rules of Evidence rules 801(d)(2)(D), 803(6) and (8). Answer at 5. *The Postal Service has not moved to strike the admission of the documents as evidence into the record through a timely motion. In view of the pleadings and the transcript of the June 16, 2010 hearings, the Postal Service's objections based upon authenticity and hearsay are not persuasive.*

POR 24 at 12 (emphasis added).

In four subsequent rulings, the Presiding Officer reiterated the admissibility against the Postal Service of unsponsored Postal Service documents of this kind. In Presiding Officer's Ruling No. C2009-1/40 (October 1, 2010), he specifically rejected the Postal Service's contention that "witness testimony is 'the only evidence in the record stating Postal Service processing standards and policies.'" POR 40 at 8 n. 13. He explained:

> The Postal Service views the scope of evidence too narrowly. . . . Even if there were some basis to exclude the documents of record as the Postal Service professes for want of authenticity, a proposition which has repeatedly been denied under the law of the case, the written designations of discovery answers which often refer to the documents further belie the veracity of the Postal Service's argument as to the "only" evidence. [Citations omitted.] *As the objections relating to authenticity do not withstand closer scrutiny, the documents may be presumed to speak for themselves.*

POR 40 at 8 & n. 13 (emphasis added).

Presiding Officer's Ruling No. C2009-1/41 (October 18, 2010) reiterated these points. *Id*. (discussing Tr. 7/1374-1376 and Tr. 8/1556). The precise issue was whether GameFly could move into evidence two Postal Service documents at the October 5

hearing without their authentication by a GameFly witness or by Robert Lundahl, the Postal Service witness whom GameFly cross-examined about the documents. Once again, the Presiding Officer held that documents created in the ordinary course of business and produced by the Postal Service in discovery could be offered against the Postal Service, the producing party, without any further authentication. POR 41 at 2. Commissioner Blair held, however, that he would entertain a Postal Service motion within seven days to strike the documents, if the Postal Service filed such a motion "along with one or more supporting declarations within the next seven days." *Id*. at 2 & n. 4. The October 25 deadline passed without any such Postal Service filing, and POR 41, like POR 24 and POR 40, became the law of the case.

Presiding Officer's Ruling No. C2009-1/45 (issued November 8, 2010), considered and overruled the same objections now advanced by the Postal Service against admitting into evidence the 2006 Christensen Associates reports, the 2007 OIG report, and other internal Postal Service documents obtained from the Postal Service in discovery. POR 45 considered and rejected essentially all of the arguments that the Postal Service now raises again in its initial brief. (Indeed, much of the Postal Service's discussion of this issue in its brief appears to have been copied verbatim from the Postal Service pleading that the Commission found unpersuasive in POR 45.)

Presiding Officer's Ruling No. C2009-1/46 (issued November 8, 2010) denied the Postal Service's motion to strike the rebuttal testimony of GameFly witness Glick on the ground that he had relied on the 2006 Christensen Associates reports and other documents that the Postal Service sought to exclude.

The Commission has bent over backwards to give the Postal Service ample opportunities to be heard. The Postal Service's unrelenting attempts to relitigate the issue are part of what the Public Representative has described as "delaying tactics ad infinitum" (Pub. Rep. Br. 2), i.e., frivolous claims that "cause unnecessary delay or needless increase in the cost of litigation." Fed. R. Civ. P. 11(b). Unless the Commission brings these tactics quickly to an end, these delaying tactics will destroy the viability of the Section 3622 complaint process.

2. The Commission's rulings on this issue are correct.

Even if (contrary to fact) the Postal Service's latest attempt to relitigate the admissibility of the Christensen reports, the OIG report, and other internal Postal Service documents out of the record were a matter of first impression, the same outcome as the Presiding Officer's previous rulings on the issue would be warranted. The decisive points, which the Postal Service continues to ignore, are as follows.

The OIG Report. The OIG Report is admissible without a sponsoring witness for the reasons summarized in Presiding Officer's Ruling No. C2009-1/45 at 8-10. First, the Postal Service, despite being given repeated opportunities to seek review of the Presiding Officer's rulings admitting portions of the OIG Report, failed to do so. Hence, the adverse rulings are now the law of the case. POR 45 at 8-9.

Second, the OIG report, as the report of a public agency in the course of exercising its responsibilities, is subject to official notice under Rule 3001.31(d). The OIG report is a public record within the meaning of Fed. R. Evid. 803(8). Moreover, because the report was created by the OIG, an agent of the Postal Service acting within

the scope of its responsibilities, the report is admissible under Fed. R. Evid. 801(d)(1)(2)(D). The Postal Service has not asserted that the versions of the documents offered into evidence by GameFly or relied on by Mr. Glick were doctored or fabricated in any way.

Third, the Postal Service has acknowledged the continuing relevance of the OIG report as a benchmark for the amount of manual processing received by Netflix mail. Joint Statement Of Undisputed And Disputed Facts (July 20, 2009) at ¶¶ 83, 84, 87.

For all of these reasons, it was entirely appropriate for GameFly—and Mr. Glick—to rely on those documents as evidence of the truth of their contents. POR 45 at 9; 39 C.F.R. § 3001.31(d).

The Christensen Reports. The Christensen Reports and underlying workpapers are admissible without a sponsoring witness for the reasons summarized in Presiding Officer's Ruling No. C2009-1/45 at 10-12. First, maintaining the reports in evidence is consistent with the law of the case in light of the Postal Service's failure to act on the Commission's invitation to challenge the rulings admitting portions of the report into evidence. POR 45 at 10.

Second, even if "authentication" of the Christensen report were necessary, the Postal Service has supplied it. POR 45 at 10-12. The Postal Service and several of its individual witnesses have stipulated to or otherwise acknowledged the evidentiary value of the most important documents relied on by Mr. Glick in his rebuttal testimony. *See* USPS answers to GFL/USPS-17 and 18 (admitting that the Postal Service used the Christensen and OIG reports to estimate the relative amounts of manual vs. automation

letter process received by Netflix and another DVD rental company); USPS response to GFL/USPS-163(c) **[BEGIN PROPRIETARY]**

[END PROPRIETARY] Tr. 10/17889, 1792-93, 1795 (USPS witness Seanor) (citing Christensen report as support for his position on the efficiency of culling Netflix mail at the point of collection); USPS Br. 107 **[BEGIN PROPRIETARY]**

[END PROPRIETARY] In fact, the Postal Service relied on the cost estimates developed in the Christensen report in its own comments to the OIG in response to the 2007 OIG report. GFL703. Having vouched for the Christensen and OIG reports by relying on them, the Postal Service can no longer object that they lack authentication.[12]

Third, the spreadsheets underlying the Christensen reports are admissible as adoptive admissions by a party opponent. POR 45 at 45 (citing 39 C.F.R.

[12] The Postal Service's opposition to the admission of unsponsored documents produced by an opposing party is also selective. The Postal Service itself has relied without a sponsoring witness on documentary evidence discovered from adverse parties in similar circumstances. Indeed, the Postal Service did so in this very case. Except for a limited class of GameFly discovery responses that the Postal Service has chosen to withdraw from designation, the Postal Service moved into the record the narrative responses, documentary appendices, and library references produced by GameFly in response to virtually every one of the Postal Service's discovery requests. *See* USPS Designation of Written Cross-Examination (June 10, 2010); USPS Supplemental Designation of Written Cross-Examination (June 16, 2010); Tr. 3/66-69 (June 16, 2010 hearing); Tr. 4/129-131 (list of items designated by USPS as written cross-examination). This mass of material includes hundreds of megabytes, and thousands of pages, of GameFly documents and communications. The Postal Service presumably entered the material to enable its use against GameFly. Yet the Postal Service offered no sponsoring witness for any of the material.

§ 3001.30(e)(3)). The spreadsheets are also admissible for the independent reason that the Postal Service used portions of them to cross-examine Mr. Glick. Fairness requires that the those portions be considered as part of an integrated whole, and the remainder of the spreadsheets were properly admitted for that reason. *See* Fed. R. Evid. 106.

Memoranda, emails and other internal documents generated by Postal Service employees. The documents of the Postal Service internal working group that considered the treatment of DVD mailers between 2005-2007, and similar emails, internal documents and communications generated within the Postal Service since 2002, are admissible for the reasons summarized in Presiding Officer's Ruling No. C2009-1/45 at 12-14.

First, the documents at issue were not merely business records, but *admissions by the Postal Service's employees and agents.* Fed. R. Evid. 801(d)(2)(D) ("a statement by the party's agent or servant concerning a matter within the scope of the agency or employment, made during the existence of the relationship" is not hearsay if offered against the party); POR 24 at 12 (citing Fed. R. Evid. Rule 801(d)(2)(D)). Statements by a party's agent or employee are treated as party admissions if they were made during the agency or employment and they relate to a matter within the scope of the agency or employment. Fed. R. Evid. 801(d)(2)(D). *See also* Fed R. Evid. 803(6); Fed. R. Evid. 803(8); *Barnes v. Owens-Corning Fiberglas Corp.*, 201 F.3d 815, 829 (6th Cir. 2000); *United States v. Lavalley*, 957 F.2d 1309, 1314 (6th Cir. 1992) (letters from commander of military base were admissible as business records); *United States v. Jenkins*, 928 F.2d 1175, 1180 (D.C. Cir. 1991); *United States v. Boylan*, 898 F.2d 230,

257 (1st Cir. 1990) (police personnel files were admissible as business records). These standards apply fully here.

The contrary position advanced by the Postal Service would effectively gut the complaint remedy for discrimination. A Postal Service customer who is the victim of discrimination by the Postal Service is unlikely have any witness with personal knowledge of the oral and written communications within the Postal Service, and between the Postal Service and its favored customer, that document the discrimination. If admissions of the kind at issue cannot be given weight without a sponsoring witness, complainants will have no way to cut through the veil of secrecy that typically envelopes misconduct of this kind.[13]

III. THE POSTAL SERVICE OFFERS BETTER TERMS OF SERVICE TO NETFLIX THAN TO OTHER DVD RENTAL COMPANIES.

A. USPS concedes that automated letter processing breaks DVDs.

The record in this case provides overwhelming evidence that automated letter processing of DVDs, and the bending stresses and impacts that result, cause high rates

[13] The Postal Service also seeks to resurrect the litigation hold issue that the Postal Service raised in its June 16, 2010, Motion to Compel GameFly to Designate a Witness to Sponsor Interrogatory Answers and Interpretations of Postal Service Documents. *See* USPS Br. 130-132. The Commission properly disposed of this issue in Presiding Officer's Ruling No. C2009-1/24 (July 6, 2010) at 16-18; *see also* GameFly Answer to Motion (June 23, 2010) at 23-24. Developments since POR 24 have further underscored the soundness of the Commission's action. On July 27, 2010, GameFly produce thousands of pages of additional documents, including the files of former key executives that GameFly previously believed had been lost. *See* Supplemental Answers Of GameFly, Inc., To USPS Discovery Request USPS/GFL-4, -67, and -68 (July 27, 2010). The Postal Service has made little or no use of the mass of material produced by GameFly. This is unsurprising; the documents most relevant to the claims and defenses in this case are the Postal Service's own documents, not those of its customer. *See* GameFly Answer to Motion (June 23, 2010) at 12-23.

of DVD breakage. The documents produced in discovery reveal a broad consensus among the employees of the Postal Service, Netflix, Blockbuster and GameFly on this point. GameFly Br. 10-18. The record also shows that most DVD mailer designs—particularly those used by Netflix—have a second operational problem: they tend to jam Postal Service letter processing equipment. GameFly Br. 18-21.

The Postal Service does not seriously dispute these points. While speculating about the precise rate of DVD breakage rate that would result if GameFly used the Lundahl "fixes" (USPS Br. 71) or received Netflix-level processing ((USPS Br. 116),[14] the Postal Service ultimately concedes that DVD's

> exhibit a tendency to break during handling, and particularly during processing on Postal Service letter automation equipment. Breakage can be costly. Damage to rental DVDs incurred in processing and delivery can significantly impair rental companies' finances.

[14] Several other Postal Service points on this issue warrant only brief comment. First, the Postal Service criticizes GameFly for failing to conduct a "rigorous study" of the causes of damage. USPS Br. 115. But GameFly *has* studied the causes of DVD damage. Its studies show that automated letter processing is overwhelmingly the leading cause of damage, and that other factors lag far behind. *See* GameFly Response to USPS/GFL-4 (C266) and Appendix USPS/GFL-4A (C___); GameFly Response to USPS/GFL-6 (C272) and Appendix USPS/GFL-6 (C____); Tr. 5/890-91 (description by GameFly CEO David Hodess of his visits to postal facilities and observations of automated letter processing equipment damaging DVDs).

Second, the Postal Service assails GameFly for supposedly assuming that Postal Service BMEU employees would deliberately process flat-rated GameFly pieces as letters. USPS Br. 116-117. GameFly made, and needed to make, no such assumption. GameFly return mailers are not entered in BMEUs because they are not bulk mail. They are single piece mail entered by consumers in retail mail collection facilities. *See* Glick Direct (GFL-T-1) at 9-12 (Tr. 4/145-148).

Third, the Postal Service suggests that GameFly is not being discriminated against because the breakage rates of GFL and Netflix DVDs are similar even though processing methods differ. USPS Br. 115-116. The Postal Service neglects to mention, of course, that maintaining this rough equivalence in breakage rates requires GameFly to spend $1.22 extra in postage per round trip.

USPS Br. 1-2.

B. The Postal Service cannot seriously dispute that it discriminates in favor of Netflix by culling most of its pieces from automated letter processing.

Nor is there any serious dispute that Netflix receives far better service than the Postal Service offers to other DVD mailers. The Postal Service, by its own admission and the observations of independent observers, culls approximately 80 percent of Netflix DVDs from automated letter processing. GameFly Br. 22-28 (discussing record). The corresponding manual processing rate for Blockbuster DVD mailers significantly less, *id*. at 29-31 (discussing record), and the manual processing rates offered to smaller DVD rental companies are even lower. *Id*. at 32-36 (discussing record).

The Postal Service, as it has done through this proceeding, retreats behind a shroud of local discretion. The disparities in manual processing rates are purely the result of decentralized processing decisions, the Postal Service insists, so headquarters cannot be held accountable for the outcome. USPS Br. 2 (bottom half of page), 28, 84-86. As GameFly has repeatedly explained, however, the Postal Service cannot evade responsibility for undue discrimination by hiding behind its field offices. GameFly Br. 65-67.

First, 39 U.S.C. § 403(c) bars undue discrimination and preferences by "the Postal Service"—not just by "Postal Service headquarters." Headquarters rulings that vest field officials with discretion to violate Section 403(c) are as much an affront to the statute as discriminatory actions by headquarters officials themselves. *See Koch Pipelines, Inc.*, 63 FERC ¶ 62,104 at 64,177 (1993) (suspending a proposed tariff

because "[t]he vagueness of the prorationing language appears to leave Koch with excessive discretion in determining which shipper nominations will be accepted for shipment."); *Boynton v. Commonwealth of Virginia*, 364 U.S. 454 (1960) (racial discrimination by restaurant in the Trailways bus terminal in Richmond, Virginia, violated former 39 U.S.C. § 316(d), which barred "undue or unreasonable preference" or "prejudice" by "any common carrier by motor vehicle" in interstate commerce, even though the restaurant was owned and operated by a tenant of Trailways, not by the bus company itself). Hence, the undue discrimination against Netflix and other DVD mailers would have been actionable under 39 U.S.C. § 403(c) even if Postal Service headquarters officials had been unaware of the discrimination.

Second, as GameFly noted in its initial brief, the fingerprints of Postal Service headquarters officials are all over the key decisions that led to this case. The 2002 decision to classify the Netflix mailpiece as machinable was a headquarters decision—and one that remains uncorrected three years after the 2007 OIG report urged headquarters management to take corrective action. *See* GameFly Br. 42-43; Tr. 10/1885 (Seanor). Headquarters officials have known for years of the high rate of manual processing received by Netflix, and the continuation or growth of this practice after the issuance of the 2007 OIG Report, but have deliberately chosen not to stop this practice or otherwise rein in local discretion over the processing of Netflix return mailers.[15] Moreover, the acquiescence of headquarters officials in the ongoing

[15] USPS Responses to GFL/USPS-23(b)-(e), 24, 25, 70(f), 86 (C_____); Joint Statement ¶¶ 79, 87, 90; Tr. 4/304 (GFL517); Tr. 4/641 (GFL81093) **[BEGIN PROPRIETARY]**

[END PROPRIETARY] The Postal Service's acquiescence in manual processing of DVD return mailers at field offices was a deliberate policy approved by the "[s]enior

discrimination did not stem from any belief that headquarters was powerless to eliminate it. To the contrary, USPS witness Seanor conceded that the discrimination between Netflix and Gamefly could be ended by a headquarters or other nationwide directive if the Postal Service chose. Tr. 10/1814, 1819 (Seanor)**.**

Presiding Officer's Ruling No. C2009/1-10 (issued November 4, 2009) established three rebuttable presumptions:

> Senior management of the Postal Service was aware that (a) a significant portion of the return DVD mailpieces of Netflix was culled manually and condoned this conduct; (b) that some of the areas and districts had such standard operating procedures in place and condoned them; and (c) that Netflix has been actively "lobbying" field personnel to an appreciable degree.

Id. at 5-6. The ruling directed the Postal Service to "provide any evidence upon which it may rely to refute a presumption within the next two weeks to avoid the risk of surprise." *Id*. at 6 n. 11. The Postal Service did not try to refute the presumptions, and they are now irrefutable.

Finally, the Postal Service's observation that it does not "guarantee that any particular processing method will be used for mail entered at any specific price or within any specific mailpiece characteristic" (USPS Br. 117-118 (citing testimony of Lawrence

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management of the Postal Service." USPS Response to GFL/USPS-88; *see also* Tr. 4/375-76 (GFL1484-85) (October 9, 2005, email from **[BEGIN PROPRIETARY]**

[END PROPRIETARY] summarizing their discussions and dinner meeting during his site visit to the Netflix Sunnyvale Operations Center, and noting the continued need for "culling of our returns prior to getting into the automation stream"); Tr. 4/586 (GFL80740) (Feb. 16, 2006, email from **[BEGIN PROPRIETARY]**

[END PROPRIETARY]

Buc)) is indisputable but irrelevant. No one disputes that departures from processing standards occur. But there is a fundamental difference between the random and infrequent departures from standard practice noted by Mr. Buc (FE Return Scenario 1 v.xls, "SP VV Costs.")) and the massive, sustained and systemic disparities in service among customers at issue here.[16]

C. The terms of the Andrew German letter would not eliminate the discrimination between Netflix and GameFly.

The Postal Service's initial brief confirms that the "non-settlement offer" set forth in the May 17, 2010 letter from Andrew German to GameFly counsel was a litigation stunt, not a good faith attempt to remedy the discrimination between Netflix and GameFly. As GameFly has previously noted, the letter offers no commitment that GameFly would actually receive the same avoidance of automated letter processing as Netflix—or satisfy any particular quantitative benchmark at all.[17] To the contrary, the letter emphasizes that the offer, if accepted by GameFly, would continue to leave the method of processing GameFly mailers to local discretion.[18] The lack of any commitment to a quantitative benchmark is a crucial omission, because the Postal Service's offer would require GameFly to abandon the protection currently offered by its use of flats processing and protective inserts. And the Postal Service's performance to

[16] Mr. Buc's actual testimony was that "unit costs in [unexpected, nonstandard operations] tend to be small . . . and in aggregate they comprise 0.079 cents of unit mali processing costs for presort letters." Docket No. R2006-1, PB-T-2 (Buc) at 22.

[17] GameFly Br. 36-37; Tr. 4/654-5 (Glick); Tr. 5/897-900, 948, 954-5 (Hodess cross-ex); Glick Rebuttal (GFL-RT-1) at 14 (Tr. 11/1921, 12/2024); Tr. 11/1960-1961, 1964 (Glick cross-ex).

[18] GameFly Tr. 37; German Letter at 1 (Tr. 5/950); Tr. 5/899 (Hodess); Glick Rebuttal (GFL-RT-1) at 15 (Tr. 11/1921, 12/2024).

date in providing manual culling to letter-shaped DVD mailers other than Netflix gives no grounds for optimism. GameFly Br. 37-38; Glick Rebuttal (GFL-RT-1) at 15 (Tr. 11/1921, 12/2024).

Whether these disparities are truly the result of local discretion, as the Postal Service contends, or local discretion is just a fig leaf for a headquarters decision to treat Netflix DVD mailers better than the DVD mailers of other rental companies, ultimately does not matter. In either case, an offer that reserves the ultimate choice of processing method to the Postal Service's discretion, rather than committing to a specific and enforceable minimum level of manual processing, is just a warmed-over version of the status quo. Tr. 11/1960-61 (Glick cross-ex). Even USPS witness Seanor acknowledged that a formal directive is probably necessary to ensure the same level of culling for GameFly pieces.[19]

Moreover, two of the preconditions that the Postal Service would require GameFly to satisfy in exchange for an empty and unenforceable service commitment would impose additional costs on GameFly for no legitimate reason. Specifically, the Postal Service conditioned its offer on GameFly's commitment to:

- Take delivery of its mail via caller service at approximately 130 locations (a number much larger than GameFly's current number of pickup points).

- Enter outbound pieces significantly deeper into the mail stream.

[19] Tr. 10/1811, 1814, 1818-9 (Seanor); Glick Rebuttal (GFL-RT-1) at 15 (Tr. 11/1921, 12/2024). Mr. Seanor stated that, while the instruction would not need to come from Headquarters, achieving Netflix-like rates of manual culling and processing would require a nationwide commitment.

As GameFly has explained, these conditions are merely pretexts for continuing to discriminate. Requiring a minimum number of GameFly pickup points or a minimum average depth of entry into the postal system would run up GameFly's costs without significantly reducing the Postal Service's costs. GameFly Br. 39-41 (discussing record).

The Postal Service's responses to these criticisms confirm that the German letter was a litigation gambit, not a good faith settlement offer. The Postal Service chides GameFly for failing to "respond" to the letter (USPS Br. 12, 65, 75-76, 77-78)—as if the testimony of GameFly witnesses Glick and Hodess left any doubt about the nature of GameFly's objections to the proposed settlement terms. After nearly two years of unanswered settlement overtures by GameFly—and 19 months of litigation—the Postal Service knows perfectly well what GameFly finds unacceptable about the German proposal.

The Postal Service's insistence that no formal service commitment to GameFly is necessary because Netflix receives no formal service commitment either (USPS Br. 79-80) is equally wrongheaded. As Mr. Glick noted:

> Netflix can look at history, and history says very clearly that the Postal Service is going to cull the vast majority of Netflix pieces.
>
> If GameFly looks at history, what does it show? It shows that the Postal Service does not do the same for other mailers of letter-shaped DVD mail pieces. That's what the record shows. So for GameFly to get the same processing as Netflix there needs to be a commitment on behalf of the Postal Service, and there is no commitment in the [German] letter.

Tr. 11/1960-61 (Glick cross-ex).

D. Other Forms Of Discrimination In Favor Of Netflix Are Essentially Undisputed.

The Postal Service does not seriously dispute that it has offered other preferences to Netflix but withholds them from other DVD rental companies. These preferences include the classification of the Netflix mailpiece design, which is effectively nonmachinable, as machinable (GameFly Br. 42-45); the Netflix- and Blockbuster-only drop slots (*id*. at 53 n. 14); and the extraordinary oversight authority that the Postal Service extends to Netflix (*id*. at 53-54 n. 14). The Postal Service professes not to understand the relevance of these additional preferences. USPS Br. 17-21. Their relevance is clear. The additional forms of discrimination preclude any claim that the discriminatorily high levels of manual culling and diversion offered to Netflix have anything to do with cost minimization. Cost minimization cannot explain the jams and other self-inflicted costs that the Postal Service has needlessly inflicted on itself by classifying the Netflix mailpiece design as machinable. Nor can cost minimization explain that widespread practice of offering mailpiece drop slots to Netflix (and sometimes Blockbuster) but not to anyone else. Only a desire to cater to Netflix can explain these practices.

IV. GAMEFLY AND NETFLIX ARE SIMILARLY SITUATED UNDER 39 U.S.C. § 403(c).

A. The Postal Service Mischaracterizes The Governing Legal Standards

As GameFly explained in its initial brief, two customers of the Postal Service may be "similarly situated" under 39 U.S.C. § 403(c) despite differences in their mail characteristics and mailing operations. Substantial similarity does not require that the circumstances of two similarly situated mailers be "the same" or identical. *Experimental*

Rate and Service Changes to Implement Negotiated Service Agreement With Capital One, MC2002-2 PRC Op. & Rec. Decis. (May 15, 2003) ("*Capital One NSA*") at ¶ 7015. "Minor," "incidental" or "immaterial" differences between two customers' mail do not make them unlike. *Id.* at ¶¶ 7015-7021; *MCI Telecoms. Corp. v. FCC*, 917 F.2d 30, 39 (D.C. Cir. 1990). Thus, for example, it is immaterial in this context whether two rate-payers are the same size, generate the same amount of mail, impose the identical operating requirements on the Postal Service, cost the Postal Service the same to serve, or have the same competitive options. *Capital One NSA* at ¶¶ 7020-7021, 7023.

The Postal Service tries to distinguish these cases on the theory that GameFly is not "similarly situated" to Netflix within the meaning of *Capital One* and its antecedents because GameFly does not currently mail DVDs at letter rates, making the similarity between the two DVD rental companies purely "hypothetical." USPS Br. 31-33. This distinction is no more persuasive here than in the context of standing. To the contrary, *Capital One* makes clear that "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*. ¶ 7009 (emphasis added))—i.e., other ratepayers who are "*willing and able* to meet the contract's terms." *Id*. at ¶ 7014 (quoting *Sea-Land Service v. ICC* , 738 F.2d 1311, 1317 n. 10 (D.C. Cir. 1984) (emphasis added)). Nothing in *Capital One* or the discrimination cases cited therein support the notion that mailers who are otherwise "willing and able" to use the desired service must be left unprotected from discrimination because they are not currently using the desired service.

B. The Postal Service Has Failed To Identify Any Material Dissimilarities Between Netflix and GameFly.

The Postal Service predictably claims that Netflix and GameFly differ in a host of supposedly important characteristics. USPS Br. 3-4, 10, 30-31, 34-35, 52, 63-64, 67, 69-75, 85, 118-120, 124-125. In fact, the differences identified by the Postal Service are either mutable, insignificant or completely irrelevant.

1. Mutable differences

The mutable differences include the rate category of the mailpiece (letter-rated vs. flat-rated), the actual shape of the mailpiece (letter vs. flat), and the brightness and visibility of the mailpiece design. USPS Br. 4, 10, 30 n. 22; 34-35, 52, 63-64, 67, 75, 85, 118-19, 124). All of these differences are artifacts of the Postal Service's refusal to offer GameFly service at letter rates that is comparable in quality (i.e., in avoidance of automated letter processing) to Netflix service. If the Commission ordered an end to this discrimination, and the Postal Service offered letter-rated DVD service on terms comparable to those now offered to Netflix, GameFly would be perfectly willing to enter its DVDs in brightly colored and highly visible letter-sized pieces at letter rates. GameFly Br. 62-64 (citing record).[20]

[20] The Postal Service's claim that GameFly and Netflix differ significantly because GFL operates in the "flat mailing market" and Netflix operates in the "letter mailing market" (USPS Br. 30 n. 22) is silly. *The shape of the mailpiece is not a market-defining characteristic in the DVD rental business.* DVD mailers are merely packaging, and the various mailer shapes are readily substitutable depending on their cost and Postal Service processing practices.

2. Insignificant differences

The Postal Service notes that GameFly has lower volume and volume density than Netflix; moves longer distances in the postal system; and is collected at fewer pickup points. USPS Br. 67, 119-120, 124-125. These differences, while real, are insignificant. The Postal Service contends that the lower volume and density of GameFly pieces is important because these characteristics make GameFly pieces more difficult to identify and cull from the mailstream. If the Postal Service induced GameFly to resume mailing at letter rates, however, GameFly would have every reason to adopt a mailpiece design similar in its brightness and visibility to the Netflix design. The resulting densities of DVD mailpiece volume, from the perspective of Postal Service mail sorting employees, would be the *combined* volume densities of Netflix *and* GameFly *and* any other DVD rental companies that adopted similar designs. GameFly Br. 77.

In Section VI, *infra*, we respond to the Postal Service's claim that differences between the characteristics of GameFly and Netflix mail somehow provide a rational basis for discriminating between the two companies. As we explain there, the cost differences resulting from differences in volume, length of haul, and the number of mail pickup points have only minor effects on Postal Service costs.

3. Completely irrelevant differences

The remaining differences (or supposed differences) between GameFly and Netflix identified by the Postal Service are utterly irrelevant under 39 U.S.C. § 403(c). These items include: (1) the absence of direct competition between GFL and Netflix (USPS Br. 30 n. 22); (2) the greater replacement cost of game DVDs (*id.* at 72); (3)

resulting differences in the importance of theft to video game rental companies (*id*. at 72-73); (4) GameFly's supposed ignorance of the details of the DVD industry (*id*. at 73-74); (5) GameFly's supposed sloth and lack of initiative in failing to pursue the fixes touted by USPS witness Lundahl (*id*. at 69-71, 74).

The scope of Section 403(c) is not limited to discrimination between competitors; to the contrary, the statute forbids undue preferences to "any" user. *See ICC v. Martin Bros. Box Co.*, 219 F.2d 811, 821 (9th Cir. 1955) (Pope, dissenting) (quoting with approval trial judge's statement that "nothing in the [Interstate Commerce] Act and no decision that I have been able to find permits discrimination as between shippers merely because they are not in the same type of business and therefore do not compete against each other."); *Wight v. United States*, 167 U.S. 512, 518 (1897) (holding that whether shippers compete with each other is not a relevant concern in determining whether a rate is unduly discriminatory under § 2 of the Interstate Commerce Act; the prohibition against discrimination "refers to the matter of carriage, and does not include competition.")

Differences in the value and wholesale or retail cost of video vs. game DVDs, other aspects of the DVD industry, and the varying techniques used by individual DVD rental companies to protect their DVDs from breakage in postal processing are concerns of the DVD rental companies, not the Postal Service. Absent any evidence that these characteristics affect the *Postal Service's* costs, differences in these characteristics are completely irrelevant under Section 403(c).[21] The same is true of

[21] The costs that are relevant for determining whether discrimination is justified by cost are the costs incurred *by the Postal Service itself*, not the costs incurred by its customers Netflix and GameFly. *See, e.g.*, *Experimental Rate and Service Changes to Implement Negotiated Service Agreement with Capital One*, Docket No. MC2002-2,

physical variations among DVD's that heavily preoccupied USPS witness Lundahl. Notwithstanding the variations in design and specifications among DVDs from the perspective of DVD manufacturers and users, Mr. Lundahl failed to offer any evidence that such variations are apparent to the Postal Service, or in any way affect its operations or costs.

Finally, the Postal Service's claim that GameFly is not similarly situated to Netflix because GameFly has not been as "proactive" as Netflix in dealing with the Postal Service (USPS Br. 74-75) is not only irrelevant but ridiculous. GameFly spent the better part of two years working with the Postal Service in a fruitless effort to devise a constructive solution for its DVD breakage problems. How much longer should GameFly have continued in this unproductive path?

PRC Op. & Rec. Decis. (May 15, 2003) at ¶¶ 1008, 3030 (discrimination analysis under 39 U.S.C. § 403(c) focuses on the relationship between the rate differentials with the "costs avoided by the Postal Service"); *UPS Worldwide Forwarding v. USPS*, 66 F.3d 621, 632 (3rd Cir. 1995) (adopting Postal Service position that price discrimination among customers could be justified under Section 403(c) by differences in the costs "incurred by the Postal Service"); *Sea-Land Service, Inc.. v. ICC*, 738 F.2d 1311, 1317 (D.C. Cir. 1984) ("The core concern in the nondiscrimination area has been to maintain equality of pricing for shipments subject to substantially similar costs and competitive conditions, while permitting carriers to introduce differential pricing where dissimilarities in those key variables exist."); *Transcontinental Bus System, Inc.*, *v. Civil Aeronautics Bd.*, 383 F.2d. 466, 483 (5th Cir. 1967) (explaining that the relevant factors for determining whether shipments are similarly situated are generally "limited to competition and factors directly relating to the cost of carriage or transportation."); *Trailways of New England, Inc. v. Civil Aeronautics Bd.*, 412 F.2d 926, 933 (1st Cir. 1969) (holding that the "inconvenience to traveler" of a service does not provide a legitimate basis for offering preferential services to certain travelers if the differing services provide no cost benefit *to the carrier*); *Cal. Comm. Ass'n v. Wells, Fargo & Co.*, 14 I.C.C. 422, 430 (1918) ("Unless there be a difference in the conditions of carriage there can be no difference in charges.").

V. THE POSTAL SERVICE'S COST JUSTIFICATION FOR MANUAL PROCESSING OF NETFLIX MAILERS IS A FICTION.

The Postal Service's main line of defense in its initial brief is a supposed cost justification. The Postal Service asserts that it gives Netflix special manual processing primarily to save the Postal Service money. Local operating officials, free to exercise their "management judgment" in a "dynamic" operating environment, but pressured by "strict budget constraints" to find the lowest cost solution, divert Netflix DVD mailers from automated letter processing when—and only when—manual culling and handling is cheaper than automated letter processing. It (conveniently) happens that manual processing is cheaper than automated letter processing about 80 percent of the time. This is because manual processing requires just "one touch" of culling at the point of first handling; after that, the culled pieces literally fly through the system without needing any further significant handling or intervention. USPS Br. 11, 28, 84-86, 92, 105.

These claims are revisionist fantasies. They are flatly at odds with the Postal Service's own discovery responses in this case, which admitted that the Postal Service "has not performed the necessary calculations" to determine how often manual processing of Netflix mail is more economical. USPS response to GFL/USPS-71(b); USPS response to GFL/USPS-73(b) and (d) (C_____) ("This response is not predicated on any studies."); **[BEGIN PROPRIETARY]**

[END PROPRIETARY]

The most important evidence on this issue remains, as previously noted, the 2006 Christensen Associates reports. As GameFly witness Glick demonstrated in his rebuttal testimony, the Christensen Associates Netflix returns cost model, modified to

reflect the assumption that Netflix return mailpieces are machinable, shows that the average cost of the Postal Service's current methods of processing Netflix returns is **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** the cost of processing these pieces on letter automation. Glick Rebuttal (GFL-RT-1) at 29-31 and App. A (Tr. 12/2038-2044).[22] The Christensen studies constitute the best evidence of record on this issue. Christensen Associates is a highly respected economic consulting firm, and it produced the report with input from knowledgeable subject matter experts from Postal Service headquarters. This was a study by the Postal Service's "A team." Tr. 12/2075-2076 (Glick).

Unable to rebut this evidence, the Postal Service tries to discredit Christensen Associates and Mr. Glick by portraying them as incompetent, uninformed, and even dishonest. USPS Br. 11-12, 87-89, 92-93, 100, 102-113, 122-124. This strategy reveals more about the Postal Service than about its consultant or Mr. Glick. We respond in turn to the Postal Service's attacks on Christensen Associates and Mr. Glick, then discuss other Postal Service documents that contradict the Postal Service's "one touch" cost saving fantasy, and then respond to the testimony of USPS witnesses Belair, Seanor and Barranca.

[22] Mr. Glick calculated the incremental cost of the special treatment Netflix receives by comparison with the cost of a fully machinable Netflix return that is sorted on letter automation. This approach is correct (indeed, necessary) because allowing Netflix to mail pieces that are effectively nonmachinable at machinable letter rates is part of the special treatment Netflix receives. This is, by definition, a "self-imposed wound." Tr. 11/1940 (Glick). Consistent with the recommendations set forth in the 2007 OIG report (which the Postal Service still has not implemented three years later), Netflix returns should be eligible for the 44-cent rate that it pays only if those pieces are effectively machinable. GFL-RT-1 at 28, fn. 19 (Tr. 12/2037); GFL696 (C13).

A. The Postal Service's Attacks On The Christensen Associates Reports Are Baseless And Unfounded.

Perhaps the most astonishing and tawdry spectacle in this case is the Postal Service's attempt to salvage its position by turning on Christensen Associates, a reputable consulting firm that has faithfully provided expert testimony and consulting services to the Postal Service for years. Despite having commissioned and overseen the 2006 Christensen study, the Postal Service now throws Christensen to the wolves, likening the firm to "Arthur Andersen and Enron," USPS Br. 100, and savaging Christensen's work product as "flawed," statistically "unreliable," based on unrepresentative and "limited" data, uninformed, unreasonable, incomplete, **[BEGIN PROPRIETARY] [END PROPRIETARY]** "stale" and "outdated." USPS Br. 11-12, 87-89, 92-93, 102-113, 122-124. (Other than that, Mrs. Lincoln, Christensen Associates **[BEGIN PROPRIETARY] [END PROPRIETARY]** USPS Br. 107.) These criticisms are scurrilous and unfounded.

1. Christensen Associates is a respected consulting firm that the Postal Service has relied on heavily in recent Commission proceedings.

The first reality check is the number of times in recent years that the Postal Service has asked the Commission to accept the testimony of Christensen Associates professionals as knowledgeable, expert and reliable. The Postal Service has sponsored approximately *twenty* pieces of Christensen Associates testimony on financial and costing issues in Commission rate and classification cases since 2000, including eight pieces of testimony in the last omnibus rate case, Docket No. R2006-1:

Docket No. R2000-1. The Postal Service sponsored four pieces of testimony from Christensen Associates professionals in this docket: Direct Testimony of A. Thomas Bozzo (USPS-T-15) (January 12, 2000); Rebuttal Testimony of A. Thomas Bozzo (USPS-RT-6) (August 14, 2000) (concerning mail processing volume variability); Rebuttal Testimony of A. Thomas Bozzo (USPS-RT-18) (August 14, 2000) (concerning estimates of cost by weight increment); Response of A. Thomas Bozzo to Notice of Inquiry No. 4 (August 21, 2000).

Docket No. R2001-1. The Postal Service sponsored three pieces of testimony from Christensen Associates professionals in this docket: Direct Testimony of A. Thomas Bozzo (USPS-T-14) (September 24, 2001); Direct Testimony of Leslie M. Schenk (USPS-T-43) (September 24, 2001); Direct Testimony of L. Paul Loetscher (USPS-T-41) (September 24, 2001).

Docket No. MC2002-2. The Postal Service sponsored one piece of testimony from a Christensen Associates professional in this docket: Rebuttal Testimony of B. Kelly Eakin (USPS-RT-2) (February 25, 2003).

Docket No. MC2004-2. The Postal Service sponsored one piece of testimony from a Christensen Associates professional in this docket: Direct Testimony of L. Paul Loetscher (USPS-T-3) (June, 3, 2004).

Docket No. R2005-1. The Postal Service sponsored three pieces of testimony from Christensen Associates professionals in this docket: Direct Testimony of A. Thomas Bozzo (USPS-T-12) (April 8, 2005); Direct Testimony of L. Paul Loetscher

(USPS-T-32) (April 8, 2005); Direct Testimony of Samuel T. Cutting (USPS-T-26) (April 8, 2005).

Docket No. R2006-1. The Postal Service sponsored eight pieces of testimony from Christensen Associates professionals in this docket: Direct Testimony of A. Thomas Bozzo (USPS-T-12) (May 3, 2006); Direct Testimony of Samuel T. Cutting (USPS-T-26) (May 3, 2006); Direct Testimony of Daniel Talmo (USPS-T-27) (Aug. 28, 2006); Direct Testimony of L. Paul Loetscher (USPS-T-28) (May 3, 2006); Direct Testimony of A. Thomas Bozzo (USPS-T-46) (May 3, 2006); Rebuttal Testimony of A. Thomas Bozzo (USPS-RT-1) (November 20, 2006); Rebuttal Testimony of A. Thomas Bozzo (USPS-RT-5) (November 20, 2006); Rebuttal Testimony of L. Paul Loetscher (USPS-RT-9) (November 20, 2006).

This list obviously does not include the unknown number of internal consulting studies that have not come to light because they were not submitted as testimony to the Commission.

2. Christensen Associates based its 2006 study on input from a Postal Service Headquarters working group that included some of the most knowledgeable experts on operations and costing in Postal Service headquarters. Christensen also received input from Postal Service headquarters experts in the modeling of postal costs.

The Postal Service portrayal of the Christensen project team as uninformed theoreticians, speculating about operational facts without the benefit of input or supervision from Postal Service officials with actual knowledge of Postal Service operations and finance, is equally unfounded. *See* USPS Br. 122 (““The report does not indicate whether the various postal functions, namely Operations and Finance,

endorsed its findings."); *id*. ("With respect to the Christensen study, the Postal Service does not believe that the study provides any realistic understanding of how DVD mail is processed….The Postal Service has shown, using the budget- and performance-driven financial and operational logic of mail processing decisions, exactly how and why the Christensen study is unreliable.").

[BEGIN PROPRIETARY]

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The presence of **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** in this headquarters working group is especially noteworthy. **[BEGIN PROPRIETARY]**

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Although the group to which **[BEGIN PROPRIETARY]**

[END PROPRIETARY] belonged was not a participant on this working group (apparently because her group was busy working on Docket No. R2006-1)[23], she and her group were given opportunity to review the Christensen study. For example, **[BEGIN PROPRIETARY]**

[24] **[END PROPRIETARY]**

[23] *See, e.g.*, 9/8/2006 email from **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** USPS92044

[24] An email exchange between **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** should not pass without comment. **[BEGIN PROPRIETARY]**

3. The sample of postal facilities studied by Christensen Associates was reasonably drawn and large enough.

The Postal Service's further assertions that that the 17-facility sample studied by Christensen was too small or improperly selected (USPS Br. 88, 92, 102-103, 105-108) are equally wide of the mark. In fact, the Christensen sample is projectable, and provides a reasonable and unbiased estimate of the Postal Service's cost for handling Netflix mail.

[BEGIN PROPRIETARY] **[END PROPRIETARY]** an economist on the Christensen study team, explained in an email to **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** of the Postal Service **[BEGIN PROPRIETARY]**

[END PROPRIETARY]

By contrast, the alternative methodology advocated by the Postal Service—projecting the unit cost for the sampled facilities based on the frequency with which the processing method (SOP) is used (USPS Br. at 106)—would be unworkable. It "would be a huge effort to try to crosswalk facility to SOP and to precisely define where each of these different SOPs are. I . . . think it's a nonstarter." Tr. 12/2083 (Glick).

[END PROPRIETARY]

The Postal Service's criticism of the size of the Christensen sample of facilities is equally unfounded. The size of the population in a sample does not bias a cost estimate, but merely affects the magnitude of random error around the cost estimate. While the magnitude of error might have been important **[BEGIN PROPRIETARY]**

[END PROPRIETARY] As Mr. Glick explained in his rebuttal testimony, the cost of automated processing is **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** cents, **[BEGIN PROPRIETARY]**

[END PROPRIETARY] The latter value ranged from 13.6 cents to 43.6 cents at particularly facilities, but at most facilities was between 20 and 30 cents—i.e., roughly **[BEGIN PROPRIETARY]**

[END PROPRIETARY] of the estimated cost of automated processing. **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** Christensen Report at GFL 1043 (C106). **[BEGIN PROPRIETARY]**

[END PROPRIETARY] Tr. 12/2056 (Glick cross-ex).

In analogous contexts, the Postal Service itself has repeatedly built cost models used for rate design purposes on much smaller samples. **[BEGIN PROPRIETARY]**

[END PROPRIETARY] Tr. 12/2046 (Glick). A

recent example occurred in Docket No. RM2010-12, *Petition Of The United States Postal Service Requesting Initiation Of A Proceeding To Consider Proposed Changes In Analytic Principles*. One of the Postal Service's costing proposals drew nationwide estimated values based on data collected at *three* network distribution centers, and *one* P&DC and *two* delivery units per NDC:

> "The Postal Service began conducting a field study during the summer of 2009 in which data were collected that could be used to develop a Standard Mail parcel / NFM mail processing cost model. These data were collected at three network distribution centers (NDC), as well as one processing and distribution center (P&DC) and two delivery units (DU) within the service area of each NDC."

USPS Petition, Proposal 7 at 2.

4. The failure of the Christensen Associates study to report the presence of "one-touch" manual processing at any of the sampled facilities provides strong evidence that "one-touch" processing is atypical or nonexistent.

The Postal Service also criticizes the sampling method of the Christensen study on the ground that Christensen failed to report use of the "one-touch" (cull and forget) method supposedly used by the Postal Service at any of the 17 sampled facilities, **[BEGIN PROPRIETARY]**

[END PROPRIETARY] USPS Br. 103, 107-108. The Postal Service has it backwards. The failure of Christensen to observe the occurrence of "one-touch" processing at any facility indicts not the Christensen sampling method, but the "one-touch" hypothesis itself.

If the "one touch" processing method (or any other processing method) were in fact used to a significant degree throughout the universe of Postal Service facilities, the

odds that at least some occurrences of this method would be observed in a random sample of 17 facilities would be overwhelmingly high—indeed, close to absolute certainty. For example, if 90 percent of all facilities used the "one touch" process, the odds that the process would be absent from 17 randomly selected facilities would be less than 1 in *100 quadrillion* – that is, less than 1 in 100,000,000,000,000,000.[25] This likelihood is so vanishingly small that the failure to find any use of the process in the 17 facilities allows us to confidently reject a claim that the process is being used in 90 percent of the facilities.

Even if only *50 percent* of the universe of facilities used the "one touch" process, the chance that a random sample of 17 facilities would fail to find the process would be less than 1 in 130,000.[26] Again, this is so unlikely that we can confidently reject a claim that the process is being used in 50 percent of the facilities.

Thus a failure to find any use of the "one touch" manual processing method in a random sample of 17 facilities is sufficient to conclude that few if any of the facilities in the population are using the process. The fact that the "one-touch" processing method

[25] If 90 percent of all facilities use the process, then the chance that a given randomly-sampled facility does not use the process is only 10 percent. To produce a string of 17 sampled facilities that don't use the process requires that each of the 17 facilities chosen randomly turn out by chance to be the type of facility that occurs only 10 percent of the time. The chance that this will happen is 10 percent raised to the 17th power, which is the figure given in the text.

[26] As above, if 50 percent of all facilities use the process, then there's only a 50 percent chance for each randomly sampled facility that it won't use the process. To produce a string of 17 sampled facilities that don't use the process requires that each of the 17 facilities chosen randomly turn out by chance to be the type of facility that occurs only 50 percent of the time. The chance that this will happen is 50 percent raised to the 17th power, which is the figure given in the text.

was not identified at any of the sampled facilities is significant evidence that it is not the main method of processing Netflix returns.

This conclusion is also supported by the Postal Service's own standard operating procedures. The existence of a national SOP that specifies mandatory traying and containerization processes (which are post-one-touch activities) independently contradicts the one-touch scenario. GameFly Br. 76 (discussing record).

5. Miscellaneous criticisms of the Christensen study by Postal Service lawyers are equally mistaken.

The Postal Service's initial brief also offers several additional criticisms of the Christensen methodology that are unsupported by the record, and appear for the first time in the brief. The criticisms merely underscore the risks of error that lawyers invite when they start freelancing as professional witnesses.

a. The assumption that pieces are processed on automation after culling from the AFCS is entirely reasonable.

The Postal Service asserts that USPS witness Glick overlooked obvious flaws in the mail flow assumptions of the Christensen model. The supposed flaw that the Postal Service singles out is the assumption that manual processing would entail the culling of pieces before the Advanced Facer-Canceller System ("AFCS"), followed by the processing of the same culled pieces on the outgoing primary DBCS. USPS Br. 112, 123-124. There is nothing self-evidently nonsensical about Christensen having observed such a process at sampled facilities, however.

Netflix has reported that the most destructive stage of automated letter processing is processing at the AFCS. Tr. 4/310 (GFL523). It is likely that some local facilities, left to their own "local discretion" by Postal Service headquarters and area officials, would cull Netflix pieces to avoid the AFCS, but then allow those same pieces to be processed on barcode sorters because Netflix does not perceive the latter processing to be as destructive of DVDs.[27] Indeed, this very process was codified in a Houston SOP for Blockbuster. GFL 554 (C_____). **[BEGIN PROPRIETARY]**

[END PROPRIETARY] (GFL2468) (C_____).

Finally, and in any event, excluding the three facilities cited in the USPS Brief (Tampa, Abilene and Orlando) from the Christensen analysis has little effect on the estimated cost of Netflix returns. In fact, omitting the observations from these three sites would *increase* the estimated unit cost of Netflix processing by about 0.2 cents.[28]

b. Riffling productivities cannot be used as a proxy for the productivity of culling Netflix mail.

The Postal Service also derides the Christensen model on the ground that the lowest cost model used by Christensen relies on a proxy of the costs of riffling. "One

[27] **[BEGIN PROPRIETARY]**

[END PROPRIETARY]

[28] The Commission can replicate this result by deleting the three sites from FE Return Scenario 1 v.xls, "Summary."

touch" culling of Netflix mail, the Postal Service contends, is faster and cheaper than riffling. USPS Br. 92-93, 108-109. Here again, the Postal Service errs.

The reality is that culling Netflix mail is much more expensive than riffling because the former operation requires employees in essentially all mail processing operations to be continually on the lookout for Netflix pieces at all times:

> Netflix inbound pieces are culled throughout postal operations. *See* GFL0001025. This means that clerks and mailhandlers and other USPS personnel must watch for Netflix inbound pieces in addition to performing their primary jobs.

Glick response to PR/GFL-T1-1(c) (C383). By contrast, riffling requires no comparable diversion of employee time and attention.

Finally, the transcript pages cited in the Postal Service brief (Tr. 12/2070-2071) include no discussion at all of the riffling activity. Once again, the Postal Service's criticism is unsupported by any evidence in the record.

c. Relative cost of Netflix returns and nonmachinable letters

In a further attempt to discredit the Christensen cost estimates, **[BEGIN PROPRIETARY]**

[END PROPRIETARY]

USPS Brief at 112-113, 121, 122. In fact, the Christensen study found no such relationship. In Docket No. ACR2009, the Postal Service estimated that mail processing costs for single-piece nonmachinable letters were 41.19 cents per piece (USPS-FY09-10, USPS-FY09-10 FCM Letters Costs Final.xls, "SP NMACH COST", cell

L49). **[BEGIN PROPRIETARY]**

[END PROPRIETARY] While the two values are not precisely comparable—the estimates use different methods and are from different years—nothing in the record supports the Postal Service's claim that Christensen that the opposite relationship is true.

d. Ability to use ACR cost model to estimate cost difference between manual and automated sorting

[BEGIN PROPRIETARY]

[END PROPRIETARY] This makes sense because single-piece letters are generally culled in this "010" operation. Docket No. R2006-1, USPS-T-42 (McCrery) at 2-3.

e. Criticisms by Postal Service witnesses

The handful of criticisms of the Christensen and OIG studies actually advanced by the Postal Service witnesses (as opposed to the Postal Service's lawyers) are insignificant. (USPS Br. 101) Mr. Belair offered minor quibbles about the Christensen

cost model; Mr. Glick rebutted those criticisms in his rebuttal testimony. *Cf.* Tr. 9/1715-17 (Belair); Glick Rebuttal (GFL-RT-1) at 30 n. 23 (Tr. 11/1936; Tr. 12/2039). Furthermore, Mr. Belair's complete lack of cost modeling experience warrants giving his criticisms of Christensen's modeling approach essentially no weight. Tr. 9/1721.

While Barranca's testimony quibbled about GameFly's use of documents, he said nothing at all about the Christensen study. Mr. Barranca's only criticism of the OIG study concerned its cost estimate; but GameFly did not rely on the OIG cost analysis at all. Tr. 10/1888-1889.

6. The Postal Service's criticism of the vintage of the Christensen Associates study is unfounded.

The Postal Service also criticizes the Christensen study for being four years old and therefore outdated. USPS Br. 88-89, 92, 122. This criticism is also unwarranted.

First, as the Postal Service has admitted, the Christensen model is **[BEGIN PROPRIETARY]**

[END PROPRIETARY]*;* Tr. 10/1757 (Seanor answer to GFL/USPS-T3-16); Tr. 10/1793 (Seanor) (admitting that the Christensen study is the only study commissioned by the Postal Service on the costs and benefits of manual culling).[29]

Second, the notion that a four-year-old cost model is too old be relied on in cost estimation is a radically higher standard than the Postal Service applies to its own

[29] At the risk of belaboring the obvious, the Christensen study was only two-plus years old when GameFly filed this case more than 18 months ago. To a large extent, the aging of the Christensen study data is a consequence of the delay in the litigation of this case caused by the Postal Service's failure to respond to discovery in a timely fashion.

models in Commission proceedings. For example, numerous cells in the Postal Service's First-Class Mail Presort Letter cost model (USPS-FY09-10, USPS-FY09-10 FCM Letters Costs Final.xls) rely on data that are four years old or older:

Worksheet	Cell	Reference
PRODUCTIVITY	G25	Docket No. MC95-1
PRODUCTIVITY	G26-G27	Docket No. MC95-1
PRODUCTIVITY	G28	Docket No. MC95-1
MISC	E5-E6	FY 05 RBCS Data
MISC	E9	Docket No. R2000-1
MISC	E10	Docket No. MC95-1
MISC	E11	Docket No. R2000-1
DENSITY	Unspecified	Docket No. R2000-1
BUNDLE SORT	Rows 12, 15, 21	Docket No. MC95-1
BUNDLE SORT	N28-N40	Docket No. MC95-1

And the Postal Service's Office of Inspector General recently found that many regulatory cost models still used by the Postal Service at the Commission were first introduced in Docket No. MC95-1, and thus are more than 15 years old. OIG Report No. MS-AR-10-003, *Audit Report—First-Class And Standard Mail Workshare Discounts* (July 2, 2010). Given the lack of any significant technological change in the Postal Service's letter processing equipment in the last ten years, there is no reason for arbitrarily imputing a shorter useful life to the Christensen study. *See* USPS Br. 122 ("letter mail processing equipment has not changed significantly over the past ten years.").

Third, the Postal Service never explains how GameFly should have gone about performing a more recent study. See USPS Br. 88-89, 123 (criticizing USPS witness Glick for failing to perform an updated study of Postal Service mail processing operations and productivity). Shortly after the filing of this complaint, the Postal Service shut down even routine access by GameFly representatives to Postal Service mail processing facilities. USPS Response to GFL/USPS-34 (C_____).

Further, the Postal Service even criticizes GameFly for failing to update the Christensen study to reflect operational changes *that have not yet occurred.* Specifically, the Postal Service cites the current deployment of AFCS 200 and the narrowing of the AFCS processing window as current developments that should have been, but were not, reflected in GameFly's cost analysis. USPS Brief at 122. This criticism is nonsensical. Since the AFCS 200 is just now being deployed, even a current study could not capture the effect of its deployment. Furthermore, the Postal Service concedes that the effect of this deployment is speculative: "The specific impact that it might have on future DVD mail piece processing is unknown." *Id*. And the reduction in the AFCS processing window is irrelevant. The Postal Service has already conceded that meeting services standards is not the reason for manual culling. GFL Initial Br. at 82. Thus, the reduction in the AFCS processing window (to better align with reduced single-piece volumes) is immaterial.

7. Despite all its criticisms, the Postal Service has admitted that the Christensen Associates study is the best available evidence of record and an example of Christensen's "usual high quality work."

The final answer to the Postal Service's welter of criticisms of the Christensen study comes from the Postal Service itself. Even it has admitted that the Christensen study is the best—and only—study of its kind. USPS response to GFL/USPS-163(c) **[BEGIN PROPRIETARY]**

[END PROPRIETARY] Moreover, the Postal Service has also admitted that manual processing is not more economical than automated letter processing at any of the sites studied by Christensen Associates:

[BEGIN PROPRIETARY]

[END PROPRIETARY] *See also* USPS Br.107 **[BEGIN PROPRIETARY]** **[END PROPRIETARY]**

In fact, as noted above, the Postal Service has relied on the Christensen report a number of times in this proceeding to support its claims. USPS answers to GFL/USPS-17, 18 (admitting that the Postal Service used the Christensen Report to estimate manual culling) (C196-98); **[BEGIN PROPRIETARY]**

[END PROPRIETARY] (C262); Tr. 10/17889, 1792-93,

1795 (USPS witness Seanor) (citing Christensen report as support for his position on the efficiency of culling Netflix mail at the point of collection)

B. The Postal Service's Attacks On The Credibility Of GameFly Witness Glick Are Equally Unfounded.

Given the Postal Service's willingness to throw its own consultant under the bus, the Postal Service's assault on GameFly witness Sander Glick is unsurprising. Once again, the Postal Service's arguments reveal more about the Postal Service than about Mr. Glick—a fact that becomes apparent when one compares the Postal Service's characterization of the transcript with Mr. Glick's actual testimony.

1. Mr. Glick's supposed ignorance about how Netflix mail is actually processed.

The Postal Service derides Mr. Glick for never having personally observed the actual processing of Netflix or GameFly mail, and for his supposedly uncritical reliance on the Christensen study. USPS Br. 87-88, 103-104, 109-110. The short and dispositive answer is that Mr. Glick relied on the first-hand observations reflected in the Christensen study, and reasonably so, since the Christensen study is the most thorough analysis of the topic in the record. Tr. 11/1983 (Glick cross-ex). As an expert witness, Mr. Glick was fully entitled to rely on this type of study. Fed. R. Evid. 703; *see also* Presiding Officer's Ruling C2009-1/46 at 3 (Nov. 8, 2010) ("The Postal Service largely neglects that the opinion testimony of experts is not subject to the constraint that testimony be based on personal knowledge.").

2. Mr. Glick's supposed ignorance about the meaning of the terms "incoming primary" sort and "manual processing."

Mr. Glick's supposed ignorance of the meaning of the terms "incoming primary" and "manual processing" (USPS Br. 104, 113) is refuted by the very transcripts that the Postal Service cites.

First, Mr. Glick explained quite clearly what "incoming primary" is (Tr. 12/2054). His testimony makes clear that his confusion involved not the concept, but the meaning of the poorly worded question asked by Postal Service counsel (Tr. 12/2054):

> Manual incoming primary is a type of manual sort. Incoming primary is a sort scheme. And so manual incoming primary sorting is a type of manual processing. . . . I don't understand your question more than that."

What Glick failed to understand was postal counsel's question, not the meaning of incoming primary sortation.

Mr. Glick's supposed confusion about the meaning of the term "manual processing" is another invention of Postal Service counsel. Mr. Glick made clear that, when using the term "manual processing" as a general descriptor, he did so to highlight that the mail is being handled by hand, rather than on letter automation, and thus was less likely to be broken:

> The key point I'm making when I refer to "manual processing" is I'm referring to the fact that… Netflix is not being processed on automation…. [M]annual processing can refer to lots of different types of handlings that happen when touched by human rather than by a machine.

Tr. 12/2051-52 (Glick cross-ex). Conversely, when describing the specific activities that are included in the processing of Netflix return mailers, Mr. Glick's testimony was clear and precise. "I have [also] defined the specific manual operations, which are typical for

processing Netflix returns [in my testimony]." Tr. 12/2053. Glick Rebuttal (GFL-RT-1) at 7 (Table 1) (Tr. 12/2016).

3. Mr. Glick's supposed lack of understanding of the First-Class Mail letter cost avoidance model.

Mr. Glick's supposed "lack of knowledge regarding . . . the First-Class letter model he refers to in his responses to oral cross-examination" (USPS Br. 104, 109-110) is another cheap shot. During cross-examination, both Postal Service counsel and Mr. Glick made clear that the latter understood the letter cost model. Tr. 12/2100. The only aspect of the model that Mr. Glick was unwilling to comment on was a one-page printout of one tab from a spreadsheet that the Postal Service sprang on Mr. Glick without advance notice. Tr. 12/2100-2101. After counsel for GameFly objected to this ambush tactic, a clear violation of Rule 3001.30(e)(3), the Presiding Officer sustained GameFly's objection to further questioning of Mr. Glick about the printout:

> . . . I'm going to sustain the objection. I can understand why this would have taken the witness by surprise, and if this was part of the public domain, it could have been provided to the witness at an earlier date, so I'm going to sustain Mr. Levy's objections.

Tr. 12/2102-03. Mr. Glick's supposed "lack of knowledge" rests entirely on his refusal play along with this improper line of questioning.

4. Mr. Glick's supposed ignorance of the purpose of the Christensen study.

Mr. Glick's supposed ignorance of the "purpose for which" the Christensen study "was requested" (USPS Br. 111) is another invention. The main purpose of the

Christensen study was to estimate the cost of processing Netflix mail—and Mr. Glick testified as much:

Mr. Mecone: What was the purpose of the Christensen study?

The Witness: **[BEGIN PROPRIETARY]**

.[30] **[END PROPRIETARY]**

5. Mr. Glick's supposed inability to cite documents showing that "the desire of Netflix for reduced breakage" was a major reason for manual processing of Netflix mailers.

Mr. Glick's supposed inability to identify more than two passages from documents showing that "the desire of Netflix for reduced breakage" was a reason for manual processing of Netflix DVD mailers (USPS Br. 89 n. 47; id. at 90; Tr. 11/1939-1945) is another crude misreading of the hearing transcript.

Mr. Glick pointed to two citations that specifically referred to "DVD breakage." He also pointed to citation after citation about reducing damage to Netflix mailpieces and the product therein until postal counsel asked Mr. Glick to stop:

[30] **[BEGIN PROPRIETARY]**

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Mr. Mecone: Okay. So of the 22 excerpts in your testimony, two of them…support that the desire of Netflix to reduce disk breakage is a reason for the Postal Services' treatment of Netflix DVD mailers?

The Witness: I disagree with your characterization of my statement.

Mr. Mecone: Okay. Of the 22, how many others support that statement?

* * *

The Witness: Okay. Well, let's go. Lines 13 through 17. One, employees manually process approximately 70 percent of the approved first class two-way DVD return mail pieces from one DVD rental company because these mail pieces sustain damage.

* * *

The Witness: Page 21, line 13 through 17. The next quotation is on page 22, lines 1 through 7, and I'll refer you specifically to line 5 through 7.

* * *

The Witness: The next one, line 8 through 10….The next one, from lines 11 through 14 on page 22….The next one, lines 18-23.

* * *

Mr. Mecone: Just so we don't have to go through every one, is there anything that's not actually cites in here that in your opinion supports the statement at the top on page 20 that I read earlier?

The Witness: I do believe that there are many other documents . . . that are not cited in my testimony that have been cited in previous GameFly pleadings. I'd be happy to walk through this binder if you'd like me to.

Tr. 11/1940-1944. Mr. Glick later identified virtually an entire single-spaced page summarizing other responsive documents appearing on pages 10-11 n.5 of Mr. Glick's rebuttal testimony. Glick Rebuttal (GFL-T-1) at 10-11 (Tr. 11/1916-1917, Tr. 12/2019-2020). The Postal Service makes no mention of these documents in its brief.

C. The One-Touch Hypothesis Is Refuted By A Host Of Other Postal Service Documents And Analyses.

The conclusions of the Christensen Associates study, and Mr. Glick's analysis of the study, are supported by a wide variety of less formal analyses performed within the Postal Service before and after the Christensen reports. These include the SOPs and other management instructions for the territories where Messrs. Belair and Seanor are posted. These documents made clear that manual culling and processing activities occur through the system, not just at or shortly after the initial point of induction. *See* Tr. 4/165-171, 245-46, 256-57, 287, 298-99, 313-20, 321-28, 344-45, 346, 382, 534, 536, 584, 587-88 (GFL12-GFL18, GFL302-GFL303, GFL347-348, GFL462, GFL495-496, GFL527-GFL534, GFL535-GFL542, GFL558-GFL559, GFL562, GFL2422, GFL73959, GFL73961; GFL80729; GFL80749-80750).; *see also* Tr. 9/1653, 1708 (Witness Seanor confirming USPS interrogatory response that the processing of Netflix mail remains similar to that described in the Pacific Area SOP); Glick Rebuttal (GFL-RT-1) at 3 (Tr. 12/2012).

A myriad of other Postal Service analyses before and after the Christensen study also refute the "one-touch" hypothesis, and the Postal Service's related claim that manual processing costs less than automated letter processing. As **[BEGIN PROPRIETARY] [END PROPRIETARY]** observed in 2005:

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[END PROPRIETARY] *see also* Tr. 4/188 (GFL58), Tr. 4/205 (GFL107), Tr. 4/285 (GFL458) ("if so much of this mail is being

manually trayed, where is the savings? This must be costing us a **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** to process"); Tr. 4/359 (GFL845), Tr. 4/370 (GFL1335), Tr. 4/372 (GFL1359), Tr. 4/373 (GFL1360); USPS response to GFL/USPS-147; Tr. 4/218 (GFL211) (Test Results of USPS 2-Way DVD Mailer Machineability and Automation Test dated March 4, 2005) ("Although Mailers were enjoying automation rates for their [2-way DVD mailer], most pieces were being handled as flats or manually, resulting in financial losses to the postal service; Tr. 4/367 (GFL1115) (note from **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** estimating that USPS losing $75,000 a day from manual processing of return DVDs); Tr. 4/378 (GFL1664) **[BEGIN PROPRIETARY]**

[END PROPRIETARY] Tr. 4/372 (GFL1359) (estimating that extra labor cost of manual processing totaled $61.5 million in FY 2008 and FY 2009).

In August 2005, Headquarters Pricing and Classification employees estimated that **[BEGIN PROPRIETARY]**

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In the same month, **[BEGIN PROPRIETARY]**

[END PROPRIETARY] advised other senior headquarters officials that:

> We have had discussions of how to adjust to DVDs in the mail data the rates group review. At NOVA (and they are not dummies) the plant is asking the collection people to pull them out for manual processing. If they are still in the mailstream, every AFCS operator is individually pulling them out. The fundamental belief is that a DVD is not flexible enough to be handled as a letter mail piece. *This is costing us a HUGE increment over an average letter mail automated rate on the returns.* . . .

Tr. 4/383 (GFL2423) (capitalization in original; italics added).

In the same year, the Postal Service estimated that providing manual processing to a one-ounce letter without collecting a nonmachinable surcharge essentially eliminates any contribution to institutional costs from the piece. Tr. 4/205 (GFL107). *See also* **[BEGIN PROPRIETARY]**

[END PROPRIETARY]

Finally, an internal Postal Service analysis reported in 2009 that "a large return volume [of DVD mailers was still being] processed manually at the mailers' request. Manual processing of DVDs imposes undue expenses on the USPS." Tr. 4/370 (GFL1335).

D. Postal Service Witnesses Belair And Seanor Lack Credibility.

Against this mass of evidence, the Postal Service offers only the unsupported assertions of two field operating officials—USPS witnesses Belair and Seanor—that

manual processing of Netflix return mailers is usually cheaper than automated letter processing. USPS Br. 89-90, 101-102; USPS-T-2 at 11 (Belair); USPS-T-3 at 7 (Seanor). This testimony is utterly lacking in credibility.[31]

In response to discovery and cross-examination, Messrs. Belair and Seanor conceded that the "one-touch-culling-is-cheaper-than-automation" hypothesis is unsupported by any empirical data, analyses or studies. Specifically, Mr. Belair admitted that he could provide no "analyses, studies, memoranda" or "other documents quantifying the cost savings asserted" resulting from 'culling Netflix mail." Tr. 9/1626 (Belair), 1627 (same), 1631 (same), 1634 (unable to quantify any cost savings from manual processing of Netflix return mail), 1649 (unable to quantify cost savings resulting from manual processing in Fort Lauderdale); 1664-1666 (unable to quantity percentage of trays that were not sleeved), 1675-76 (claiming not to know whether manual processing breaks fewer DVDs than does automated letter processing); 1681 (unaware of any "formalized study" of the costs saved from manual culling of Netflix DVDs); 1682 (unaware of average cost of an automated sort of a Netflix DVD mailer); 1684-1685 (unaware of average cost of setting up flat tubs or initial culling), 1690-91 (does not know the cost of processing Netflix mail), 1721 (has no experience in cost modeling).

[31] The Postal Service also attaches to its brief an appendix, purportedly by USPS witness Barranca, that criticizes the representativeness, accuracy, and reliability of a sample of the Postal Service documents cited by GameFly. USPS Br., Attachment A. The document is a smokescreen. It does not even try to discuss the most important documents in the case—the Christensen Associates study, the OIG report, and the subsequent admissions by the Postal Service about the continuing special treatment given to Netflix since 2007. Instead, the Attachment offers 90 pages of nitpicking about secondary and peripheral documents and issues. A brief response to the main points in the Postal Service Attachment appears in Appendix A, *infra*.

Postal Service witness Seanor made clear that much of his testimony was a regurgitation of information provided by his handlers on the Postal Service litigation team, not his own personal knowledge. Tr. 10/1746, 1748, 1749, 1752, 1753, 1754, 1763. And he admitted that he had no data, studies or analyses to show the costs of manual culling (Tr. 10/1792-93) or to "support the proposition that culling 'can save additional downstream processing costs'" (Tr. 10/1757); that manually separating Netflix mail saves money (Tr. 10/1759-60); that volume density plays an important role in manual culling decisions (Tr. 10/1764); or that manual culling of Netflix mail increases the Postal Service's ability to meet critical dispatch times (Tr. 10/1766). Nor could he offer any data on jam rates of Netflix DVDs in Postal Service mail processing equipment (Tr. 10/1778).

Compared with the analyses cited above, particularly the rigorous and comprehensive work performed by Christensen Associates with input from headquarters officials, the party line that the Postal Service witnesses parroted in this case has no credibility. The Public Representative properly reached the same conclusion after reviewing this evidence, explaining that "[o]n 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 DVDs not to reduce costs, but to reduce damage to the contents of Netflix mailpieces." Pub. Rep. Br. at 8.

VI. THE POSTAL SERVICE HAS FAILED TO ESTABLISH ANY OTHER RATIONAL BASIS FOR ITS DISCRIMINATION AMONG DVD RENTAL COMPANIES.

A. None Of The Differences In The Mail Characteristics Of The Two Companies Has A Significant Effect On Costs.

The Postal Service has also tried to justify its preferential treatment of Netflix over GameFly on the grounds that Netflix has (1) more mail pickup points, (2) a shorter average length of haul in the postal system, (3) greater volume and density, and (4) a brighter and more visible mailpiece design. The record shows, however, that these factors are pretexts. None provides a rational justification for the Postal Service's existing and proposed discrimination in favor of Netflix.

The number of mail pickup points, and the resulting average length of haul, have no significant effect on the Postal Service's costs. Length of haul has only a minimal effect on cost. The average transportation cost of a piece of single-piece First-Class mail is only about one cent. GameFly Br. 39-40, 77.

The depth of entry into the postal system also has no significant effect on the Postal Service's costs. Outbound pieces are processed on automation. And it is telling that the Postal Service was willing to offer Netflix manual processing at no extra charge when the number of Netflix mail entry and pickup points was only a fraction of the current number. GameFly Br. 39-41, 78. Nevertheless, as a condition to relief in this case, GameFly is willing to pay the (minimal) extra costs of transportation and container handling that result from the greater average travel of its pieces in the Postal Service system. *Id*. at 79.

The greater visibility of the current Netflix mailpiece design also fails to provide a rational basis for discriminating against GameFly. As long as automated flats processing is the least bad alternative open to GameFly, the company has no reason to use a more conspicuous mailpiece design. If the Postal Service provided Netflix levels of manual processing to GameFly pieces entered at machinable letter rates, GameFly would enter its pieces as letters, and would mark its pieces as brightly and conspicuously as Netflix does. GameFly Br. 62-63.

Once GameFly pieces are marked as visibly as Netflix pieces, the smaller volume of GameFly disappears as a factor in sorting costs. The resulting volume densities observed by Postal Service mail sorting employees would be the *combined* volume densities of Netflix and GameFly and any other DVD rental companies that adopted similar designs. GameFly Br. 77.[32]

[32] It is not enough to point out that Netflix is a higher-volume mailer; rational justification requires more. *See, e.g.*, *California Commercial Ass'n v. Wells, Fargo & Co.*, 14 I.C.C. 422, 426 (1908) (holding that a rule with the effect that "a group of smaller merchants are denied a rate which a large merchant is given . . . . can not be based on solid principle, even though it may have most specious and persuasive reasons to support it."); *Id.* at 428-29 ("A different rate may be given to the larger shipment, but it must be justified upon transportation conditions. The rate is made as applying to the shipment, not to the shipper."); *Id.* at 431 (surveying cases, including English cases which informed the development of the ICA, and concluding that it is "universally recognized that the only discrimination which can legally be made between a large shipment and a small one must be based upon the difference in the cost of service.")

B. The Postal Service's Failure To Comply With The Filed Rate Doctrine Further Undermines The Postal Service's Defenses Of Its Discrimination.

As GameFly has previously explained, the Postal Service's operational and cost justifications for its discrimination are further undermined by the Postal Service's failure to comply with the filed rate doctrine by publishing in the DMM or the MCS the terms and conditions required to get Netflix-like levels of special manual processing. The filed rate doctrine is a necessary corollary of Section 403(c) and other similar antidiscrimination provisions. Requiring a regulated monopoly to publish important terms and conditions of service in tariff or tariff-like form reduces the likelihood that illegal discrimination will flourish in secrecy. GameFly Br. 58-59, 83-86.

The Postal Service disputes that its preferences for Netflix are subject to the filed rate doctrine. To the extent that the Postal Service's argument can be discerned, the Postal Service appears to be claiming that the processing preferences given to Netflix are *de minimis* or routine operational details that are below the threshold of significance required for formal disclosure in the DMM or the MCS. USPS Br. 13, 21-22, 58-63. But preferences as costly to the Postal Service, and as significant to its customers as the special manual processing offered to Netflix, cannot be glossed over on the theory that they are below the threshold of materiality for DMM disclosure.

The only case cited by the Postal Service for the proposition that the filed rate doctrine does not apply here is *Concord v. FERC*, 955 F.2d 67 (D.C. Cir. 1992). Far from supporting the Postal Service's interpretation, however, *Concord* recognizes the fundamental importance of the filed rate doctrine. The contested issue in *Concord* was whether the filed rate doctrine required the carrier to pay refunds for charges it had

imposed above the rate on file. *Id.* at 70. In fact, there was no controversy in this case over whether the filed rate doctrine had been violated—it applied, and the carrier violated it. *Id.* at 72. The court nevertheless held that the filed rate doctrine, standing alone, does not mandate refunds, and therefore upheld FERC's decision not to order them. In the passage quoted by the Postal Service in its Initial Brief, the court explained that the filed rate doctrine does not mandate any particular remedy apart from those provided in the statute. *Id.* at 73. Since the statute in question, the Federal Power Act, authorized but did not require FERC to issue refunds, FERC had discretion to award refunds or not as FERC chose. *Id.* As GameFly has not asked for refunds in this case, or suggested that the Commission's discretion is restricted by the filed rate doctrine, this aspect of *Concord* is inapplicable here.

Concord is nonetheless instructive in its recognition of the purposes that underlie the filed rate doctrine. In explaining why the doctrine can serve these purposes even without the availability of refunds, the court noted that there was no "reason to suppose that the Commission's refusal to order a refund will undermine its primary jurisdiction over the reasonableness of rates, *promote discriminatory rate payments*, or in any other manner thwart the core purposes of the filed rate doctrine or of the statute." Id. at 75 (emphasis added). As GameFly explained in its initial brief, the filed rate doctrine protects against discrimination by prohibiting exactly the sort of secret preferences the Postal Service has granted to Netflix. GameFly Initial Brief at 58-59; 84-86. Congress recognized this principle in requiring that the terms of Negotiated Service Agreements ("NSA") be made "available on *public* and reasonable terms to similarly situated mailers" in 39 U.S.C. § 3622(c)(10). (emphasis added) Likewise, the Commission has long understood the importance of this principle and has consistently applied it in the name

of mitigating the potential discriminatory effects of special arrangements between the Postal Service and individual mailers. *See, e.g.*, *Rate and Service Changes to Implement Baseline Negotiated Service Agreement with Bookspan*, Opinion and Recommended Decision, Docket No. MC2005-3 at 38-39 (May 10, 2006) (specifically pointing to the public availability of the terms and conditions of the NSA and the ability of other mailers to obtain service on substantially the same conditions as support for holding the NSA nondiscriminatory); Docket No. RM2003-5, *Rules Applicable to Baseline And Functionally Equivalent Negotiated Service Agreements*, Order No. 1391 at 23 (Feb. 11, 2004) ("Public disclosure also provides transparency, which helps curtail arguments of discrimination and secret dealings . . . . The Commission will adhere to its preference, and presumption, that the contents of the actual contract shall be made publicly available.")

While the filed rate doctrine does not specify a remedy, it nevertheless requires the Postal Service to publish its terms of service, especially when, as here, those terms are offered only to certain mailers. As there is no question that the Commission is authorized by 39 U.S.C. § 3662 to grant the relief GameFly has requested, the concerns raised by the Postal Service regarding the filed rate doctrine are inapplicable to this controversy.

CONCLUSION

The Postal Service's practice of giving Netflix custom processing of DVD return mailers at letter rates with no extra charge, while denying the same terms to GameFly and others, constitutes unlawful discrimination under 39 U.S.C. § 403(c) and other provisions of Title 39. The law requires that this discrimination be eliminated. The Commission should do so by requiring the Postal Service to implement one or both of the two remedies proposed on pages 87-88 of GameFly's initial brief.

Respectfully submitted,

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November 18, 2010

APPENDIX A

REPLY TO USPS ATTACHMENT A

ANALYSIS OF BARRANCA CITATIONS

The Postal Service filed a 90-page appendix to its Initial Brief ("Attachment A"). The appendix purportedly sets forth USPS witness Nicholas Barranca's analysis of the documents GameFly obtained from the Postal Service in the course of discovery and cited in its April 12, 2010 Memorandum Summarizing the Documentary Evidence ("Memorandum"). The analysis offers a myriad of criticisms of the representativeness, accuracy, and reliability of some of the citations in GameFly's Memorandum.

It is unclear whether Attachment A was actually prepared by Mr. Barranca, or was prepared for him by Postal Service counsel as a crib sheet to help him prepare for his cross-examination. Either way, however, Attachment A amounts to little more than a distraction, with 90 pages of nitpicking and grousing about tangential, peripheral and secondary issues.

First, Attachment A does not even attempt to discuss the most important documents in the case—the Christensen Associates study, the OIG report, and the subsequent admissions by the Postal Service about the continuing special treatment given to Netflix since 2007. Nor does Appendix A attempt to refute the central facts in the case: the huge disparity between Netflix and other DVD rental companies with respect to the percentage of DVDs culled from automated letter processing; the gross inferiority of automated letter processing to manual culling in terms of DVD breakage; the knowing complicity of Postal Service headquarters officials in this discriminatory arrangement; and the internal Postal Service analyses—especially the 2006

Christensen Associates report—confirming that the net effect of processing Netflix reply DVD mailers manually is to increase the Postal Service's costs substantially.

Instead, Attachment A is an elaborate attempt to discredit secondary documents that are not critical to GameFly's case. These criticisms are repetitious, trivial or immaterial. We discussion the main themes of the Postal Service's attack in the remainder of this Compendium.

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In sum, the Postal Service's argument that GameFly's reliance on documents obtained during discovery creates an unreliable record, asserted in the Initial Brief and elaborated in Attachment A, is an attempt to obscure the central claims and supporting documentation in this case: the Christensen Associates, OIG reports and other undisputed documents that document the Postal Services' violation of 39 U.S.C. § 403(c). The Commission should give no weight to this 11th-hour smokescreen.