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

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

REPLY BRIEF OF THE UNITED STATES POSTAL SERVICE

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UNITED STATES POSTAL SERVICE

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INTRODUCTION AND SUMMARY

GameFly initiated this proceeding pursuant to 39 U.S.C. § 3662(a) allegedly to redress what it regards as unlawful discrimination in the Postal Service's operations. GameFly alleges that, in providing First-Class Mail service to companies that mail DVDs, the Postal Service provides preferential service to Netflix, Inc. and Blockbuster, Inc., and denies comparable service to GameFly. All three companies rent DVDs to their customers and deliver them principally through the mail. Netflix and Blockbuster DVDs primarily contain movies or other video content. GameFly DVDs contain video games. All three companies mail DVDs to their customers utilizing either permit reply mail (Netflix), or Business Reply Mail (Blockbuster and GameFly). They mail movies and games to their customers in prepaid mailers, which the customers return by converting them and placing them in the mail.

Netflix is by far the largest of these firms, having been in the DVD-by-mail business the longest. Of the total volume of DVDs mailed in First-Class Mail, Netflix represents approximately 97 percent of all DVDs. Blockbuster represents less than two percent; and GameFly represents less than one percent. A handful of other miscellaneous companies share the minute balance of the overall DVD volume. Netflix is also structurally distinct by comparison. Netflix maintains approximately 60 distribution centers nationwide. It enters its outgoing DVDs (from Netflix to the customer) into the mailstream at a comparable number of postal facilities, and it picks up its return DVDs (from the customer to Netflix) at approximately 130 facilities (many of which are picked up several times per day).

By contrast, GameFly maintains four distribution centers. It enters and picks up its DVDs at a comparable number of postal facilities. Because of their dramatically lower volumes compared to Netflix, GameFly DVDs on the return trip exhibit substantially lower densities when viewed at each facility in the postal system.

Normally, it might be expected that a mailer alleging undue discrimination in favor of another mailer would exhibit a reasonably equal footing with the mailer allegedly receiving the benefit of discrimination. At the least, one would expect the complaining mailer to occupy the same status as a mail user as the allegedly preferred mailer. In this case, Netflix and Blockbuster, and, as far as can be determined from the record, all other DVD mailers, mail at one-ounce First-Class Mail letter rates. GameFly, however, has always chosen to mail at substantially higher First-Class Mail flats rates. It has never mailed at letter rates. Furthermore, using packaging specifically designed to be mailed as a flat, rather than as a letter, GameFly chooses to reinforce its mailpiece with material that adds weight to the DVD and packaging. As a consequence, GameFly must pay the still higher flats rate for a two-ounce piece.

Under jurisdictional principles of standing that would apply to cases brought in federal courts, GameFly would lack the requisite status to maintain its complaint. It could not establish that it has in fact been injured by the alleged discrimination; it could not establish a causal connection between the discrimination and the injury; and it could not establish that any remedy sought would correct the alleged harm.

To rationalize its complaint, GameFly submits a hypothetical: if it were to mail at First-Class Mail letter rates, it would not receive the preferred treatment in mail processing that Netflix mail gets. As a companion allegation, GameFly asserts that it can predict that hypothetical result, because it has been "denied" or "refused" equal treatment by the Postal Service. That assertion of denial, however, is itself based on a conclusion constructively drawn from GameFly's version of the facts and the Postal Service's fundamental operations policy, which relies on local management judgment to make basic decisions on how to process and deliver mail.

As the central feature of its discrimination complaint, GameFly contends that Netflix DVDs get preferred treatment as First-Class Mail letters, because they avoid machine processing to a very large degree. GameFly contends that most First-Class Mail letters receive machine processing, rather than manual processing. Contrary to this normal expectation, however, according to GameFly's allegations, the Postal Service culls or manually processes most Netflix DVDs on the return trip. According to GameFly, this treatment represents a critical departure and preference. In this regard, GameFly describes the susceptibility of DVDs to be broken when processed on letter sorting machines as a "common industry problem." Under GameFly's complaint, Netflix avoids this problem as a consequence of the Postal Service's decision to give it preferred treatment that permits it to avoid the risk of damage. GameFly further argues that it has been told that, if it were to mail DVDs as one-ounce letters, they would not be culled or manually processed, and therefore would be exposed to a higher

risk of breakage. According to GameFly, this result would largely be dictated by the Postal Service's operations policy of relying on local management judgment to make processing decisions. GameFly therefore concludes that it has been forced to mail its DVDs as flats, because, in that category, they receive processing that has a lower risk of breakage or theft than they would receive as letters.

In stating its case, GameFly tends to rely heavily on the emotional appeal of a familiar popular suspicion. It tends to characterize the facts as representing an instance where a business deliberately provides preferential treatment to its largest, most lucrative customer. According to GameFly, furthermore, this preference is based on blind favoritism or prejudice, rather than rational justification. Much of GameFly's posturing and the intemperate rhetoric in its pleadings gives rise to the inference that GameFly seeks to capitalize on its alleged status in a David-and-Goliath relationship. The Commission's Public's Representative (PR), who joins GameFly in condemning the Postal Service's policies and practices, apparently shares this view.

GameFly's initial brief and its pleadings describe its Complaint as culminating GameFly's efforts over the past three years to persuade the Postal Service to offer it a lower rate than it currently pays for its DVD mail, or to offer to process GameFly's DVDs "on terms and conditions offered to two large DVD mailers, Netflix and Blockbuster." On May 17, 2010, Postal Service counsel extended an offer to GameFly's counsel to provide manual processing of GameFly DVDs on terms and conditions that reflect Netflix's practices and the

Postal Service's handling of Netflix mail. In connection with this offer, the Postal Service invited GameFly to discuss reasonable alternatives to the conditions stated in the letter. GameFly has concluded in its brief and pleadings, and in its rebuttal testimony, that this offer is not acceptable. GameFly now contends that it will accept nothing less than an enforceable guarantee that, if mailed as letters, 80 percent its DVDs will receive manual, rather than machine processing. GameFly also insists that this guarantee must be ensured by a national directive that would override the Postal Service's fundamental policy of relying on local management judgment that accounts for local conditions.

The Postal Service's response and defense in this Complaint rest on the expert testimony of its four witnesses and the arguments presented in its initial brief and other pleadings. The Postal Service believes that GameFly has failed to establish facts adequate to support its claims of undue discrimination under 39 U.S.C. § 403(c). Furthermore, the Postal Service asserts that GameFly's representation of the facts present an overly simplistic and misleading view of the basis for its complaint. Under a proper reading of the facts, the Postal Service has established that the Postal Service's operations treating DVD mail are reasonable.

The Postal Service also believes that GameFly has built its case on flawed and unreliable factual representations. The Postal Service has repeatedly challenged the legal status of much of the information that has been relied upon by GameFly as evidence, and does not withdraw from its position. Most importantly, the Postal Service believes that GameFly has failed to conform to

long-established Commission standards and rules for sponsoring evidence and for sustaining a proponent's burdens of proof and persuasion in Commission proceedings. In particular, GameFly's reliance on the unsponsored and flawed Christensen study, and on unsponsored, unexplained commentary in a report by Office of the Inspector General (OIG), creates an unreliable and defective foundation on which to base its complaint. GameFly's reliance on unsponsored and unexplained internal Postal Service communications and other documents selected from tens of thousands of documents produced by the Postal Service during discovery is also defective. GameFly's refusal to sponsor testimony to attest to its interpretations of these documents has denied the Postal Service an opportunity under due process to challenge and test GameFly's unsupported characterizations and interpretations. GameFly's use of this information as support for its arguments and legal position in many instances is incorrect and misrepresents the true facts.

Applicable legal standards would support a finding that the Postal Service has not unreasonably discriminated against GameFly under 39 U.S.C. § 403(c). Courts have properly interpreted that statutory provision as affording the Postal Service reasonable latitude in treating mail users differently. Commission precedent has consistently applied a logical, fact-based standard for evaluating claims of discrimination under section 403(c) that would support the Postal Service's position. The Filed Rate Doctrine does not establish any independent legal standard for reviewing the Postal Service's alleged discriminatory conduct, or that would dictate any rate and classification result for First-Class Mail.

Finally, the Postal Service believes that the relief requested in GameFly's brief is inappropriate and unrealistic. The facts do not create any reasonable basis for the remedies that GameFly has proposed. The operations directive outlined by GameFly is unworkable and does not reflect sound operations policy. No adequate foundation has been laid on the record that would support GameFly's alternative request for lower rates. Nor is that approach warranted by a fair reading of the facts on the record of this proceeding.

ARGUMENT

I. RELIABLE FACTS ESTABLISHED ON THE RECORD DO NOT SUPPORT GAMEFLY'S COMPLAINT.

A. The Postal Service Makes Decisions About How to Process Netflix and Other Disc Mail Based on Efficiency and Service Considerations.

1. The Postal Service does not dispute that the majority of Netflix mail receives manual processing.

GameFly devotes a large section of its initial brief to the argument that the Postal Service manually culls the vast majority of Netflix mail pieces. *See* GameFly Brief at 21-41. The Postal Service does not contest that it uses one-touch manual separation to process the majority of Netflix mail pieces. Postal Service witnesses have explained repeatedly the efficiency benefits that result from manual handling of Netflix mail pieces. Initial Brief of the United States Postal Service (November 8, 2010) ("Postal Service Brief") at 84-93.

It appears that GameFly does not understand what the Postal Service's manual handling of Netflix mail entails, why the Postal Service processes Netflix mail using this particular method, and how Postal Service processing of Netflix

mail differs across processing plants. Postal Service witnesses have explained that one-touch manual separation of Netflix mail is the most common processing method applied to Netflix mail, and that decisions to use this method reflect efficiency and service concerns. *Id.* These witnesses have also explained that the processing methods applied to Netflix mail vary from one-touch manual separation to full automation, depending on a number of factors specific to each processing facility. *Id.* Like Netflix, GameFly receives different types of processing, including manual culling, depending on the conditions of each plant. *Id.* GameFly's misconceptions about Postal Service processing operations result from its insistent reliance on outdated and unsubstantiated documents, and its rejection of more current and accurate information provided by knowledgeable and experienced witnesses with personal knowledge of Postal Service processing operations.

2. The manual processing applied most commonly to Netflix mail is one-touch manual separation.

As explained in the initial brief, GameFly has a weak basis for making comparative assertions regarding the processing received by Netflix mail. It has ignored the descriptions of processing provided by knowledgeable and experienced Postal Service witnesses with current, in-depth understanding of processing operations. Instead, GameFly has chosen to rely on a witness who has never observed the processing of Netflix mail, and an outdated, four year-old study that entailed limited observations in seventeen randomly selected processing facilities—none of which were sufficiently similar to rely upon any common processing model. *See* Appendix to the Initial Brief of the United States

Postal Service (November 12, 2010) ("Appendix"), at Tab 20, GFL1040, USPS Mail Characteristics Study of DVD-By-Mail ("**REDACTED**"). GameFly continues to present and rely upon its outdated, uninformed, self-serving, and fabricated processing world, despite its inaccuracy and strong contrary evidence.

The term "manual processing" refers to a variety of operations. GameFly witness Glick's testimony demonstrates the different uses of the term. *See* Tr. 11/1978-1981. The wide range of meanings of the term "manual processing" has led to a studied misapprehension by GameFly about how the Postal Service processes Netflix mail, such that GameFly has based its case on processing methods different from those commonly applied to Netflix mail today.

For purposes of this case, the relevant "manual processing" is the processing received by disc mail generally, and more specifically, by Netflix mail that presents itself as a high proportion of volume in a given context. GameFly has focused its case on the processing received by Netflix mail, and has alleged that the processing of Netflix mail constitutes discrimination under 39 U.S.C. § 403(c). *See, e.g.,* Complaint at ¶ 49. As described by Postal Service witnesses, the Postal Service utilizes one-touch manual separation as the primary method of processing Netflix mail. *See* Postal Service Brief at 84-89. The one-touch manual separation method entails separating Netflix mail at the first touch, placing it in a tray or tub, and handing it off to Netflix. *See id*. at 103. Because GameFly based its understanding of the processing received by Netflix on the testimony of a witness who has never observed the processing of Netflix mail, plus a study that similarly failed to recognize today's one-touch operational

reality, it has chosen to pretend that the type of processing actually received by Netflix does not exist. *See id*. at 87-89. GameFly relied on its witness testimony and a four year-old study that measured the costs of many types of "manual processing," but not the type of processing most commonly received by Netflix. *See id*. at 103. The study concedes that its cost estimates reflect merely proxies, and not actual measurements, and that it does not measure the type of manual processing received currently by Netflix. *See id*. Despite these alerts, GameFly has not even attempted to updated its understanding of the processing received by Netflix to more accurately reflect reality and instead argues that reality does not exist. *See* Post-Hearing Brief of GameFly, Inc. (November 8, 2010) ("GameFly Brief") at 69-74.

3. GameFly receives processing commensurate with the service it purchases.

GameFly makes no assertion that the Postal Service fails to provide the level of service it purchased. GameFly purchases First-Class Mail flats service. GameFly Brief at 6. This service is more expensive and superior, for purposes germane to GameFly's unique business model, to the service purchased and received by Netflix and other disc mailers. *See* Postal Service Brief at 78-84; Tr. 11/1961-1967 (asserting that GameFly should not be required to accept service meeting all the terms of service received by Netflix, and that GameFly should instead receive a national directive or standard operating procedure addressing—to the exclusion of all other mailers—only processing of GameFly mail).

As part of its flats service, GameFly disc mail is processed primarily on automated flats processing machines. Tr. 3/99-100. This processing method satisfies three key elements of GameFly's business model. First, flats processing addresses GameFly's expectation that automated flats processing results in less breakage than processing on letter automation machines.[1] GameFly Brief at 63. Next, GameFly expects that flats processing minimizes exposure to manual handling that pieces experience in the letters mail stream.[2] *See* Postal Service Brief at 83; Tr. 9/1611 (discussing perception that avoidance of manual handling reduces theft risk). The limited exposure occurs because of the orientation of the automated flats equipment and the lower likelihood of jams. Finally, GameFly obtains from flats service, together with its CONFIRM subscription, information key to GameFly's customer service: when a CONFIRM scan tells GameFly that a particular customer has mailed back a DVD game, GameFly immediately sends that customer the next game on that customer's

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[1] No empirical basis for this expectation appears in this docket's evidentiary record. Witness Lundahl's testimony (USPS-T-4) does address ways in which mail processing and transportation of all types adds cumulative stress to DVDs that eventually leads to non-functional DVDs. Since Netflix hired him, and Netflix uses letter shaped mail, witness Lundahl's testimony focuses upon automation letters processing to the exclusion of automation flats. Netflix and GameFly both apparently report current breakage rates approximating one percent, but no systematic examination of breakage on flats equipment has yet been undertaken. Notwithstanding, what matters here is GameFly's choice of flats processing for purposes of its business model.

[2] Since GameFly's entire case depends on its pretended interest in letter-shaped processing, its expectation regarding manual handling is, at least, awkward. Yet in meetings with postal officials, GameFly's representatives do emphasize its preference to avoid manual processing, hence its mailpiece endorsements that emphasize the preference for automated processing on AFSM 100 flats processors.

preference list thereby speeding its arrival in the customer's hands.[3] *See* Postal Service Brief at 36 FN26, 85-86. GameFly has admitted that without CONFIRM service, it would have no other method to track its mail. Tr. 5/707, GameFly Response to USPS/GFL-14 (identifying GameFly's use of CONFIRM service as GameFly's only "means of tracking individual DVD mailers").

In actuality, GameFly today receives automated flats processing and, in some locations, manual service that resembles the service afforded to most Netflix pieces. *See* Tr. 9/1611-1614 (describing manual processing of GameFly mail in South Florida). This manual processing occurs in South Florida and in other places where the density and other factors make manual processing of GameFly mail efficient. *See* Postal Service Brief at 66. Like the processing decisions applicable to Netflix mail and other mail, the Postal Service makes these processing decisions for GameFly mail because it is efficient, and without any consideration of GameFly's preferences. *See* Postal Service Brief at 77; Tr. 5/932-933 (conceding that GameFly witness "do[es] not have any evidence" of a meeting where a denial of manual processing occurred, and "can't identify anybody specifically who participated in the conversations" pertinent to the alleged denial of manual processing).

[3] This element of GameFly's business model also constitutes an awkward fit with GameFly's pretense of wanting Netflix-like manual processing (howsoever defined) of letter shaped pieces, since such processing would preclude any CONFIRM scans on the return trip.

B. **The Postal Service's Policy of Decentralized Operations Decisions Does Not Embody Unlawful Discrimination.**

GameFly's version of the facts depends heavily upon its (mis)characterization of the Postal Service's policy of deferral to local conditions and local managerial discretion as the embodiment of centrally-directed, undue discrimination against GameFly DVD mail. GameFly expends considerable effort portraying the practical consequences of this policy as a situation acknowledged and endorsed by the Postal Service's senior management.[4] GameFly contends that this awareness at the national level converts the combination of local decisions into a *de facto* national directive. GameFly's Memorandum contains a separate section titled, "The Postal Service cannot evade compliance with Section 403(c) by acquiescing in discrimination by employees in the field." Memorandum of GameFly, Inc., Summarizing Documentary Evidence (April 12, 2010) ("GameFly Memorandum" or "GameFly Memo") at 52. GameFly asserts: "The Postal Service, however, cannot wash its hands of responsibility for undue discrimination by pushing the relevant decision-making authority out to the field." *Id.* at 53. It further states: "The Postal Service's acquiescence in mail processing of DVD return mailers at field offices was a deliberate policy approved by the '[s]enior management of the Postal Service." *Id.* at 54.

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[4] The Postal Service is not claiming that Headquarters officials were necessarily in the dark. To the contrary, especially as strong financial management practices have driven over ten billion dollars in costs from mail processing in the last few years, Headquarters officials have had no reason to question field decisions driven by and demonstrating enormous efficiency gains. Since Netflix volume can reach ten percent of the total volume passing through a given plant, the processing of Netflix mail critically informs the bottom line impact.

Repeating almost verbatim the arguments made in its Memorandum, the Brief continues, characterizing the mail processing practices that have been applied to Netflix DVD mail as centrally-directed. GameFly Brief at 65-67. Discussing the OIG's 2007 report, the Brief emphasizes:

> The Postal Service's practice of giving manual processing to DVDs from Netflix has continued since the OIG Report. Joint Statement ¶ 87; GFL1335 (Tr. 4/370). Headquarters officials of the Postal Service have been aware that the manual culling and processing of Netflix return DVD mailers has often occurred since November 2007." Joint Statement ¶ 90.

GameFly Brief at 24. GameFly refers to the operations policy as a "a fig leaf for a headquarters decision to treat Netflix DVD mailers better than the DVD mailers of other rental companies" *Id.* at 38. GameFly further states:

> 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.

Id. at 66 (emphasis added, footnote 17 omitted). Implying a conspiracy, GameFly observes:

> But key headquarters officials, unwilling either to deprive Netflix of its preferential terms of service or extend the same terms to other DVD rental companies, *have blocked all attempts at reform*.

Id. at 45-46 (emphasis added).

GameFly's accusatorial rhetoric conforms to the central theme of its complaint, namely, that Postal Service senior management has directed, or at the least acquiesced in, a coordinated program of discrimination against GameFly in favor of the Postal Service's largest DVD mailer, and one of its largest First-Class Mail customers. As evident in its Initial Brief, according to

GameFly, senior management has tolerated this discrimination irrationally, and the disparate treatment has assumed the status of national policy. Yet, GameFly offers no credible explanation why the Postal Service would pursue this course of blind favoritism. In this regard, GameFly populates its arguments with straw men and innuendo, implying some sort of fraternal conspiracy, but it stops short of presenting the source and explanation for its allegations of discrimination. In pointing to Netflix's efforts to influence Postal Service policy, GameFly identifies what it alleges to be the means through which this undue influence is directed, but it never explains the Postal Service's motivation.

More importantly, GameFly offers no credible evidence to support its inference that senior management has "deliberately chosen" to discriminate in favor of Netflix and against GameFly. GameFly repeatedly cites one particular email chain describing a meeting between senior officials of Netflix and the Postmaster General five years ago (GFL1484-85) as evidence of its alleged conspiracy.[5] GameFly Memorandum at 22, 30, 37, 54; GameFly Brief at 14, 23, 53, 66, n. 17. GameFly, however, does not successfully explain why, if the favoritism it alleges so infects Postal Service national policy, events following that meeting do not support GameFly's allegations. In that meeting, as described by Netflix, the Postal Service was urged to extend nationally the Pacific Area SOP, which outlined procedures for processing the large and growing volumes of DVD mail, the overwhelming majority of which originated with Netflix. Not only did the Postal Service not extend the Pacific Area SOP, but, two years later, the Pacific

[5] **REDACTED**

Area rescinded it. Tr. 9/1652. Furthermore, at other points in history, a national directive was considered, but was rejected in deference to the fundamental operations policy of relying on local decisions to determine mail processing of DVDs along with all other mail, all in light of demands inherent in each local environment. Attempts by Blockbuster to induce a similar national directive in its favor were rejected for the same reason: local judgment assessing local conditions and capabilities within the framework of strict discipline imposed by financial controls and accountability were more reliable guides to efficient and effective operations and commitment to service than arbitrary decrees by national headquarters.

GameFly counters this conclusion by citing a mixture of documents and internal communications obtained through discovery. GameFly has not systematically evaluated all of the catches dredged up in its over-one-year-long fishing expedition. Rather, from the literally tens of thousands of records produced by the Postal Service, it has selected what it considers to be the most useful for purposes of its allegations. See Tr. 10/1850 (USPS-T-1, at 16-22). Many of the documents it cites do not relate directly to the core of its complaint, namely, that the Postal Service discriminates in its mail processing decisions. Many relate to a “host of preferences” that GameFly alleges, in addition to preferences in mail processing. Most of GameFly’s citations, however, share one characteristic: they originate with lower and mid-level employees, many of whom were employed in functions other than processing operations, and they express prejudicial language (or fragments of language) that create the

appearance of support for GameFly's allegations of a centrally-directed conspiracy of discrimination. Notwithstanding GameFly's intense search, however, it has failed to produce any "smoking gun" that would directly link headquarters control with its allegations.

The Postal Service has addressed GameFly's approach to the evidence upon which it relies elsewhere in this brief, the Postal Service's initial brief, and its testimony. Stripped of its inflammatory and unsupported accusations, GameFly's case for system-wide, unlawful discrimination rests on its indictment of the Postal Service's fundamental operations policy. According to GameFly, that policy results in massive culling of Netflix mail. Furthermore, GameFly alleges that, hypothetically, local decision-making would not result in culling GameFly mail to an equal degree, if GameFly were to mail at First-Class Mail letter rates. According to GameFly, this hypothetical disparity in treatment proves that the Postal Service unlawfully discriminates in favor of Netflix, since, according to GameFly, the Postal Service cannot offer a rational justification for its actual conduct, or its hypothetical conduct. Against the testimony and explanations offered by Postal Service operations managers, GameFly essentially contends, either, a) the witnesses' justifications are not the real reasons for the alleged discriminatory effect of operations policy, or b) their explanations are not credible, because they conflict with a flawed, unsponsored study and an odd collection of internal emails and other documents expressing undocumented, unexplained conclusions that were never adopted as the Postal Service's own.

In responding to GameFly's Complaint, the Postal Service presented the testimony of Nicholas Barranca (USPS-T-1), a senior advisor in operations, who, over the course of 37 years of experience with the Postal Service, served in several officer positions in Operations and Marketing, including those having key responsibilities for mail processing operations, as well as several other managerial positions in mail processing. Among other topics, Mr. Barranca explained the Postal Service's basic operations policy, both generally and specifically with regard to DVD mail, *id.* at 14-16, and he made himself available for further inquiries about this central element of GameFly's allegations. Regarding the Postal Service's basic approach, Mr. Barranca stated:

> The Postal Service maintains a vast and extremely complex operating system that has evolved over many years to provide mail service to an enormous and widely diversified spectrum of customers. In this system, the interplay of numerous variables favors a decentralized approach to operations management that relies substantially on local decision-making. Because the mail enterprise takes place in the context of substantially different geographies, operating conditions, and economic and social environments, the need to make decisions tends to favor a system that is flexible enough to react to diverse practical goals and problems throughout the nation while undergoing constant change. In this context, variations in staffing, weather, mail flow, transportation capabilities, and other factors such as natural disasters, create a continually shifting operating environment. While there are many instances in which standardized procedures are preferred for different reasons, by and large determinations affecting acceptance, processing, transportation, and delivery of mail depend heavily on local decisions. The postal system, furthermore, has evolved over many years of trial and adjustment, and it makes the most practical and administrative sense in most respects.

Tr. 10/1850 (USPS-T-1, at 14-15). Regarding the processing of DVD mail, he stated:

> As witnesses Belair and Seanor demonstrate, operations practices involving the processing of DVD mail are supported by sound reasons and are well-justified. Even without national directives, the patterns of processing Netflix versus other mailers' volume have evolved out of the practical realities faced in the field. While I am not aware of any comprehensive cost studies or operations analyses that dictate field operations in this regard, local decisions are supported by the logic of each individual set of circumstances, reliance on local data and experience, and judicious coordination at both District and Area levels of administration. Headquarters does not impose a discriminatory formula on local decisions. If there are similarities in approach to Netflix mail in the field, it is because operational decisions have arisen from similarities in the mailing environment.

Id. at 16.

GameFly's Brief characterizes Mr. Barranca's testimony as follows:

> The evidentiary value of Mr. Barranca's prefiled testimony (USPS-T-1) is virtually nil. While labeled testimony, it is in substance a trial brief. It appears to have been written by the Postal Service's attorneys, and does not appear to be based on any personal knowledge of the facts by Mr. Barranca. *See* Tr. 10/1852-54, 1856-63 (indicating that he based his testimony on little more than a review of testimony, pleadings and other case documents and "conversations with Postal Service counsel"); Tr. 10/1866-72, 1876 (unable to identify the documents supposedly supporting several of his claims). Moreover, while the testimony asserted that GameFly "cherry-picked" or miscited documents obtained from the Postal Service in discovery, Mr. Barranca offered no analysis of most of the documents that GameFly cites. And Mr. Barranca's testimony did 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.

GameFly Brief at 24, n. 6. GameFly does not address the logic or reasonableness of the operations policy that Mr. Barranca describes, or attempt to demonstrate that it lacks theoretical or empirical justification. GameFly asked not one question of Mr. Barranca in written or oral cross-examination regarding

the policy, nor did it attempt to rebut the Postal Service's approach with contrary expert opinion in its own rebuttal testimony.[6]

GameFly's arrogant dismissal of Mr. Barranca's testimony highlights a critical gap in the logic of its case. GameFly complains about the high degree of manual culling given to Netflix return DVDs. It complains about a hypothetical result in which GameFly, if it ever were to choose to mail at First-Class Mail letter rates, would not receive an equal amount of manual culling. Both circumstances result from the application of local management judgment to local conditions and specific mailflows presented by Netflix and Blockbuster, on one hand, and the hypothetical GameFly situation, on the other. Yet, GameFly offers no credible proof that local management determinations regarding the processing of DVD

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[6] GameFly's protest that Mr. Barranca's testimony more closely resembles legal argument is ironic. First, the testimony itself consists almost entirely of Mr. Barranca's commentary and opinion on GameFly's explicit and implicit allegations, based his expertise and long experience in mail processing and marketing as an officer and manager with high responsibility for the conduct of the Postal Service's business. Except for his detailed analysis of GameFly's methodology and use of discovery documents (USPS-T-1, at 16-22), Mr. Barranca's testimony contains few citations or references to documents other than GameFly's own unfounded allegations and contentions. By contrast, GameFly's own case consisted primarily of a self-styled legal pleading, which GameFly chose to submit for its direct case pursuant to a transparent litigation strategy to avoid having to defend its own interpretations of the documents upon which it relies. In rebuttal, GameFly offered the testimony of an economic consultant who has no experience in postal operations and who has not even observed the processing of Netflix mail in the field. The rebuttal testimony itself was essentially legal argument, unsupported by anything other than the unsponsored documentation from which the witness's opinions were principally derived. *See* Motion of the United States Postal Service to strike the Rebuttal Testimony of Sander Glick for GameFly, Inc., Docket No. C2009-1 (Nov. 1, 2010). Incredibly, GameFly contends that Mr. Barranca lacks requisite expertise. Had GameFly attempted to inquire about the substance of his opinions, it would have been rudely awakened to discover the depth and breadth of Mr. Barranca's knowledge, not only of DVD processing, but of postal operations generally.

mail lack a reasonable basis, or are motivated exclusively by factors other than effective and efficient operations and service goals. Nor does GameFly successfully justify its conclusions by demonstrating that the decisions that lead to the circumstances about which it complains should be different, given the facts and conditions confronting postal managers in the field every day. The most that GameFly can do is to argue a) that the factors evaluated and objectives pursued on a local level are not the *real reasons* leading to decisions to cull or not cull, b) that the local conditions that induce particular behavior by the Postal Service are the products of the Postal Service's own making, and c) that, even if local decisions have a rational basis, the individual determinations are not the right choices, in light of evidence on the record that can be used to contradict local processing decisions, namely and principally, the unsponsored results of the Christensen study, the unexplained commentary in the OIG report, and the opinionated remarks found in a disparate collection of internal correspondence and other documents obtained in discovery.

Beyond Mr. Barranca's testimony, Postal Service witnesses Seanor and Belair testified extensively on the local decision-making process. Mr. Seanor described generally the relationships leading to local processing determinations as follows:

> Local plant management is empowered to develop local operating procedures given their own unique operating conditions. Factors a local plant manager may consider include available equipment, mail flow (volume, service commitment shape and weight), and destination (which may include delivery). No two facilities are exactly alike; differences arise among mail arrival profiles, mail base (volume, shape, or class characteristics), and equipment type and quantity. However, similarities among facilities do allow for the

> sharing of best practices; management's ongoing challenge is to figure out what works best in each location, and how operations in each facility may need to change over time. National guidelines serve to help ensure operations conform to service standards and budget targets. Decisions regarding the culling of DVD mail depend upon factors such as volume, density, how easily the mailpiece can be identified and captured (aided by visibility and easy access), and consideration of benefits versus costs (with time being a critical element of the latter).

Tr. 10/1739 (USPS-T-3, at 2-3). *See* USPS-T-2, at 11-13 (Tr. 9/1603-05), 20-22 (Tr. 9/1612-14); Tr. 10/1739 (USPS-T-3, at 2-12). Both in discovery and cross-examination, the Postal Service's operations managers elaborated on their explanations. *See* GFL/USPS-T3-7 (Tr. 10/1747); GFL/USPS-T3-10 (Tr. 10/1750); GFL/USPS-T3-18 (Tr. 10/1761); Tr. 9/1663-64; Tr. 9/1669-71; 9/1694-97; 9/1703-04; 9/1704-05; 9/1717-18; Tr. 10/1811-22.

In response, GameFly does not contest the logic of local decision-making, although it complains bitterly about the treatment given to Netflix mail currently and in the past, and about the predicted results, if GameFly were to mail at letter rates. In this regard, GameFly does not contest the logic of the decisions leading to culling a majority of return Netflix DVDs. In does not even contend that Netflix pieces should be placed on automation in current circumstances, rather than culled prior to any distribution operations. Rather, it challenges the credibility of the Postal Service witnesses who testified that local operations decisions applied to Netflix mail under varying local conditions are justified. Especially regarding the Postal Service's view that the field consistently chooses a low-work-hour, lower cost solution to the situation created by high density, high volume mailflows of Netflix DVDs in most localities, GameFly simply denies that these decisions

are based on honest application of sound operating principles to local conditions and circumstances. In its Brief, GameFly states:

> These claims are absurd, and the Postal Service should be embarrassed at making three of its employees take the witness stand to defend them. No Postal Service study supports them, and they are refuted by a host of Postal Service documents, including the Christensen Associates study and the Postal Service's own stipulations and institutional discovery responses in this case.
>
> As explained above, the main reasons for Postal Service culling of Netflix pieces from automated processing are to reduce DVD breakage, jams, and other processing problems, not because culling is a low-cost process.

GameFly Brief at 68.

The Postal Service has addressed elsewhere GameFly's contention that a careful weighing of the evidence that contrasts the Christensen study results against Postal Service testimony would nullify the justification presented for local operations. Postal Service Brief at 84-93. In this regard, the PR joins GameFly in condemning Postal Service operations judgment. In his brief, the PR states:

> The record establishes as a fact that Netflix and Blockbuster receive better service than other DVD return mailers. Is this treatment justifiable? The answer boils down to an issue of credibility: given that Netflix initially received special treatment *at the request of Netflix* [citing GameFly's legal Memorandum], is it plausible that Netflix now receives special treatment because such treatment is cheaper? The question almost answers itself. The only quantitative evidence on the record shows that manual handling of Netflix return pieces is more expensive than manual handling. The evidence to the contrary consists of *the unsupported opinions of witnesses Belair and Seanor. Mere unsupported opinion cannot rebut quantitative studies such as witness Glick's direct testimony and the Christensen report.* And the opinions of witnesses Belair and Seanor are contradicted by internal Postal Service documents [citing GameFly's legal Memorandum].

PR Brief at 10 (emphasis added).

This incredible statement exposes a profound bias against real-world experience in favor of "quantitative evidence," regardless of its form or reliability. Such a bias would prefer the disconnected modeling and opinions of analysts and observers with no mail processing experience and no direct knowledge of operations to the testimony of highly experienced postal managers with current and direct knowledge of the issues presented in GameFly's Complaint.

The application of this bias fails at many levels. By far the most astounding contention, however, is the claim that postal management flies blind, without benefit of data or quantitative support. That view might gain traction were there an ounce of truth in it. The Postal Service's extensive testimony in this proceeding, however, belies GameFly's and the PR's conclusions. In particular, the contention that postal managers lack operating expertise and the tools to make critical decisions regarding the processing of DVD mail was addressed directly by Mr. Seanor. In explaining the operating context of these decisions, he stated:

> While field managers are heavily data driven, they do not rely upon analysis by economists or statistical studies as I understand may happen at Headquarters or here at the Commission to discuss operations. Field managers rely upon expertise developed over the course of a career that involves endless trial and error or success, followed by exploration of better alternatives or best practices identified by colleagues. Each plant manager reviews performance reports daily to determine where improvements may be made in his or her operation. Many tools have been built to provide area, district and local managers data that is instrumental to decision-making. And, I suppose, to be fair, many of these tools were built with the assistance of experts that would have included economists and statisticians. In general, formal economic studies are not useful to field managers, but I understand that many of the data sources we use to drive our decisions also end up being used in Commission proceedings. Run Plan Generator and End Of Run

> are two programs used in real time and for historical performance reviews. Both give a good account to front line management as to how long machines should be required to run a given volume. Field managers use planning tools to decide and schedule staffing levels, expected clearance times, and productivity achievements. MPE Watch is a real time tool for monitoring machine performance and gives the front line managers the ability to see jam issues or even potential operator induced errors such as poor mail flow, bin sweeping, and jam clearing time. MPSOM or Mail Processing Staffing Opportunity Model gets used daily and weekly for productivity and human capital management by front line managers; it factors levels of leave, productivity achievement, and performance against expected targets (including other facilities), and even historic volume levels.
> The field commonly refers to this and other information to drive what we call "The 24 hour clock". This clock relies on volume data from MODS and ODIS to assist in calculating operational time. The timekeeping database or TACS as well as MODS is used to accurately track work hour usage to specific operations and times during the day. All of this information combined with the current state of the economy and electronic diversion have brought substantial pressure to bear on the time assigned to the AFCS operation.

Tr. 10/1739 (USPS-T-3, at 3-4). Both witnesses Seanor and Belair, furthermore, have explained the financial and operating framework within which local decision-making takes place. *See* Tr. 9/1710-15; Tr. 10/1834-37.

GameFly and the PR invite the Commission to override the Postal Service's fundamental operations policy and to supplant the judgment of local managers with the disconnected opinions of armchair economists and inexperienced observers armed with an outdated, unsponsored costing study. While such a study might serve a useful function in some contexts, it cannot substitute for the first-hand knowledge and experience of managers who must daily make decisions in the real world. The Christensen study was commissioned to support an effort to develop a pricing strategy for a proposed

experimental classification. In that context, an estimate of average costs derived from observing seventeen different facilities with seventeen significantly different operating plans and procedures, if it were reliable, might be used to establish a price point for a proposed experimental classification. It would be totally inappropriate, however, to apply such a standard to evaluate the logic and performance of management decisions operating under a policy of decentralized decision-making. That would be the function of the Postal Service's elaborate and reliable administrative and budgetary framework for ensuring the effectiveness and quality of local operations.

Furthermore, the effort by GameFly and the PR to impugn the motives and capabilities of postal management officials who testify in Commission proceedings should be rebuffed. GameFly's accusation that senior postal management made "three of its employees take the witness stand" to defend unsound decisions should be offensive to the Commission. It must be remembered that this proceeding does not focus on a clash of opinions over financial or public policy goals where senior management and the Commission might reasonably disagree. Rather, in the terms GameFly has framed its Complaint, this proceeding focuses on allegations of unlawful discrimination in operations decisions, and whether a reasonable basis exists to support those decisions in the field. Other than its unsupported and unfounded innuendos that the Postal Service irrationally favors a large DVD mailer, GameFly and the PR have offered no reason why senior management or the Postal Service's witnesses would deliberately misrepresent the facts. Nor has GameFly offered

one shred of credible evidence that the contemporaneous testimony of Postal Service managers should be regarded as inferior to GameFly's unsponsored interpretations of comments made in emails and power-point presentations.

The heart of GameFly's complaint lies in its accusations that the Postal Service deliberately pursues a program of unlawful discrimination in favor of Netflix. GameFly has failed to establish that finding based on direct, credible evidence, in the face of the Postal Service's testimony and evidence. GameFly's fallback position, that, even if there were no discriminatory intent, the policy of relying on local decisions represents a form of institutional discrimination is similarly unsupported. GameFly has not demonstrated that this operations policy results in undue discrimination currently, or that it would result in undue discrimination against GameFly, in a hypothetical circumstance in the future, in light of GameFly's substantially different mailing practices and characteristics.

C. Substantial Differences Between GameFly and All Other DVD Mailers Undermine GameFly's Status and Arguments as a Complainant.

A comparison of GameFly and Netflix reveals many more differences than similarities. Each purchases a different service (single ounce letter versus two ounce flat); ships DVD discs that have mutually exclusive sets of uses, customers, and for the most part, physical characteristics (movie DVDs versus game DVDS—and other media); has different volumes, costs and business onsiderations; serves different customers whose needs also differ; has different implications for mail processing operations (with varying volume and density consequences in each plant's service area); and undertakes a different level of

cooperation with the Postal Service (thereby minimizing—or not—distance each mailpiece travels in the mail). Postal Service Brief at 63-76. GameFly concedes these differences. GameFly Brief at 61-64. Hence these differences between Netflix and GameFly are not matters in dispute.

GameFly argues, using a simplistic analysis and hypothetical facts, that it is similarly situated to Netflix because it uses First-Class Mail to ship discs, its discs "are small and light enough to be mailed as one-ounce letters," and "both companies' DVDs suffer from high breakage rates if subjected to automated letter processing when mailed back from subscribers."[7] *Id.* at 61. GameFly acknowledges some of the distinctions between Netflix and GameFly that the Postal Service identifies, including payment of different rates, GameFly's theft risk, different mail pieces, GameFly's failure to pursue breakage reduction design changes, Netflix's efficiency-based mail entry and collection practices, and Netflix's higher volume. *Id.* at 62. GameFly dismisses these significant and numerous changes with remarkably little discussion, claiming that they blame the mailer or (without explanation) are immaterial. *See id.* at 62-64. Yet as the

[7] Mailers, rather than the Postal Service, are generally responsible for packing mailpieces sufficiently to protect contents (*see generally,* Postal Service Brief at 60-70). Mailers are accordingly free to design their mailpieces to meet whatever breakage rate each considers appropriate to its business model. GameFly has apparently made its choice through use of its own mailer for two ounce flats; moreover, GameFly's claim that a postage rate decrease with no change to its mailpiece would be an appropriate remedy (GameFly Brief at 5-6) confirms GameFly's comfort with its choice. As such, GameFly's repeated claim that it should be provided handling that produces an acceptable breakage rate (*see e.g.,* GameFly brief at 1, 60) should be seen as exemplifying the deliberately misleading argument that has suffused GameFly's conduct throughout this docket. No such standard as an "acceptable level of breakage" has been shown to exist, and even if it had, attainment of that level would constitute an input of GameFly's own into decisions about its business model and mailpiece design.

Postal Service explained (Postal Service Brief, Section I, pp 13-63), close analysis of factual circumstances is necessary when evaluating whether good business reasons inform Postal Service action.

GameFly claims three alleged similarities shared by GameFly and Netflix, only one of which–use of First-Class Mail–is supported by substantial record evidence. GameFly chooses not to address, thereby glossing over, how much variation exists among mailers who use First-Class Mail. *See, e.g.,* Postal Service Brief at 121. As such, the truth that both GameFly and Netflix use First-Class Mail does not demonstrate meaningful or sufficient similarity for purposes analyzing claimed undue discrimination. First-Class Mail covers a broad range of products, rates and services, and the fact that two mailers use First-Class Mail reflects nothing about their similarity.[8] Given the broad diversity in users of First-Class Mail, even two customers who use identical rate cells and shapes still may not be sufficiently similar for purposes of triggering any remedy pursuant to a complaint under section 403(c). Postal Service Brief at 30 and footnotes 21-22; Tr. 10/1850 (USPS-T-1 at 9).

The other alleged similarities presented by GameFly - its discs "are small and light enough to be mailed as one-ounce letters" and "both [Netflix and

[8] While GameFly and Netflix now have similar breakage rates of approximately one percent, were GameFly mailpieces all to receive essentially the same handling as Netflix pieces, GameFly's breakage rate would presumably increase, given GameFly's failure to investigate, let alone implement, any of the methods of forestalling the accumulation of damage that DVDs incur by their normal use, transportation, and transit through the mail. Witness Lundahl (USPS-T-4) explains all of this. If GameFly finds a one percent breakage rate unacceptable today, there is no reason to think that a remedy requiring Netflix-like handling could possibly be acceptable to GameFly.

GameFly's] DVDs suffer from high breakage rates if subjected to automated letter processing when mailed back from subscribers" – rest upon hypothetical conduct that GameFly has never undertaken. GameFly has never mailed its discs as letters, or packaged its discs for mailing as letters. Tr. V/744 (GameFly Response to USPS/GFL-48 confirming that "GameFly [did not] mail any DVDs as First-Class Mail single ounce letters" and that "GameFly has always sent and received its DVD mailers as single-piece First-Class flats"). Accordingly, GameFly lacks a factual foundation for concluding what breakage rate it would experience if its hypothetical single ounce mailpiece were processed in automated letter processing; GameFly itself admits that it does not know the breakage rate it would experience if it mailed its discs on automated letter processing. Tr. 11/1968-1976; Tr. 5/890, 908.

Whether, hypothetically, GameFly's discs "are small and light enough to be mailed as one-ounce letters" or would "suffer … high breakage rates if subjected to automated letter processing when mailed back from subscribers" remains entirely conjectural. GameFly cannot demonstrate substantial similarity to Netflix because, in practice, GameFly's discs have not been mailed in the same manner as Netflix. *See* Tr. 10/1850 (USPS-T-1 at 9). GameFly's self-serving statements about the reasons it has not mailed its discs as one-ounce letters do not outweigh the facts, which show that GameFly is not similar to Netflix. *See* Postal Service Brief at 63-76. The need for GameFly to use overly broad categories and hypothetical situations as support for its allegations about the similarity of GameFly to Netflix, and its minimal attention to the many

differences between the two companies, provide further evidence that there is a wide gap between GameFly and Netflix, and that they are not similarly situated.

The illustrations above of the dissimilarities between GameFly and Netflix confirm GameFly's lack of standing to bring this complaint alleging injury from the Postal Service's letter processing practices. As described by the Postal Service in its initial brief, under generally accepted requirements for standing, GameFly would not have standing to bring its complaint in a court. Postal Service Brief at 35-37. The jurisdictional requirements for standing, and the underlying policies requiring actual proof of injury—not mere hypothetical supposition—if made applicable by the Commission, would ensure that the Commission's limited resources are applied to consideration of a real situation. A well-founded complaint must rest upon more than hypothetical and suppositional facts, thereby avoiding the waste of judicial and other resources entailed in responding to a hypothetical injury. *See generally Baur v. Veneman*, 352 F.3d 625, 632 (2d Cir. 2003). Here GameFly brings the exact type of complaint that standing requirements are intended to repel, a complaint based on a merely hypothetical, and not an actual, injury. And GameFly's submission of this case based on a hypothetical injury has caused the delay and lack of plaintiff involvement that the jurisdictional standing requirements seek to avoid.

After essentially attempting to gloss over the real facts underlying this case and GameFly's supposed substantial similarity to Netflix, GameFly resorts to insults and claims of fabrication by the Postal Service as a response to Postal Service witnesses' explanations of the efficiencies underlying the processing of

DVD mail in today's operational environment. GameFly Brief at 67-68.[9] Such claims are, at least, consistent with GameFly's attempts to ignore the facts and alter reality through reliance upon the hypothetical facts it prefers.

GameFly's preferred explanation for why the Postal Service removes Netflix return pieces from the automated mail stream is that such conduct responds mainly to Netflix' requests for such processing and thereby avoids "DVD breakage, jams and other processing problems." GameFly Brief at 68. GameFly goes on to repeat its exclusive prescription for how the Postal Service must make decisions, pointing to a Postal Service agreement that it has not conducted calculations that prove the economy of its current processing decisions. *Id.* Fortunately, the Postal Service understands how to manage its business, and has a proven track record of prudent management that has driven out billions of dollars in costs from its processing operations over the last decade.[10]

GameFly instead returns to its contention that the processing of Netflix mail reflects a main interest in satisfying Netflix by avoiding mail damage and jams. GameFly Brief at 68. GameFly makes this assertion despite contrary Postal Service witness testimony, and without identifying any motive for the

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[9] GameFly variously insists that postal witnesses' testimony is "absurd", lacking in support, and that the Postal Service should "be embarrassed at making three witnesses … defend the[testimony]."

[10] "We continued an aggressive pace of cost-cutting. Building on record savings of more than $1 billion every year since 2001 and reducing our total costs by $3 billion in 2010, on top of the $6 billion in savings achieved last year." The Postal Service's 2010 Annual Report, at 5, is available at http://www.usps.com/financials/_pdf/annual_report_2010.pdf.

Postal Service to process GameFly mail in a less than efficient manner. *See* Tr. 5/1187 (stating that GameFly witness has “no information” or “insight” into why the Postal Service offers a particular type of processing to Netflix and whether the Postal Service benefits from providing this type of processing).

In its initial brief, the Postal Service explained the reasons for the methods used to process Netflix mail. Postal Service Brief at 89-93. Postal Service witnesses explained the efficiency and service reasons that inform Netflix related processing decisions in great detail. Tr. 9/1595-1598 (explaining how one-touch manual separation of Netflix mail improves efficiency); Tr. 10/1739 (USPS-T-3 at 6-7) (same); Tr. 10/1877-1878 (“the activity of separating or culling … saves costs”); Tr. 10/1788 (confirming that “when manual handling of Netflix mailers occurs [it] is done because doing it manually is more efficient than running it through the automated letter processing equipment”). The witnesses rejected GameFly’s claims that avoidance of damage and jams is a major reason for Netflix processing decisions, and explained why damage does not affect processing decisions. Tr. 9/1607-1608; Tr. 10/1799-1801.

Instead of responding to Postal Service witnesses’ testimony with current data, or with a witness knowledgeable about postal processing operations, GameFly relies on deceptive, misleading and incomplete citations to outdated and unsubstantiated documents, many of which are repeated in the GameFly Brief at 68-74. GameFly has no factual basis for questioning the credibility of Postal Service witnesses, apparently aside from insults, or their statements in the context of actual processing operations, and must rely on the fantasy processing

world it concocted from its self-serving and unsupported interpretations of Postal Service documents. Predictably, GameFly dismisses Postal Service witnesses' testimony with sarcastic and totally unsupported attacks on the Postal Service, and refuses to address inconsistencies between processing as it occurs in the real-world and in GameFly's fantasy processing world. *See* GameFly Brief at 68 ("the Postal Service should be embarrassed at making three of its employees take the witness stand to defend [its processing decisions]"), and at 73 fn19 (citing entirely different docket dealing with unrelated issues to make sarcastic remark insulting Postal Service employee Joseph Corbett, "The Postal Service might as well have added that efficiency is in the 'organization's DNA.'"). The citation to the 2010 Annual Report, *supra,* certainly indicates that a focus on processing efficiency has dominated postal management's decisions over the last decade.

Like its arguments regarding the similarity between GameFly and Netflix, and the reasons for Postal Service operating decisions, GameFly's contention that the Postal Service denied or refused GameFly a particular service level finds no support in the record, and relies largely upon hypothetical and constructive events. GameFly has difficulty arguing that a denial of service has occurred, because it admits that it never mailed pieces that qualified for the First-Class Mail letter service received by Netflix. Tr. V/744 (confirming that "GameFly [did not] mail any DVDs as First-Class Mail single ounce letters" and that "GameFly has always sent and received its DVD mailers as single-piece First-Class flats"). GameFly's creative, but evidentially unsupportable, argument that the Postal

Service denied it service on the same terms as Netflix has significant flaws because GameFly cannot identify any specific point where denial occurred. *See* Tr. 5/932-933 (conceding that GameFly witness "do[es] not have any evidence" of a meeting where a denial of manual processing occurred, and "can't identify anybody specifically who participated in the conversations" pertinent to the alleged denial of manual processing). The Postal Service discusses this in its initial brief. Postal Service Brief at 64-65.

The Postal Service has indicated a willingness to provide GameFly with service on the same terms made available to Netflix on at least two occasions. *See* May 17, 2010 Letter from Postal Service Counsel to GameFly Counsel ("May 17 Letter"); Postal Service Response to GFL/USPS-63 ("If GameFly were to begin entering its DVDs in lightweight mailers like those of Netflix, … [a]s with Netflix, the Postal Service would allow field officials to determine whether to manually cull GameFly's return mail, based on the discretion of field operations management to carry out what they consider the most efficient processes for GameFly return mail"). The fact that GameFly mail receives manual processing in some locations suggests that, if GameFly entered its mail as one-ounce letters, it could receive service on the same terms as Netflix. *See* Tr. 9/1611-1614 (describing manual separation of GameFly mail in South Florida). Moreover, this casts doubt on GameFly's unsupported and unverified contention that it had solid reasons for supposedly abandoning any attempts to mail its discs using the same First-Class Mail letter service that Netflix uses.

A Postal Service decision to process the mail of a particular mailer in a particular way for purposes of efficiency does not, by itself, constitute a denial of that processing method to other mailers. As explained by Postal Service witnesses, processing decisions depend on a variety of factors and can change periodically. *See* Postal Service Brief at 85-86.[11] It follows that a particular type of processing passed up on one day might be selected on another. Moreover, GameFly's claimed "denial" of a particular processing method—if it can be cognizable under section 403(c)—must entail more than the choice, based on efficiency concerns, not to use a particular processing method.

If GameFly disagrees with some of the conditions in the May 17 Letter offering it service on the same terms that Netflix gets, it should have raised those issues with the Postal Service as the letter itself invites. *See* Tr. 5/944-946 (confirming that GameFly has not "made any contact with the Postal Service after receiving the May 17 Letter .. [t]o discuss the contents of the letter"). GameFly's delayed response to the May 17 Letter by its consultant witness during oral cross-examination, accompanied by a request for a commitment and standard operating procedure exceeding the level of service provided to Netflix, illustrates the emptiness of GameFly's claims that it seeks the same service as Netflix and that any real denial of this service has occurred. *See* Tr. 11/1964 ("GameFly is

[11] This testimony also illustrates how the mailing environment, and decisions affecting processing path, change over time. Hence reasons that may have helped spread Netflix style one touch processing early in Netflix' mailing life were later extirpated by the focus on efficiency described in the 2010 Annual Report, as quoted above. Unequivocal and uncontroverted evidence establishes that more recent one touch processing of Netflix mail improves the overall efficiency of mail processing.

raising [its objections to the May 17 Letter] through my testimony"), and 1966 (articulating GameFly position that national commitment by the Postal Service would be required for GameFly to obtain the processing it seeks in the Complaint).

GameFly's failure to communicate any objections to the letter illustrates the falsity of the hypothetical world upon which GameFly constructs its claims for relief. GameFly's non-response to the letter offering it the processing it supposedly seeks by itself amply demonstrates that GameFly does not really want such processing. It is quite happy with its current business model. It thus leaves the Commission with its alternative requested form or relief, a postage discount.

But even a postage discount makes no sense. GameFly does not compare itself to any other mailers of two ounce First-Class Mail flats; if it thought a postage discount was an appropriate remedy, why does it fail to provide any rational basis for justifying its having a lower rate for two ounce flats, as compared to any other mailer of two ounce flats? The remedies GameFly claims to seek are thus both quite untenable.

This conclusion brings GameFly's complaint in a full circle, and consequent nullity: 1) it is based on hypothetical facts regarding its own claimed interests that cannot be supported by substantial record evidence; 2) it is based on "facts" drawn from unlimited foraging in the files of postal officials with unsponsored opinions about how such facts are (or are not) authenticated and how they should be understood as supportive of GameFly's hypothetical world;

3) it cites to a consultant's report for what it assumes, rather than what it studies; 4) it derides the Postal Service explanation of why it processes mail as it does today based on insults and questions about witness credibility unsupported by record evidence, and 5) seeks either of two supposed remedies (Netflix like processing or a discount) when record evidence demonstrates its disinterest in the former and no evidence supports the latter as anything but an undue preference to GameFly itself.

D. GameFly Has Offered No Credible Evidence that Outweighs the Postal Service's Testimony Justifying the Reasonableness of Local Mail Processing Decisions.

Postal Service witnesses have provided extensive testimony and faced written and oral cross-examination regarding processing operations and the efficiency of processing decisions. Tr. 10/1850 (USPS-T-1 Barranca testimony); Tr. 9/1588-1615 (USPS-T-2 Belair testimony); Tr. 10/1739 (USPS-T-3 Seanor testimony); Transcript volume 9 (Belair oral cross-examination); and Transcript volume 10 (Seanor and Barranca oral cross-examination). All of these witnesses explained how processing is based on local discretion, and how it differs across processing facilities depending on a number of factors. Postal Service Brief at 84-93. They described how processing decisions regarding Netflix and other disc mailers reflect primarily efficiency and service concerns, and not mail damage concerns, and specifically how the one-touch manual separation of Netflix mail saves the Postal Service costs and man hours. *Id.* Finally, Postal Service witnesses discussed in detail the budgetary and financial controls in

place that impose strict measurement and oversight and ensure local postal managers make efficient processing decisions. *Id.*

GameFly offered no witness with knowledge of processing operations or experience with the budgetary and financial controls to rebut the testimony of the knowledgeable and experienced Postal Service witnesses. *See id.* at 87-88. Instead, it has chosen to insult the Postal Service witnesses and question the truthfulness of their testimony made under oath, with apparently little thought or basis, and certainly without any reasoned explanation. *See* GameFly Brief at 68 ("the Postal Service should be embarrassed at making three of its employees take the witness stand to defend [its processing decisions]"), at 73, fn 19 (citing entirely different docket dealing with unrelated issues to make sarcastic remark insulting Postal Service employee Joseph Corbett, "The Postal Service might as well have added that efficiency is in the 'organization's DNA.'").

GameFly's case thus apparently depends on its ability to convince the Commission that live witnesses, statements made under oath and subject to cross-examination, and knowledge of and experience with current processing operations should be outweighed by 1) outdated, unsponsored documents, most of which lack any real authentication or validation as statements of the Postal Service, 2) a study whose results are driven more by what it assumes than what it studies, and 3) the testimony of a witness who has never even observed the processing operations involved. Tr. 3/93; Tr. 11/1983 (confirming that witness Glick has never observed processing of GameFly or Netflix mail). GameFly did not provide a live witness to sponsor its main piece of testimony, consisting of

unsupported allegations regarding the significance of documents obtained from all levels of the Postal Service via discovery, and it chose instead to submit that testimony as a "memorandum" or "trial brief." *See* GameFly Memo. GameFly did file testimony of peripheral import from a consultant who has never observed the processing of Netflix or GameFly mail, but this testimony admittedly does not address the elements of a discrimination claim under 39 U.S.C. 403(c). Tr. 3/116 ("I don't believe [my testimony] … address[es any of the elements of discrimination under 39 USC § 403(c)]"). And, despite its importance to GameFly's case, GameFly could not find a witness who could describe with specificity any instance where the Postal Service offered or denied GameFly manual processing. *See* Tr. 5/932-933 (conceding that GameFly witness "do[es] not have any evidence" of a meeting where a denial of manual processing occurred, and "can't identify anybody specifically who participated in the conversations" pertinent to the alleged denial of manual processing).

When the Commission directed GameFly to provide a witness to sponsor and face oral cross-examination on its institutional discovery responses, the shallowness of knowledge and understanding by GameFly, the Corporation became apparent.[12] *See* Tr. 5/889 (confirming that GameFly witness was not aware that modification of DVDs is an available option to reduce breakage and confirming that GameFly witness has not "contacted any other DVD mailers regarding their practices"); Tr. 5/890 ("I don't know what the breakage rates

[12] GameFly counsel sought to mask the GameFly Chief Executive Officer's lack of knowledge by requesting that GameFly's litigation consultant be allowed to accompany GameFly's CEO during cross-examination and provide answers for any questions that the GameFly CEO could not answer. *See* Tr. 5/877-878.

would be [if GameFly … ran its DVDs through automated letter processing]"); Tr. 5/891 ("I have not [viewed the Wikipedia article cited in GameFly's responses to USPS/GFL-31 and 32]"); Tr. 5/892 ("I do not [have any sources of knowledge about the industry standard for DVDs or the composition of DVDs]"); *id*. ("I do not have direct knowledge [of the meetings between the Postal Service and GameFly described in GameFly's Complaint] but my guess is that folks at the local level in our warehouses have low-level discussions with a variety of the contacts at the local P&DCs when they see specific things happening to a disk"); Tr. 5/894 ("I have no direct knowledge of what occurred during those meetings [I mentioned earlier]"); Tr. 5/896 ("I can't identify specific conversations [with the Postal Service regarding manual processing]"); Tr. 5/906 ("I don't know [the names of the repair or refinishing companies GameFly uses]"); Tr. 5/908 (confirming that GameFly witness did not know what breakage rate GameFly would experience if it purchased letter service instead of flats service); Tr. 5/927 ("I don't have a strong enough understanding of USPS procedure to answer the question [about how a transition to manual processing would have worked for GameFly]"); Tr. 5/932 ("I do not [have evidence of meetings where GameFly requested manual processing from the Postal Service]"); Tr. 5/933 ("I can't identify anybody specifically [who participated in meetings where GameFly requested manual processing from the Postal Service]"); *id*. (confirming that "the support for the statement [that GameFly requested manual processing from the Postal Service] is [the GameFly witness] relaying what [he] heard from somebody [he] cannot identify"); Tr. 5/934 ("I am not [familiar with how GameFly mail is

treated in South Florida]"); Tr. 5/935 ("I am not aware [that in some areas GameFly mail is manually culled and placed in separate trays in a similar manner as Netflix mail is treated]"); Tr. 5/935-936 ("I'm generally not familiar with the documents that the USPS produced in discovery"); Tr. 5/937 ("I don't have knowledge of how other DVD mailers handle their mail"); Tr. 5/938 ("We did not [determine at what level presort discounts would have made sense]"); Tr. 5/943 ("I am not [aware that other DVD mailers modify the composition of their DVDs]"); Tr. 5/945 (confirming that GameFly witness "didn't determine what specific level of commitment would be necessary for [GameFly] to accept the conditions in the [May 17] letter"); Tr. 6/1169 **REDACTED**); Tr. 6/1171 (**REDACTED**); Tr. 6/1172 (**REDACTED**); *id*. (**REDACTED**); Tr. 6/1184 **REDACTED**); Tr. 6/1185 (**REDACTED**); Tr. 6/1186 **REDACTED**); Tr. 6/1187 **REDACTED**); *id*. **REDACTED**).

Oral cross-examination of GameFly's Chief Executive Officer also revealed the extent to which GameFly counsel has influenced GameFly's position. *See* Tr. 5/893 ("it wasn't until I was introduced to and hired Mr. Glick and Mr. Levy that we actually gained access to folks that had a more broad responsibility within the Service and gain access to discuss some of these things at higher levels"); Tr. 5/898 ("ultimately it's my decision [regarding how to respond to a letter related to operations], but I would lean heavily on the consultants and attorneys"); Tr. 5/924 ("I believe Mr. Glick or Mr. Levy [requested the meeting asking the Postal Service to waive the additional ounce rate for GameFly pieces]"); Tr. 5/928-929 (allowing GameFly counsel, and not GameFly

witness, to testify in response to question regarding what GameFly expected of the Postal Service, and agreeing with "counsel's testimony on this issue"); Tr. 5/930-931 (allowing GameFly counsel, and not GameFly's witness, to testify in response to a question about what problem the Complaint sought to resolve, and agreeing with "testimony from counsel"); Tr. 5/952 ("it's really up to [GameFly counsel] to determine if" GameFly can accept the conditions of the May 17 Letter); Tr. 5/953 (stating "Can I talk to [GameFly counsel]" in response to question "Did you take [the May 17 Letter] as an invitation from the Postal Service to discuss the contents of the [May 17] letter?"); Tr. 5/954-954 (agreeing with "counsel's testimony" in response to question directed to the GameFly witness and asking about the GameFly witness' understanding of the May 17 Letter).[13]

By contrast, the Postal Service's essentially unrebutted oral and written testimony was submitted under oath in the presence of the Commission. Tr. 9/1586 (Belair); Tr. 10/1736 (Seanor), 1849 (Barranca). GameFly has not contested the knowledge and experience of the Postal Service witnesses, and GameFly has provided no witness competent to provide any rebuttal. Conversely, the Postal Service has challenged GameFly's overwhelming reliance on unsupported documents, and provided extensive analysis demonstrating GameFly's misleading and inaccurate use of the Christensen Study and other documents. Postal Service Brief at 93-113.

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[13] No GameFly representative—not even its CEO—was competent to answer *any* reasonable questions about what GameFly had thought or done about the supposed conditions complained about in GameFly's complaint.

E. GameFly's Alleged "Host of Preferences" Do Not Establish Unlawful Discrimination in Mail Processing Operations.

The core of GameFly's allegations of discrimination in operations rests on GameFly's general contention that Netflix occupies a favored status among DVD mailers, and that the Postal Service has established a "caste system" in DVD processing. Preference in mail processing represents the central feature of Netflix's preferential treatment, according to GameFly. This status, however, is allegedly only one of a constellation of discriminatory results amounting to a "host of preferences" that Netflix allegedly enjoys. GameFly Brief at 21. In addition to manual culling at no extra charge, GameFly's Memorandum describes these preferences as (1) unjustified classification of the Netflix mailer as machinable, (2) Netflix oversight of Postal Service operations, (3) dedicated Netflix-only mail drop slots, and (4) the Postal Service's failure to require Netflix to pay extra for its preferential treatment. GameFly Memorandum at 13-37. Among these preferences, GameFly's initial brief emphasizes the alleged unjustified classification of the Netflix mailer as machinable (GameFly Brief at 42-45), and the Postal Service's failure to charge Netflix more for its preferred status. *Id.* at 45.[14] The remaining element of the "Netflix-does-not-pay-enough" allegation focuses on the history of initiatives to develop a mail classification specifically for round-trip DVD mail. GameFly Memorandum at 35-37; GameFly Brief, at 50-53.

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[14] GameFly's brief continues to note the drop-slots and the "extraordinary license" that Netflix personnel have to enter mail processing facilities and influence decisions, but these preferences receive less attention in GameFly's brief. GameFly Brief at 54-54, n. 14.

1. The Postal Service's nonmachinability standards for First-Class Mail do not establish undue discrimination in Postal Service operations.

GameFly's position on the Postal Service's decision not to revise its nonmachinability standards for First-Class Mail, and its decision not to impose a per-piece nonmachinable surcharge on Netflix DVDs on the return trip embodies an element of ambivalence. On one hand, GameFly argues fiercely that the Postal Service's refusal to change its standards to clarify that Netflix packaging is functionally nonmachinable stands as the prime example in GameFly's portrayal of favoritism towards Netflix. GameFly argues that this situation is the major cause of the Postal Service's decision to give Netflix manual culling, since avoiding jams as a result of the Netflix mailer's nonmachinability is the primary factor that induces local management to cull Netflix DVDs.

On the other hand, GameFly professes to be neutral on the question of the nonmachinable surcharge. In its Brief, GameFly states:

> GameFly takes no position on whether the Postal Service should impose a nonmachinable surcharge on DVD mailers. That is an issue for the Postal Service to decide. If a surcharge is imposed, however, it must be imposed without discrimination on all DVD mailers whose pieces are nonmachinable, including those of Netflix.

GameFly Brief at 88, n. 23.

This ambivalence led to an interesting dialogue during GameFly's cross-examination of Mr. Barranca. Mr. Barranca's direct testimony had observed that GameFly asserts that Netflix pays too little for its mail service. Tr. 10/1878-79. Counsel for GameFly challenged that statement, demanding to know where GameFly had made that assertion. Mr. Barranca responded that his testimony

was an inference drawn from GameFly's repeated reliance on documents critical of the decision not to impose a surcharge. *Id.* at 1878-79, 1881. Counsel for GameFly then described an alternative view of the Netflix rates issue. He contrasted a situation in which Netflix was asked to pay a rate higher than the single-piece First Class Mail rate with a proposal to "narrow the gap between what Netflix pays and what GameFly pays." *Id.* at 1880. Presumably this distinction is related to GameFly's current expression of the remedy it seeks, namely, the establishment of a reduced flat rate for DVD mailers, who, like GameFly, might want to continue to mail as flats at a reduced charge.

Regardless whether GameFly is currently insisting that Netflix pay the nonmachinable surcharge, GameFly clearly includes the Postal Service's failure to revise its machinability standards among the bases for GameFly's claims of unlawful discrimination. GameFly, however, has not explained how that contention relates to its primary claim that it has been denied equal treatment in Postal Service processing operations. Even if one were to accept GameFly's hypothetical construction of the facts, and GameFly's expansive view of the consequences of failure to impose the nonmachinable surcharge, GameFly has not explained how it is disadvantaged by the standards or the Postal Service's pricing decision. In other words, GameFly might explain the degree of Netflix preference (i.e., the level of manual culling) by arguing that avoidance of jams is the principal reason why Netflix mail is culled on the return trip. Under this logic, if Netflix were forced to change its mailer, or leave the mail altogether, as a result of a decision to declare its mailer nonmachinable and impose the surcharge, the

degree of culling Netflix mail would be reduced. That consequence, however, would not affect local decisions not to cull GameFly's mail, if it were submitted at letter rates. Rather, the inability to cull GameFly's mail would result from the low visibility, low volume, and low density represented by GameFly's mailing patterns and practices.

This relationship stands as a critical distinction in analyzing GameFly's Complaint. The central feature of GameFly's allegations is that the Postal Service's operations practices would, hypothetically, deny GameFly equal treatment, and that GameFly has therefore been forced to pay a higher two-ounce flat rate to achieve the same degree of freedom from risk of breakage that Netflix enjoys. GameFly has not explained, however, how its alleged circumstance would be addressed by changing the nonmachinability standards, or by imposing the surcharge on Netflix. That missing link represents a significant deficiency in GameFly's argument.

Nor has GameFly established a link between failure to impose a surcharge and the unreasonableness of the Postal Service's processing decisions. GameFly purports to have established machine jams as a factor leading to the Postal Service's decision to cull the majority of Netflix's return DVD mail. GameFly's most recent contention, however, that culling is mainly the consequence of jams and the objective to avoid breakage (GameFly Brief at 68), is contradicted by the Postal Service's operations testimony. GameFly has not rebutted that testimony with credible evidence. Even if one were to discard the potential for jams as a basis for the Postal Service's decisions, the other factors

that support the reasonableness of those decisions, namely, considerations leading to the overall effectiveness and efficiency of DVD processing, and service considerations, would remain.

Furthermore, no credible record has been established to conclude that the Postal Service's decision not to change its machinability standards, or its decision not to impose a surcharge on Netflix, represent discrimination against any other mailer, least of all GameFly, which has always mailed at the flats rate. In particular, GameFly has pointed to no substantial evidence that decisions by the Postal Service's Engineering Department to declare other DVD packaging nonmachinable have resulted in significant application of the nonmachinable surcharge in practice. In this respect, GameFly repeatedly refers to documents which it claims demonstrate that the Postal Service maintains a double standard regarding its evaluation of mailers submitted for testing since 2002, when the current Netflix mailer was approved. GameFly has pointed to documents indicating that other mailers have been deemed nonmachinable, but those records contain insufficient information and data to establish the equivalence of the tested mailer with the Netflix mailer currently in use. Rather, GameFly points to vague descriptions of similarities and characterizations of the mailers as "clones." Even if GameFly's allegations of discrimination in mail processing rested on such testing (and they do not), the facts as proved would not support a conclusion that unreasonable discrimination had occurred.

Nor has GameFly established that other mail users receive discriminatory treatment by having to pay the nonmachinable surcharge. In discovery,

GameFly inquired directly about whether mailers declared nonmachinable by the Postal Service's Engineering Department since 2007 were subjected to imposition of the surcharge. Referring to seven mailers deemed nonmachinable, the Postal Service responded:

> Two of these envelopes were samples submitted by envelope manufacturers. Of the envelopes submitted by mailers, in three instances local Business Mail Acceptance officials determined that the nonmachinable letter surcharge should be applied, though in at least two of those instances the local decisions were overturned following an appeal to the Pricing and Classification Service Center (PCSC), on the grounds that these envelopes were not subject to the nonmachinable letter surcharge under the standards of the DMM. For the third such mailer, a review of permit data from FY 2008 through FY 2009 YTD discloses no instance in which that mailer was assessed the nonmachinable letter surcharge. For another mailer, a review of postage statement data discloses an instance in which that mailer was assessed the nonmachinable surcharge, though that appears to have been an isolated occurrence, as no nonmachinable surcharge has been assessed on recent postage statements.

Tr. 4/__(Postal Service Response to GFL/USPS-9 (designated June 10, 2010).

Furthermore, training guides used by Postal Service retail associates in post offices and other facilities steer the associates away from applying the surcharge to pieces enclosing CDs or DVDs. The information instructing the associates states:

> **Letters Containing CDs or DVDs**
> A First-Class Mail letter-size paper envelope containing a single CD or DVD--whether the CD or DVD is in a paper sleeve or not—is usually machinable and priced accordingly, as long as it has no other nonmachinable characteristics, such as a rigid container. The inclusion of a single CD or DVD does not itself make the mailpiece nonmachinable.[15]

[15] The Postal Service has included a copy of the applicable page from this guide in the Appendix associated with its Reply Brief.

GameFly's allegations that the Postal Service has favored Netflix in its decisions on machinability and the nonstandard surcharge rely to a large extent on the findings and recommendations in the Postal Service OIG's 2007 report. That report summarized the OIG's conclusions based on an audit which sought to determine "whether PRM [Permit Reply Mail] mailers' mailpieces are processed in accordance with their approved classification and pricing."[16] The report concluded: "The Postal Service generally processes PRM mailpieces in accordance with their approved DMM classification and pricing." OIG Report at 4. The report further stated: "Currently, the [Netflix] envelope design with the floppy leading edge meets these [machinability] criteria, as none of the negative characteristics listed in the DMM specifically apply to this type of mailpiece." *Id.* The OIG did not find that the Postal Service's classification or rate determinations represented unlawful discrimination. In particular, it did not conclude that the Postal Service's mail processing operations represented undue discrimination; nor did the audit even inquire about unlawful discrimination in mail processing.

The OIG was critical of the Postal Service's existing machinability criteria, which, it concluded, did not realistically fence out the Netflix mailer. The OIG found that a substantial majority of Netflix DVDs were processed with manual operations, and it recommended that the Postal Service revise its machinability criteria to address the operations problems created by the Netflix mailer, and to impose the nonmachinability surcharge, if Netflix did not conform to the new

[16] Letter dated November 8, 2007, to Michael K. Plunkett, Susan M. Plonkey, and Walter F. O'Tormey, from Tammy L. Whitcomb, Deputy Assistant Inspector General for Revenue and Systems.

standards. While the Postal Service submitted a formal response to the OIG's findings, the OIG took issue with the Postal Service's apparent unwillingness to follow its recommendations. *Id.* at 11-12. Subsequently, the Postal Service has not followed up by complying with the changes recommended by the OIG in its report. Tr. 10/1884.

Regarding the testing of subsequent mailpieces from mailers other than Netflix, the OIG found that there were inconsistencies in the application of the existing criteria. In particular, the OIG found that Engineering's conclusion that one company's mailer submitted for testing was not machinable conflicted with the Postal Service's conclusion that Netflix's mailer was machinable. In evaluating this finding, the OIG stated:

> Engineering's determination that the other DVD rental company's mailpiece is nonmachinable is inconsistent with Marketing's determination that the DVD rental company's identical mailpiece is machinable. The Postal Service should give consistent treatment to two mailpieces with the same characteristics. Inconsistent treatment of mailpieces with the same characteristics may lead mailers to perceive that the Postal Service shows favoritism towards some DVD rental service companies.

OIG Report at 8.

The Postal Service's reaction to the OIG's findings since the report was issued remains controversial. In responding to the recommendation that it change its nonmachinability standards, the Postal Service stated:

> Management agrees that machinability standards need to be reexamined periodically. However, there are several factors that must be taken into consideration with respect to the instant audit. First, the Postal Service management must consider the magnitude of this decision. In the last year there were more than 96 billion pieces of First-Class Mail. Of this number, 742 million were Permit Reply Mail which equates to 0.77% of all First-Class Mail. Before

> changing any criteria in the DMM, the Postal Service must consider how proposed changes would affect all users of the mail. The specific changes envisioned by this audit could have implications for other customers that are not yet properly understood.
>
> Second, the cost is but one factor to consider when setting prices. In addition to cost, the Postal Service is greatly concerned with the possible negative impact on affected customers if a change in mailing standards results in a substantial price increase. Under the Postal Accountability and Enhancement Act (PAEA), it is even more important to consider all aspects of a product to properly price it in the marketplace.

Id. at Appendix C. Management's Comments. Witness Barranca, furthermore, testified on GameFly's contentions as follows:

> My understanding of the decision that was made in 2002 is that it was consistent with the applicable machine specifications for processing letter mail and with the conclusions cited in the letter communicating the decision to Netflix. The Postal Service' determination not to charge the nonmachinable surcharge for Netflix DVD return mail was a pricing decision consistent with the findings described in the letter. From that standpoint, the criticism that the decision was influenced by intervention of the Marketing Department is misplaced, since Marketing shares responsibility for pricing policy.
> In any event, the decision whether or not to impose a nonmachinable surcharge does not undermine the operations considerations that support the Postal Service' processing decisions affecting DVD mail in the field. Those decisions are explained in the testimonies of witnesses Belair and Seanor, with which I agree.

Tr. 10/1850 (USPS-T-1, at 25).

The Commission may agree with GameFly and other critics of the Postal Service's response and conclude that the Postal Service's failure to follow the OIG's recommendations embodies incorrect judgment. Nevertheless, the comments in the Postal Service's official response to the OIG's recommendations, and Mr. Barranca's observations, should be carefully

considered. Whether to charge one of the Postal Service's leading First-Class Mail users an additional 19 cents per piece for its return DVD mail represents an important pricing policy decision that should be given due weight. In any event, the facts supporting the Postal Service's determination on this issue have not been explored on the record of this proceeding. Moreover, as Mr. Barranca observes, judgment on that inquiry would not undermine GameFly's allegations of unlawful discrimination in mail processing. To sustain a finding that the Postal Service's decision to process Netflix mail by culling it and avoiding subsequent distribution operations constitutes unreasonable discrimination, GameFly must establish that the Postal Service's failure to change its machinability standards bears materially on GameFly's contention that it has been disadvantaged by the Postal Service's mail processing operations, even under the hypothetical that forms the basis for GameFly's complaint.

2. The Postal Service's Decision Not to Reclassify First-Class Mail Does not Establish Discrimination in Mail Processing Operations.

GameFly's Memorandum lists GameFly's conclusion that the Postal Service has "shrunk" from requiring Netflix to pay more as another element of the overall favoritism that Netflix enjoys. GameFly Memorandum at 33-37. In its Brief, GameFly has somewhat modified the slant on this accusation. The topic is introduced in the Brief by stating that "the Postal Service has shrunk from eliminating the special treatment given to Netflix." GameFly Brief at 45-53. Nevertheless, the Brief reproduces almost verbatim the pricing argument made in the Memorandum and adds additional commentary.

These sections in the Memorandum and Brief focus substantially on the Postal Service's machinability criteria and the decision not to impose the nonstandard surcharge. GameFly Memorandum at 33-34; GameFly Brief at 46-47, 52-53. As noted above, GameFly now contends that it is neutral on this issue of pricing policy. Yet, it continues to emphasize this element as indicative of the favoritism toward Netflix embodied in the Postal Service's conduct.

Allegations of failure to establish an alternative classification within First-Class Mail (and presumably a higher rate for Netflix) create a second theme in these arguments. GameFly quotes and cites several Postal Service internal communications pertaining to discussion of this topic over the years. *Id.* at 48-51. GameFly apparently believes that language contained in these emails that is in any respect critical of the Postal Service's policies and practices related to DVD mail enhances its general allegation that the Postal Service favors Netflix over other mail users. Many of the references, however, arise in contexts other than review of Postal Service operations.

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GameFly Memorandum at 46; GameFly Brief at 48. As with the other documents cited by GameFly in these sections, GameFly strongly implies, if not states, that the fact that certain issues that might be construed as involving references to the possibility of discrimination claims in internal discussions of DVD mail constitutes an acknowledgement by the Postal Service that it does discriminate unlawfully. GameFly also uses the appearance of views of individual participants in these discussions as, in effect, testimony against the Postal Service on this point. In

the above-quoted language, GameFly phrases its claims as Ms. Mayes and Special Studies having "noted" that the "problems with the Postal Service's processing policies for DVD mailers included" breakage and favoritism. In evaluating this claim, however, it is important to consider the context, as well as the slides themselves.

The presentation was designed to lead to a discussion of issues that needed a decision, not to brief officials on a decision that had already been made. The slide on which breakage and favoritism were mentioned was titled "What Is the Problem? What are we trying to fix?" The listing below those questions was merely a categorization of possible problems, not a conclusion that these were in fact problems, let alone that they amounted to unlawful discrimination.

Without a transcript of the presentation, including comments by the postal officials attending, it is not possible to draw any conclusions from the slides themselves. The same can be said of the slide quoted from Tr. 4/296 (GFL472). That slide was titled: "Round Trip Disk Mail Cost Study Concerns." The *question* quoted by GameFly was below one of several "concerns", not conclusions. The "Is it fair…" quotation was below the concern: "Results will be skewed toward the Netflix picture." Again, without hearing the presentation, it is impossible to know whether any of the participants, even Ms. Mayes, espoused that view as anything other than a question. In any event, these slides certainly cannot be cited as evidence that the Postal Service unlawfully discriminates.

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The obvious observation about this quotation on its face is that it addresses the issue of whether to establish a pricing category; it does not answer a question of whether unlawful discrimination exists. Ms. Mayes was expressing a reservation that might have reflected her opinion on whether Netflix's position as a mailer represented by the proposed category might distort the cost and revenue bases that might be used to justify creating it. The concluding sentence was a question not a conclusion. The opinion, let alone the facts that it might have been based on, are unclear from the quotation. As with the previously discussed citations, furthermore, even at face value, no conclusions can be drawn without considering the entire context.

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The common thread in these and other citations by GameFly in these sections of the Memorandum and Brief consists of the observation that the Postal Service has several times in the past considered reclassifying First-Class Mail to create a separate rate category for DVD mail. In this connection, GameFly makes several references to documents discussing the work of the Round-Trip Disc Mail working group, which was established in 2005 to explore the possibility of creating a distinct classification for DVD mail. GameFly Brief at 49-51. This project, as well as others that considered the issue in the past, did not produce a proposal by the Postal Service to reclassify First-Class Mail DVDs.

GameFly inquired about these developments during discovery. The Postal Service replied as follows:

> The Postal Service's determination not to file such a request [to establish an experimental or permanent classification for Round-

> Trip Disc Mail] was based on several considerations. These considerations included concerns about how such a case would affect the second ounce rate for First-Class Mail, and concerns about how such a case would impact volume growth in the DVD industry. There was also a belief that existing processes were an efficient way to handle Netflix, and other DVD mail, considering the characteristics of those mailers.

GFL/USPS-145. GameFly also asked about the role of Netflix in this determination. The Postal Service replied: "The lack of clear support by the largest customer in the two-way DVD industry was a consideration." *Id.* In another interrogatory, GameFly asked why a three-year experimental case had not been pursued. The Postal Service responded:

> The decision not to pursue a case was originally made in October 2005 (see GFL0074300). Subsequent to that, consensus was never reached that a classification case was the proper way to handle DVD mail, and Pricing ultimately decided to commit resources to other tasks.

GFL/USPS-161.

GameFly goes to lengths to emphasize Netflix's opposition to elements of the various initiatives to consider reclassification. Again referring to Postal Service internal correspondence, GameFly notes in particular that Netflix has variously opposed a Negotiated Service Agreement (NSA) (GameFly Brief at 50), use of standardized packaging in connection with a DVD mail classification (*id.* at 51), and having to pay more for existing service. *Id.* From these observations, GameFly concludes:

> Unwilling to confront Netflix, the Postal Service has backed down repeatedly, continuing to give Netflix's DVD mailers special handling with no extra charge—not even the one-penny surcharge suspected by Netflix.

Id. at 53 (citations omitted).

GameFly clearly implies that this "shrinking" from establishing a pricing alternative represents a key element among the preferences that it alleges Netflix enjoys. GameFly's direct testimony from Mr. Glick also suggests that the basic rates paid by Netflix and GameFly need to be revisited. Mr. Glick compared the rate differential between First-Class Mail letters and flats with his estimate of the cost differential between processing GameFly as a flat and processing Netflix as a letter. Furthermore, GameFly's Brief suggests, as an alternative remedy, that the Commission should direct the Postal Service to establish a reduced automation rate for *flat*-shaped DVD mailers sent and received by GameFly." *Id.* at 88.

Mr. Barranca's testimony addressed the rates component of GameFly's approach to its discrimination complaint. He observed:

> As I understand GameFly's complaint, it has not challenged the specific rates for either the flats or letter categories in First-Class Mail as inconsistent with statutory policies, but has attempted to demonstrate that the differential that arises from those rates is inequitable, compared to the differences in costs that those categories represent. GameFly contends that this disparity is an outgrowth of the discrimination that it alleges.
> In connection with this position, GameFly asserts that the Postal Service has avoided establishing a distinct rate that matches the level of service allegedly afforded to Netflix as a result of field operations decisions to process Netflix return DVD mail manually. *Id.*, at ¶¶ 83-92. GameFly alleges that, since 2002, the Postal Service has "shrunk" from establishing a separate rate category in First-Class Mail that would provide a rate that more closely corresponds to the costs of manually processing Netflix's DVD mail. GameFly refers to internal Postal Service correspondence and documents to support its contentions that, on several occasions, the Postal Service has failed to follow through on proposals to create a separate classification for DVD mail. GameFly strongly implies that the Postal Service' failure to act is a result of Netflix' influence and the Postal Service' discriminatory reluctance to make a large customer pay more.

> It is not the purpose of my testimony either to critique or defend First-Class Mail rates or Postal Service pricing policy. I would note, however, that GameFly's arguments primarily have implications for rate design and pricing policy, rather than its complaint which alleges that the Postal Service has discriminated unreasonably in favor of Netflix in its field operations decisions. In this connection, it is important to understand that rate design for First-Class Mail involves many considerations not addressed in GameFly's testimony.
>
> First-Class Mail has always represented a highly diverse mailstream that spans mailing practices of a wide spectrum of mailers. First-Class Mail rates, furthermore, have always been characterized by a high degree of cost aggregation and averaging. The goal of rate simplicity has heavily influenced rate design. Only recently has shape affected rate structure. Policy considerations, such as national uniformity, the integer rule, and the effects on the diverse mailing community, including individuals who mail at single-piece rates (the rates used by Netflix as well as GameFly), are very important in establishing First-Class Mail pricing. The point is that few of these factors can justifiably be used to identify undue discrimination against or for any one mailer. First-Class Mail rates reflect important choices of pricing policy that lie squarely within the Postal Service' management prerogatives, and its pricing discretion and flexibility under the current statutory scheme. Failure to choose a First-Class Mail rate structure that benefits a particular mailer, or choosing one that disfavors any other mailer, cannot be reliably evaluated in the highly biased and incomplete context that GameFly describes.

Tr. 10/1850 (USPS-T-1, at 23-25).

Mr. Barranca's observation highlights a significant gap in GameFly's arguments. GameFly insists that the Postal Service has "backed down repeatedly" and "blocked" alternative solutions that would reclassify DVDs and create a lower rate for GameFly or a higher rate for Netflix. GameFly has not explained, however, how these arguments relate to the central feature of its Complaint, namely, that Postal Service operations practices disadvantage GameFly, because they unreasonably discriminate in favor of Netflix and, hypothetically, against GameFly. GameFly seems to argue that the Postal

Service's failures in this area establish a pattern of favoritism that supports its operations claims.

If that is GameFly's argument, the Postal Service submits that it is essentially disconnected from evaluation of the reasonableness of the Postal Service's operations. If, however, GameFly is contending that failure to pursue reclassification is itself discriminatory conduct that should be evaluated independently, that would be another question. If GameFly is contending that the Postal Service's pricing policy, or specific rates, represent undue or unreasonable discrimination, that allegation must be evaluated on its own terms. In that regard, GameFly has offered no reliable proof of unreasonableness. Rather, it pieces together innuendo from a disparate collection of documents, and parts of documents obtained through discovery. As discussed above, its use of these citations is in many instances questionable, if not misleading. The Postal Service, on the other hand, has expressed logical rationales for its views and conduct related to pricing and other policy considerations. While a more complete record could be developed, the evidence submitted by the Postal Service would at least support a *prima facie* conclusion of reasonableness.

The Commission knows full well that requests to reclassify products and establish new rates entail an intense and highly technical and systematic review of concrete proposals. Under the PAEA, furthermore, the balance of responsibilities between the Postal Service and the Commission has been redrawn, and, theoretically at least, the Postal Service has more pricing and classification flexibility. GameFly has not begun to establish that First-Class Mail

needs to be reclassified and repriced. Nor has it developed a record on which such reclassification could be responsibly accomplished.

3. GameFly's Allegations that Netflix Enjoys a Favored Status on the Workroom Floor Do Not Establish Unreasonable Discrimination in Postal Service Operations.

GameFly's Memorandum emphasizes that the Postal Service "has given Netflix personnel extraordinary license to enter mail processing facilities." GameFly Memorandum at 26. GameFly repeats this allegation in its Brief, although it is now relegated to a footnote. GameFly Brief at 53-54, n. 14. In a fashion similar to its other arguments, GameFly supports its allegations by referring to documents obtained in discovery. These include references to Netflix's weekly "damage" reports keeping postal personnel informed about damage to DVDs, specific proposals for improvement at specific facilities, and complaints about Netflix activities and communications expressed by postal personnel in various emails. GameFly Memorandum at 26-30. The thrust of GameFly's arguments is that Netflix wields inordinate influence over Postal Service decisions.

The Postal Service addressed these allegations at length in its direct testimony. Tr. 10/1850 (USPS-T-1, at 11-14); USPS-T-2, at 2 (Tr. 9/1594); Tr. 10/1739 (USPS-T-3, at 12-16). The issue of mail user interaction with the Postal Service, and the techniques employed by Netflix, were also topics of discussion during cross-examination. Tr. 9/1719-21; Tr. 10/1839-40, 1843-46. The Postal Service testified that Netflix's activities are neither unique nor unusual in the postal businesses. Many mailers, including GameFly, undertake to influence

local decision-making, and even national decision-making. Some mail users, like Netflix, are more aggressive and systematic about their approaches. Furthermore, the more prominent the mailer is, because of high volume, density, and national dispersion, the more internal correspondence there is likely to be. Mr. Barranca placed GameFly's allegations in perspective in his direct testimony:

> I have reviewed GameFly's representations and much of the correspondence it cites. I have also reviewed the testimonies of witnesses Belair and Seanor on this topic. I agree that Netflix's activities reflect an aggressive approach to its relationship with the Postal Service at all levels of operations. I agree that Netflix has enjoyed some success in these efforts, and that postal managers sometimes follow Netflix's suggestions. I agree that postal managers take these interactions seriously, that they are responsive to criticisms of operating conditions and procedures, and that they take measures to improve operations, where warranted. I agree that sometimes postal managers and other employees chafe at Netflix' aggressive conduct.
> What I do not agree is that there is anything irregular or unreasonable about either Netflix' aggressive efforts or most Postal Service reactions. Many mailers take an active interest in their mail service and attempt to communicate their views to the Postal Service. There is nothing extraordinarily unusual or irregular, however, about Netflix' efforts to influence operations decisions in the field. Many other mailers, large and small, who mail in all mail classifications, make efforts to encourage the Postal Service to adopt practices that promote the quality of mail service, as well as the particular mailers' objectives. These practices are typical in a large, complex service industry such as that represented by the Postal Service and its competitors. In fact, it would be highly unusual for a mailer who spends hundreds of thousands to millions of dollars on mail service not to attempt to improve its service in this fashion.
> GameFly is no exception. The Postal Service' field witnesses provide concrete examples that place GameFly's allegations in practical perspective. Rather than standing as evidence of unreasonable discrimination, Netflix's activities, as well as GameFly's, should be regarded as natural outgrowths of their relationships with the Postal Service. The allegation that the Postal Service grants unwarranted access and influence to Netflix compared to other mailers, however, is simply wrong.

Tr. 10/1850 (USPS-T-1, at 12-13).

It is unclear precisely how GameFly's arguments about undue access and influence relate to its claims of undue discrimination in mail processing. On one hand, GameFly appears to use its allegations to support its overall contentions that Netflix enjoys favored status. On the other hand, GameFly appears also to suggest that the Postal Service's willingness to respond to these alleged improper attempts to influence processing decisions is bound up in GameFly's claims that the Postal Service has no reasonable basis for discrimination.

Mr. Seanor squarely addressed this latter argument in his direct testimony:

> Neither Blockbuster nor Netflix is afforded any special accommodations. To summarize Mr. Belair's testimony and my own, Netflix handling is not determined by its being a customer's preferred method. Rather, the Postal Service, specifically each local plant manager, decides how best to make that plant's operations the most efficient possible. Netflix mailpieces are highly visible and in significant volume, so much so, that Netflix mailpieces are easily shifted from avoidable downstream handling in most, but not all, locations. If Netflix mail was not so easily identifiable and readily separable through normal day-to-day procedures, postal managers would allow the mailpieces to flow through the mailstream and automated mail processing procedures. When combined with the terms of Netflix Caller Service agreement, under which Netflix repeatedly during a business day relieves the Postal Service of accumulated mailpiece volume prepped for the Netflix truck at many locations, Netflix saves the postal service transportation cost while allowing us to reuse floorspace each pickup empties.

Tr. 10/1739 (USPS-T-3, at 16).

GameFly did not file testimony rebutting the Postal Service's evidence on these issues. Viewed in perspective, GameFly's arguments and its reliance on internal communications do not outweigh the Postal Service's balanced, reasonable explanations in sworn testimony. Rather, to the extent that GameFly

attempts to inflame the record with implications of undue influence and postal employee discontent, the Commission should carefully study GameFly's purported evidence. As Mr. Barranca notes in his direct testimony, GameFly's proof is not all that GameFly represents. In this regard, an evaluation of this argument by GameFly should heed the caution expressed by a postal manager to his colleagues in a relatively recent (by GameFly's standards) communication: "Netflix representatives may offer recommendations but should not try to change processing procedures at your site." *Quoted in* Tr. 10/1850 (USPS-T-1, at 14).

4. The Existence of Dedicated Drop-Slots Does Not Establish Unlawful Discrimination.

GameFly's Memorandum spent significant effort to establish the existence of a Postal Service practice of using dedicated drop-slots, as well as placards and other signage in the field, to implement a program of favoritism toward Netflix. GameFly Memorandum at 33-34. This issue gave rise to a controversy during discovery over GameFly's sources for information and photographs of dedicated drop-slots. Ultimately, it was established that the practice had been prohibited by national headquarters, although the Postal Service conceded that dedicated slots might still be found in the field.

If anything remains of this debate, it does not have a material bearing on GameFly's allegations that the Postal Services practices unreasonable discrimination in mail processing. Mr. Barranca addressed it in his direct testimony:

> I understand that this issue has been a topic of considerable discussion in the discovery process, but that this is one area where the Postal Service has directed field units not to maintain such

> slots. Beyond that, I might note that, in my opinion, drop slots for Netflix mail would not be an illogical measure, if taken to implement operations decisions to segregate that mail for more efficient and effective processing. As noted in the Postal Service' other testimony, dedicated drop slots would be consistent with the field decisions that support the processing distinctions employed by local managers for the treatment of DVD mail. In fact, these decisions are similar to the decisions to segregate IRS returns during tax time. Nevertheless, as I understand the situation—use of this practice as evidence of alleged discrimination—the practice was never approved and has been removed.

Tr. 10/1850 (USPS-T-1, at 26).

As a final note, it might be added that, if GameFly's purpose for making the argument originally was to support its claim that, as a DVD mailer, it should be afforded equal treatment, that result would run counter to the goal of efficient operations in mail processing. While, as Mr. Barranca notes, the practice might be defensible for Netflix, which exists in substantial densities at facilities nationwide, the same logic would not apply to GameFly, and attempting to provide such accommodations would likely result in unwarranted expense.

II. GAMEFLY USES UNRELIABLE AND UNSUPPORTED EVIDENCE, AND MISLEADING AND INACCURATE INTERPRETATIONS OF THIS EVIDENCE, TO SUPPORT ITS CLAIMS.

A. GameFly's Evidence Is Insufficient and Defective.

GameFly relies upon outdated, unsupported and unreliable documents, and testimony of one witness with little to no knowledge regarding Postal Service processing operations, particularly processing of mail containing DVDs. That witness, moreover, is experienced only in detailed cost studies and lacks any real understanding of how and why postal managers actually make decisions

affecting operations in plants throughout the domestic service area. GameFly uniformly rejects the more current, accurate and substantiated information provided by knowledgeable and experienced Postal Service operations witnesses who have extensive and personal knowledge of processing operations. Since GameFly provided no testimony directly rebutting that of the Postal Service, it apparently has little choice other than to argue that the Postal Service evidence should be ignored. In rebuttal, GameFly did provide supposedly rebuttal testimony from its witness Glick, a consultant; however, that testimony plows no new ground, since its continues to tout the Christensen Study and OIG Report, and Postal Service documents that lack any evidence demonstrating their probative value, beyond the level of staff discussion reflecting personal opinions or pre-decisional consideration. GameFly's direct and rebuttal testimony thus fails to demonstrate any real probity or material value, and accordingly lacks any real credibility.

B. Notwithstanding the Unsubstantiated Claims of GameFly and the Public Representative, No Reliable Evidence Establishes that the Handling of Netflix Mail Is Improper, Excessively Costly, or Inefficient.

1. Reliance on the Christensen study would conflict with the Commission's standards for ensuring the reliability of evidence in its proceedings.

In its initial brief, the Postal Service explained that, in past proceedings, the Commission has worked hard to establish and adhere to high standards regarding the quality of technical analyses and studies, and to provide a context in which such evidence can be reviewed and tested under procedures

guaranteeing due process to all parties. *See* Postal Service Brief, at 95-101. It bears noting that, in the Red Tag proceeding, which GameFly cites to support its undue discrimination claims, a situation arose parallel to the controversy over the Christensen study in the current proceeding. PRC Op. MC79-3, Docket No. MC79-3, at 34-37 (May 16, 1980).

In the Red Tag proceeding, comparison of the attributable costs of the two allegedly discriminatory categories of second-class mail, Red Tag versus Non-Red-Tag, became a major issue. The only analysis of attributable costs introduced was a study that had been drafted within the Postal Service but never used or released ("Postal Service Rate Classification Study No. 9). In the Red Tag proceeding, the Postal Service declined to sponsor it.

Dow Jones, a party representing the Red-Tag group, introduced Study No. 9 to support its position that Red-Tag mail costs less than Non-Red-Tag. Dow Jones also provided the testimony of the former Postal Service employee who drafted the study to sponsor it and explain its conclusions. Notwithstanding the circumstance that the author of the study was presented to sponsor it, the Commission found that its status as a preliminary analysis that was never formally adopted or used by the Postal Service had a significant bearing on its reliability and use as evidence to support Dow Jones' position. Observing that the study was never released by the Postal Service, the Commission stated:

> We have seen no evidence that the Postal Service ever relied upon Study No. 9 either in formulating or justifying their policy. Indeed, the Postal Service never presented this study to the Commission in any prior proceeding including MC76-2 the second class

> classification docket. Therefore, we can only conclude that the Service has never relied upon this study as final and authoritative.

Id. at 35.

The Commission went on to conclude that the study had other flaws that undermined its reliability, including the observation that the study had been conducted prior to material changes in postal operations. *Id.* at 36. Ultimately, the Commission concluded that the study was not reliable evidence of the attributable costs of the two categories of second-class mail.

In the current proceeding, GameFly relies principally on the Christensen study, which was commissioned by the Postal Service in connection with an internal review of proposals to reclassify First-Class Mail, but never sponsored or relied upon in any Commission proceeding. The Postal Service has not sponsored the study in this proceeding, although it has been cited and relied upon in its undocumented, unsponsored form by GameFly.

In light of the study's status, GameFly protests that "the Postal Service itself has relied on the Christensen study repeatedly." GameFly Brief at 70. To support this statement, GameFly cites to interrogatory answers and answers during cross-examination by the Postal Service that refer to findings in the study regarding matters such as diversity of operations in processing DVDs and the overall level of culling afforded Netflix mail. The Postal Service does not regard its references to the study in interrogatory responses, or its good faith efforts to answer questions about it during discovery, as "use" or sponsorship. In fact, GameFly had an opportunity during discovery to attempt to elicit sufficient information to document the study under Commission's rules, but it refrained

from that approach. GameFly could also have moved for the Postal Service to provide an appropriate witness, as was done in Docket No. R87-1.

By the standards articulated by the Commission in the Red Tag proceeding, such references would not qualify as sponsorship or use by the Postal Service.[17] Clearly, the Postal Service's position in this proceeding is that, whatever merits Christensen's study may have, its stands undocumented, unexplained, and unsponsored under the Commission's rules and practice. Even if the study were to have utility for some purposes, furthermore, it does not represent reliable evidence to support GameFly's conclusions regarding the efficiency of field operations. In this regard, it must be emphasized that the Christensen study was commissioned and conducted for an entirely different purpose than to evaluate local mail processing decisions. From its inception, it was intended as a costing reference for consideration of possible pricing and classification proposals, not to assess local decisions. If local review were its purpose, it would need to have incorporated a much more extensive sample of facilities selected on the basis of their representativeness for evaluating a very specific type of mail processing operation. The fact that Christensen studied 17

[17] GameFly also cites the Postal Service's response to the OIG report which GameFly describes as "relying on the cost estimates developed in the Christensen report." *Id.* This is a reference to the following sentence in the Postal Service's official response: "Through an outside consultant, the Postal Service learned that all PRM designs contribute positive contribution." It is not clear that this unattributed reference to "an outside consultant" implicated the Christensen report, especially since the OIG report explicitly relied on Christensen. In that context, it is not apparent why the Postal Service would use the odd anonymous reference, rather than identifying Christensen explicitly. In any event, in context, it is ridiculous for GameFly to conclude that this reference represents reliance on the "cost estimates" included in the report.

randomly selected facilities and developed 17 different processing models is instructive in that respect.

The Postal Service does not need, nor does it intend, to impugn the integrity or quality of Christensen's work to contest its use by GameFly. The deficiencies of the study as evidence in this proceeding derive primarily from its unsponsored status, which deprives all parties of the safeguards which Commission rules and practice have evolved to ensure, and the critical defects for GameFly's purposes that the Postal Service has noted elsewhere.

2. The Christensen model of Netflix return costs is quantitative but not empirical; its results are highly sensitive to proxy productivity assumptions.

GameFly and the Public Representative both reference the quantitative analysis in the Christensen report as contradicting the qualitative evidence of witnesses Belair and Seanor regarding the costs of handling DVD returns. PR Brief at 10; GameFly Brief at 68-69. In doing so, both GameFly and the Public Representative fail to distinguish what the Christensen study actually measured from what it merely assumed. The Christensen report's principal empirical content is in measuring outbound and return volumes by processing method at the sampled facilities. Appendix at Tab 20, GFL1024.

Complainant's claims have largely devolved into those specific to the processing of return mail, that is, mail containing at least one DVD en route from a customer back to Netflix, or GameFly.[18] **REDACTED** Appendix at Tab 20,

[18] Nominally, the complaint also involves Blockbuster return mail. However, as evidence and understanding recognized that Blockbuster was processed similarly to Netflix mail when it approaches Blockbuster plants, and accordingly

GFL1040-1042. The study makes clear reference to its extensive use of "proxy productivities" to fill in the resulting blanks.[19] *Id*.

The proxy productivities do not constitute the only significant assumed parameters used in the Christensen models. The report describes the use of a "proportional adjustment factor" in the models. Normally, such factors are used to reconcile cost model results with "top-down" cost estimates from CRA models.[20] However, in this case no CRA-based cost estimate was available, so the Christensen report borrowed the adjustment factor of 1.45 from the QBRM model. *Id*. This factor alone serves directly to increase the costs for a number of components estimated by the Christensen return cost models. Similarly, the proxy productivities chosen for use in the models are not based on any measurement; indeed the Christensen report provides no justification for use of these assumed values, which also serve to increase the cost estimates. While the use of proxies and other assumptions may be necessary for the quantification of costs in the absence of direct measures—and such use is hardly unusual in itself—it must also be recognized that resulting costs hinge on the validity of the assumptions underlying the selection of respective proxies.

While GameFly contends that the Christensen results are robust and that concerns about the models are "methodological quibbles" (GameFly brief at 70),

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constituted a substantial proportion of mail in local plants, Blockbuster has tended to disappear from contending descriptions of mail processing steps.

[19] Indeed, the only productivity directly measured in the study that is used in the Christensen models (and, in turn, witness Glick's derivatives) is a traying-and-sleeving productivity based on the observation of "11.5" trays over 147 minutes; see FE Return Scenario 3 v.xls, "Misc" worksheet, row 5 (referenced at, e.g., GFL-RT-1 at 8).

[20] Such factors commonly, but not necessarily, exceed a value of 1.

REDACTED. Appendix at Tab 20 (GFL1044-1045). Whether even this range is sufficient to represent the true cost extremes depends on the actual, unmeasured, productivities.

The sensitivity of the Christensen results to the study's proxy productivity assumptions exemplifies why the Postal Service's objections to GameFly's failure to comply with Commission rules requiring the documentation and sponsorship of complex cost studies is not mere procedural quibbling. Postal Service Brief at 90-113. Had the Christensen study adopted proxy productivities and other cost model parameters resulting in much lower estimates of Netflix return costs, it would defy credulity to suggest that GameFly would have accepted Postal Service representations that the Christensen study should be accepted as dispositive (which GameFly itself asserts) simply for having been produced by the "A team." GameFly Brief at 69.

3. The Christensen study does not, and cannot, trump the testimony of Witnesses Belair and Seanor on operational matters.

Christensen Associates' reputation, into which both GameFly and the Public Representative put much stock (GameFly Brief at 69; Public Representative brief at 6), cannot alone elevate assumptions made by its staff over the direct operational knowledge of Postal Service personnel such as witnesses Belair and Seanor. There is no reason to believe that the study could, or would, stand in opposition to operational knowledge. In promoting the Christensen report, GameFly describes it as having been produced "with input from knowledgeable subject matter experts from Postal Service headquarters."

GameFly Brief at 69. Clearly Postal Service headquarters expertise does not arise independent of the knowledge of subject matter experts from Postal Service field operations such as witnesses Belair and Seanor. Nor does the Christensen report foreclose the possibility that manual culling is not especially labor intensive. **REDACTED** Appendix at Tab 20 (GFL1041). Thus, the Christensen study explicitly considered cases in which culling costs are "de minimis" as being within the realm of possibility.

4. The observations of witnesses Belair and Seanor regarding the net costs of culling Netflix returns are supported and do not conflict with data from the operating and statistical systems upon which they routinely rely**.**

GameFly and the Public Representative characterize the testimony of witnesses Belair and Seanor to the effect that Netflix returns handling is not unduly costly as constituting "unsupported opinions" or "hunches." PR Brief at 10; GameFly Brief at 73. GameFly is particularly incredulous that field managers would employ, with "no data" at hand, certain processing methods only when they actually are cost-reducing. GameFly Brief at 67. GameFly and the Public Representative are wrong to suggest that field managers are uninformed by data. In fact, field managers' local decisions are based on a "variety of data sources… includ[ing] such operating and statistical data systems as MODS, TACS, ODIS, MPE Watch and machine utilization reports." Tr. 10/1749 (Seanor). Nor should it be considered at all extraordinary that the Postal Service would seek operating efficiencies by allowing field managers flexibility to allocate resources according to local circumstances under budget constraints.

Many of the data sources employed by the field in day-to-day management are subsequently used by Postal Service Headquarters analysts and consultants in developing product costs for the annual Cost and Revenue Analysis, and for various special cost studies. For instance, the TACS workhours (reported via MODS) and machine volumes that field managers observe in real time are aggregated and used to develop cost pools and productivities that analysts such as Christensen Associates use to populate cost models, including the DVD mail processing models. In conjunction with additional accounting and statistical data, these data are used to estimate costs for products such as single-piece First-Class Mail letters. The aggregate data from those systems reported to the Commission provide no evidence that witnesses Belair and Seanor are somehow systematically missing substantial costs associated with handling DVD returns.

From the FY2005 period used in the Christensen cost model to FY2009, mail processing unit costs for single-piece First-Class Mail letters increased from 13.61 to 14.24 cents using the Commission cost methodology. Docket No. ACR2009, USPS-FY09-26, shp09prc.xls; Docket No. R2006-1, USPS-LR-L-99, file shp05prc.xls. While the nominal unit costs increased 4.6 percent, the corresponding increase in the mail processing hourly labor cost was 17.5 percent over the same period,[21] so "real" mail processing costs (adjusting for labor cost increases) for single-piece First-Class Mail letters actually have declined

[21] Mail processing labor costs increased from $34.13/hour to $40.09/hour. Compare Docket No. ACR2009, USPS-FY09-7, Table VIII; Docket No. R2006-1, USPS-LR-L-55, TableVIII.

markedly—despite rapid growth in DVD return volumes. As such, data in the Commission's own files support the Postal Service argument that its one touch processing of Netflix, in conformity with the testimony of witnesses Barranca, Belair and Seanor, does indeed save the Postal Service money.

These data may not totally dispose of the possibility that DVD returns actually have high costs, relative to ordinary automation-compatible letters, as GameFly suggests. GFL Brief at 69, citing Tr. 12/2038-2040. The math alone cannot preclude the possibility that Postal Service field managers might be extraordinarily successful at restraining other costs of (non-DVD containing) single-piece First-Class Mail letters despite lack of visibility into their unique costs while also being saddled with costly DVD return pieces. However, the Postal Service submits that a simpler explanation of the data, and the only one substantiated by record evidence in this proceeding, is that manually culled DVD returns are not as costly as the Christensen proxy costs imply, and that field operations experts such as witnesses Belair and Seanor correctly view DVD returns as having lower additional costs as a direct consequence of one touch diversion for Netflix pieces from the automation mailstream.

Further exploration of detailed information already made available to the Commission provides additional corroborative support for witnesses Belair's and Seanor's testimony that one touch processing of high density return DVD mail improves the overall efficiency of mail processing operations. MODS data, for example, simply lack the hours in collection mail separation operations that would be implied by the high-cost scenarios in the Christensen report. Hours in

the allied labor part of operation 010C are also down faster than cancellations, implying that new efficiency is coming from somewhere. Further, IOCS has been collecting information on the Permit Reply Mail (PRM) marking for a while, and PRM mail processing costs show a lower per-piece average than non-PRM single-piece First-Class Mail letters--11 cents per piece plus or minus 1.2 cents per piece for PRM (with piggybacks and similar costs) versus 14.3 cents per piece for other First Class Mail single piece letters in FY2009. As such, the Commission can through expert examination of its own data confirm the accuracy of the Postal Service's fundamental argument that its current processing of Netflix return mail is operationally efficient, and should accordingly be continued. Moreover, extension of such mail processing in accordance with the conditions described in the May 17 Letter should afford additional efficiency gains (if they have not already been captured by astute field management).

C. The 2007 OIG Report Cannot Be Relied Upon to Support the Conclusion that the Postal Service Unreasonably Discriminates Against GameFly.

Together with the Christensen study, GameFly refers to the 2007 audit report of the Office of the Inspector General (OIG) as "the most important documents in the case." GameFly Brief at 24, n. 6. GameFly repeatedly cites the OIG report to illustrate the Postal Service's favoritism toward Netflix, primarily in connection with GameFly's allegation that the Postal Service's decision to approve the machinability of Netflix's DVD packaging represents a prominent example of unreasonable discrimination, and the OIG's observations regarding the

processing of Netflix mail compared to the processing of mail from other DVD rental companies. GameFly Brief at 19, 23-24, 37, 42-43, 45, 50, 66.

The OIG Report was entered into the record as evidence, in large part on the strength of its status as an official report of a federal governmental entity. In this regard, the report occupies a much higher status than most of the documents that GameFly cites. Nevertheless, as Commission practice has acknowledged, public document status is only the starting place for legitimate inquiry into the evidentiary value of a document submitted as evidence.[22] Beyond the label as evidence, furthermore, the reliability and use of information in a public document may be subject to inquiry and challenge. *Id.* at 9.

In this regard, the Commission should assess carefully whether the uses to which the report are put by GameFly in this proceeding are valid and stand up to critical examination. Thus, the report might support conclusions about the facts surrounding the Postal Service's practices in evaluating machinability of mail packaging containing DVDs. It might even support adverse conclusions regarding the correctness of the policies embodied in Postal Service machinability criteria. To the extent that its observations about the prevalence of culling Netflix DVDs are consistent with reliable record evidence establishing

[22] Presiding Officer's Ruling on Evidentiary Status of Certain Testimony, Exhibits, and Other Documents, POR R90-1/65, Docket No. R90-1, at 5 (Sept. 6, 1990)("In general, the analysis agrees that the documents associated with the Postal Service, the Commission, and the GAO are public documents within the meaning of rule 31(d), but finds this does not resolve their evidentiary status, nor automatically preclude any further inquiry into authentication and sponsorship. Admissibility is determined on a case-by-case basis, depending on the nature of the material and use to which it is put by the witness."). Here, it bears noting that most of GameFly's citations to the OIG Report are not sponsored by any witness.

reasonable estimates of the degree of culling, it might support conclusions regarding the scope and extent of processing that does not involve machine distribution operations.

The report should not be used, however, to support GameFly's otherwise unfounded conclusions regarding the existence of undue discrimination in mail processing. In the first place, the report did not make any finding of undue discrimination, and it did not even inquire about the existence of unlawful discrimination in processing decisions, actual or hypothetical. By its own terms, the OIG's objective was to determine whether Permit Reply Mailer mailers (return DVDs) were processed in accordance with their approved classification and pricing. The OIG concluded that the envelope design used by Netflix to return DVDs meets the published machinability criteria in the DMM for such mail. OIG Report at 4.

The OIG did find that the 2002 determination by the Postal Service's Marketing Department that the Netflix return mailer was machinable and not subject to imposition of the nonmachinable surcharge conflicted with the determination by the Engineering group at that time that the mailer was, as a practical matter, nonmachinable. The OIG recommended that the machinability criteria in the DMM be modified to clarify that the Netflix mailer would be charged the nonmachinable surcharge, unless it were modified to avoid the problems it caused in machine processing. The OIG also found that, in December of 2005, the Engineering group determined that a mailer used by another DVD rental company, which was "similar" to Netflix's mailer, was not machinable. The OIG

concluded that this determination was inconsistent with the 2002 determination that Netflix's mailer was machinable. The OIG did not find that this inconsistency constituted unlawful discrimination, but it observed that inconsistent treatment might lead mailers to *perceive* that the Postal Service shows favoritism. *Id.* at 8.

The Commission should have serious reservations regarding the reliability of the other findings in the report, in light of its lack of sponsorship, documentation, and questions raised by its explanations and descriptions. The OIG's report made several observations about the mail processing received by DVD return mailers in the field. In its discussion, the OIG report refers to "manual processing," as if the term summarized the full range of processing activities applied to DVD mail in the field. *Id.* at 4. As the testimonies of witnesses Seanor and Belair demonstrate, however, there is a wide diversity of processing operations for return DVDs in the field justified by local conditions at each facility. Furthermore, it is misleading and wrong to equate much of this processing with manual sortation or distribution, as opposed to a culling operation that removes DVDs from a particular mailstream for the purpose of avoiding all subsequent distribution operations, both by machine and manually.

The report expresses a number of generalized findings without benefit of adherence to the documentation requirements and discipline normally expected to support formal costing and other studies offered as proof in Commission proceedings. In this regard, the report only gives general descriptions of its methodology and calculations, without workpapers or detailed technical explanations. *Id.*, Appendix A, Appendix B. For example, the OIG's report

explained that its methodology included visits to 10 postal facilities and telephone contacts with 14 other facilities. The OIG does not identify these facilities, specify which operations it observed, or describe any other particular conditions. Without knowing details about what led to the OIG's findings, it is impossible to evaluate whether the OIG's observations were appropriate to its findings, or whether they would be representative of postal operations today. Based on the broad generalizations used in the report, one might seriously question whether they would apply generally, in 2006 or at present. Regarding its sampling procedures, furthermore, the report does not explain them in detail or provide data collection instruments, guidelines for collecting data, or information about the data collectors themselves. The following statement summarized the basis and extent of the OIG's methodology:

> We conducted this performance audit from September 2006 through November 2007 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective.

Id., Appendix A. These are mere vague conclusions that are of no use in understanding how the audit was conducted, or in assessing the accuracy, representativeness, and reliability of its findings.

The report also presented estimates projecting the financial effects of following its recommendations. The report states:

> Manually processing these mailpieces is costly to the Postal Service. We estimated that the costs to the Postal for this manual effort for the past 2 years were $41.9 million. If the Postal Service were to revise the DMM's nonmachinable criteria to identify

> additional characteristics and physical standards for First-Class letter mailpieces with the same design and general characteristics as the current mailer, the Postal Service could reduce processing costs and would have funds put to better use of $61.5 million over the next 2 years.

Apart from using imprecise terminology ("this manual effort"), this conclusion relies on unidentified, unexplained assumptions about the operating environment and the changes that would result from the recommended modification of the machinability criteria. Starting with a per piece cost obtained from "rate case information for 'First-Class Nonmachinable Single Piece Letters,'" Appendix B of the report identifies the calculations used to derive the figures used in the above statement, as well as the source of the information used to estimate the per-piece cost ("Library Reference 48 from the current rate case filing"). It did not, however, explain how the per-piece cost was developed from this information, or provide any other technical description. Using the same materials in this case, the Postal Service's costing experts attempted to determine how the estimate was built, but were unable to understand or replicate it.

It is unlikely that the OIG's simplistic approach to estimating the effects of the machinability criteria presents a reliable basis to assess them in the context of the complex operating environment characterized by DVD mail processing procedures.

D. GameFly's Reliance on Other Documents Obtained in Discovery Has Created a Defective Record.

The Postal Service has argued repeatedly, in pleadings and in its initial brief, that GameFly's practice of relying on unsponsored, unexplained documents of numerous types, for the truth of their contents, creates an unreliable and

defective foundation on which to evaluate GameFly's serious discrimination claims. The Postal Service has also argued vigorously that GameFly's practice of submitting its own interpretations of these documents in unsponsored legal argument in its direct case represents a substantial departure from Commission practice in ensuring that the proponent of a proposal or complaint must support its contentions through testimony offered by witnesses whose opinions can be subjected to inquiry and testing through accepted procedures guaranteeing due process of law. In its own direct case, the Postal Service presented the testimony of Nicholas Barranca, a highly qualified senior advisor in postal operations, with over 37 years of experience, including several positions as an officer in both Operations and Marketing. Mr. Barranca analyzed GameFly's usage of the discovery documents and concluded that "GameFly has created a seriously deficient case to support its unfounded allegations of unlawful discrimination." Tr. 10/1850 (USPS-T-1, at 22).

In its initial brief, the Postal Service extended Mr. Barranca's analysis by taking a closer look at the documents GameFly cites in its legal Memorandum.[23] Many of the arguments presented in the Memorandum are imported verbatim in GameFly's Brief. The Postal Service's "Analysis of Citations in Barranca Testimony" (Attachment A) looked only at the documents cited by GameFly that Mr. Barranca cited as examples in his analysis. The same type of analysis could be conducted on all of the citations relied upon by GameFly, likely with similar results.

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[23] Postal Service Brief at 127-130, and Attachment A.

The Postal Service does not contend that all of GameFly's citations would not support the propositions for which they are cited. Citations to documents having purely factual content, for example, to support a factual representation in GameFly's pleadings might be appropriate. Along these lines, a local mail processing directive relied upon to support a statement that mail processing units were instructed as to specific procedures for handling Netflix mail might constitute empirical support for the statement without much controversy. A problem with such a citation might arise, however, if the document were of a vintage that would give cause to question whether it reflected current operations. In this respect, Mr. Barranca stated:

> …I would first observe that GameFly draws from a variety of types of documents that span a wide range of time. There does not seem to have been any attempt to describe a chronological progression of Postal Service policy and practices, or a summary of current practices. Rather, the references jump back and forth in time. In this regard, I believe that there have been significant changes in policies and practices, on the parts of both the Postal Service and DVD mailers. GameFly does not appear to have attempted to encapsulate its allegations regarding current policy with any systematic, let alone comprehensive, description by reference to recent documents. Many of the key citations are to documents ranging back to 2002. Relatively few originated within the last three years. Many are five years old or older. As reflected in the testimonies of witnesses Belair and Seanor, mail processing changes over the last five years have been extensive on many fronts.

Tr. 10/1850 (USPS-T-1, at 18-19) (footnote with citations omitted).

A significant example of changes that could affect the viability of dated documents arose in the cross-examination of Postal Service witness Seanor. Commissioner Langley inquired about current culling practices:

> COMMISSIONER LANGLEY: And that too surprised me because I thought the separation – you used the term "separation" rather than culling, and one, I'd really be interested in knowing the difference between separation and culling, but I always thought the separation occurred at the plant, and not the delivery unit. So are these letter carriers or supervisors? Who is actually doing the separation?
>
> THE WITNESS: For the most part it's the letter carriers and the window clerks. But it's really changed over the years. You know, the hit we've taken in cancellation volume is just tremendous, and I know the Board sees – you know, the Commission sees the revenue figures, but the amount of work going across the AFCSs has got to be 25 percent less than it was even five years ago, and what we've seeing is, you know, there is a reduction in collection mailboxes, so the amount of mail that carriers are picking up from the street is a higher percentage than what it used to be, so they have a better opportunity getting it.

Tr. 10/1823-24. This dialogue resumed later in the cross-examination:

> COMMISSIONER LANGLEY: With the decline in the number of blue collection boxes, is there less of that type of mail coming into the plant?
>
> THE WITNESS: I would say that it is much less than what the carriers are picking up now, and I don't have a percentage on that. We might be able to obtain something like that. We could try to. But I would say the carriers are bringing in the volume.
>
> COMMISSIONER LANGLEY: The carriers are bringing in the volume.
>
> THE WITNESS: Yes, and not out of the blue collection boxes. From what they're picking up at the businesses, the households, out of the mailboxes.

Tr. 10/1826-27.

The potential for staleness of information submitted as record evidence, particularly in describing operations, has always been important to the

Commission.[24] A thorough examination of all of the documents of varying vintages cited by GameFly would entail a tremendous amount of work, if the Postal Service were to be expected to rebut with its own evidence the reliability of the information in the documents each time GameFly cites them for the truth of their contents. That is why normal rules of evidence require authentication and verification be conducted by the party sponsoring the document as evidence. In this case, where GameFly has been permitted to rely on documents as "evidence" merely by "submitting" them for the record, GameFly is able to evade all responsibility for attesting to their accuracy. If GameFly were, at a minimum, required to sponsor its use of the documents with expert testimony, at least the Postal Service would have the opportunity to test such usage through normal procedural mechanisms.

Beyond currency and accuracy, as Mr. Barranca notes (Tr. 10/1850, USPS-T-1, at 21), the more serious problem arises from GameFly's citation to documents, accompanied by GameFly's own interpretations and spins, to support GameFly's legal conclusions. As the analysis in Attachment A shows, in many instances (again, only including those that Mr. Barranca cited as examples), GameFly has taken liberties in interpreting meaning and intent, and by piecing together fragments within the same document or from different documents. Much of what GameFly cites, furthermore, comes from internal

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[24] *See* Presiding Officer's Ruling on Pleadings on Periodicals-related Designations from Other Cases, POR No. R2006-1/75, Docket No. R2006-1, at 4 (Oct. 6, 2006); Presiding Officer's Ruling on McGraw-Hill Request for Clarification of the Status of Certain Proposed Designations, POR No. R2006-1/91, at 5-7 (Oct. 26, 2006).

emails in which the authors of communications express opinions which GameFly interprets as facts. Even if the characterization of fact were appropriate in some of these instances, the sources of the observed or stated fact is often not known, and the qualifications of the observer making the comment are not clear. Official communications, or official expressions of policy, might represent an exception to this problem, if they were properly authenticated or reasonably reliable as business records. Most of GameFly's citations used to support its legal conclusions, however, come from informal exchanges among postal personnel occupying various positions and representing a variety of functions. In that context, the reliability of the "evidence" is very unclear, and the status as evidence has been established only through a perfunctory labeling that occurred merely by offering the documents for submission as "evidence" at hearings.

A significant subset of this problem is represented by documents that GameFly offers as evidence of "admissions" by the Postal Service. In most instances, the interpretation of the document as an admission has not been fully explained, and GameFly has not been required to defend its interpretation and use. In the instant proceeding, such usage is particularly troubling where GameFly has relied upon its own constructions of internal exchanges to support its own conclusions regarding the efficiency of postal operations and the Postal Service's legal culpability in light of allegations of unlawful conduct.

It would be easy to respond to these criticisms by observing that the Postal Service would have the opportunity to challenge each usage individually through its own testimony. Without requiring GameFly to sponsor its views and

usage, however, the Postal Service, or any party, would be deprived of the conventional procedures available to test them under due process. Furthermore, shifting that burden to the Postal Service distorts the responsibility for proof and persuasion that the Commission has always maintained in its proceedings.

The Postal Service has discussed many of the illustrations used by witness Barranca in Attachment A. A few are also discussed above in the discussion of GameFly's arguments pertaining to the nonstandard surcharge and proposed classification changes. A few additional examples of Mr. Barranca's examples are presented here.

In paragraphs 113-120 and 134-140 (among others) of GameFly's Memorandum, GameFly develops the central theme of its complaint that preferential treatment given to Netflix amounts to unlawful discrimination. In expressing this contention, particularly in the cited paragraphs, GameFly relies on several internal communications from which GameFly draws unfounded inferences from the candid, or not so candid, comments of postal employees. GameFly apparently believes that these references constitute evidentiary proof of discrimination.

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The Postal Service could repeat many more of these examples. A more comprehensive discussion is included in Attachment A. Again, it must be noted that Attachment A only addresses the examples that Mr. Barranca selected to illustrate the points he made in his analysis. The same exercise could be

performed for all of the documents cited by GameFly. A truly comprehensive analysis would also survey all of the documents produced in discovery.

III. THE COMMISSION SHOULD FIND THE POSTAL SERVICE'S OPERATIONS POLICIES AND PRACTICES REASONABLE UNDER 39 U.S.C. § 403(C).

A. **Section 403(c) Establishes a Practical Standard for Evaluating Discrimination**.

The Postal Service's initial brief discussed at length the legal standards applicable to evaluation of alleged discriminatory conduct and policies under 39 U.S.C. § 403(c). Postal Service Brief at 13-63. GameFly's initial brief repeats and restates its views of section 403(c) that were originally expressed in GameFly's Memorandum filed with its direct case. As noted in the Postal Service's brief, GameFly's Complaint and the legal foundation for its claims of discrimination have evolved since the Complaint was filed. GameFly originally claimed unlawful discrimination by the Postal Service in providing service to GameFly under First-Class Mail flats rates, the product category which GameFly has always used to mail its DVDs. *Id.* at 18-20. GameFly also originally alleged violations of 39 U.S.C. § 404(b). GameFly now limits its statutory claims to section 403(c). It has also added allegations that the Postal Service's provision of service to Netflix under First-Class Mail letter rates violates the Filed Rate Doctrine, since the Postal Service allegedly provides Netflix a distinctive, higher level of service that should be noticed and classified separately. GameFly Brief at 83-86.

GameFly's current theory focuses on the preferences that the Postal Service allegedly provides to Netflix and Blockbuster. GameFly contends that

the preference granted to Netflix in mail processing results in “multiple upgrades” of service beyond the service expectations embodied in First-Class Mail letters. Foremost among these upgrades is the election of “manual processing” over machine processing for DVDs being returned to Netflix by its customers. Since GameFly itself has never purchased service at the same letter rates utilized by Netflix, GameFly adopts a hypothetical construction of the facts in which GameFly would receive inferior service, or would be denied equal treatment, if it were to convert its mailings from flats to letters. In addition, GameFly asserts that the Postal Service has refused or denied equal treatment to GameFly currently. Under GameFly’s approach, this refusal takes the form of, either a direct expression of denial, or the consequence of an operations policy that relies on local management judgment in making mail processing decisions.

GameFly also alleges several other types of preference enjoyed by Netflix under Postal Service policies and practices. As discussed above (see section II.E., *supra*), these include an alleged improper classification of Netflix mailpieces as machinable, a “shrinking” by the Postal Service from charging Netflix more for its allegedly superior service, allegedly granting Netflix personnel extraordinary access to postal facilities and inordinate influence over mail processing decisions in the field, and establishing dedicated drop slots for Netflix DVDs. GameFly discusses each of these alleged preferences separately in its brief and pleadings, although it is unclear whether each constitutes a separate discrimination claim, or whether GameFly refers to them primarily to establish a “pattern” of discrimination or a “culture” of favoritism toward Netflix.

GameFly spends considerable effort discussing the relative status of GameFly and Netflix. Under GameFly's reading of applicable judicial and administrative precedents, which it draws largely from public utilities and transportation regulatory contexts, discrimination claims must first establish that the aggrieved and preferred parties in a discrimination complaint are "similarly situated." GameFly Brief at 61-64. As noted in the Postal Service's initial brief, GameFly injects some confusion into this discussion by misinterpreting Commission practice as establishing a separate status of "functional equivalence" in evaluating discrimination claims. GameFly further confuses the issue by using this term in a dual sense to apply to the party allegedly not receiving equal treatment, compared to the party benefitting from discrimination, and to the mail service given respectively to these two or more parties. *See* Postal Service Brief at 30-37.

In the Postal Service's view, status of the complainant does play an important role in evaluating GameFly's discrimination allegations. The analysis of this status, however, is not as mechanical as GameFly suggests. In the first instance, status should be considered in the same context as judicial consideration of the jurisdictional doctrine of standing. As articulated by the Supreme Court and discussed in *UPS Worldwide Forwarding, Inc. v. United States Postal Service*, 66 F3d 621, at 635 (3d Cir. 1993) (*see* Postal Service Brief at 24-25), parties asserting unlawful conduct should be held to a practical standard in evaluating whether they have the necessary status to challenge the alleged conduct. In federal courts, this status is a component of jurisdiction that

has Constitutional and statutory roots. Commission practice and jurisprudence has not evolved to adopt that jurisdictional doctrine in administrative complaint proceedings brought pursuant to 39 U.S.C. § 3662(a). Nevertheless, the logic of the standing analysis is particularly useful in assessing GameFly's Complaint. Under the Supreme Court's formula standing requires (1) injury in fact (i.e., a harm that is actual and not conjectural or hypothetical); (2) a causal link between the injury and the alleged conduct; and (3) a likelihood that a favorable decision will redress the alleged harm. *Id.*

In GameFly's Complaint, GameFly does not occupy the same status as a mail user compared to Netflix, the alleged beneficiary of the Postal Service's discrimination. GameFly has always chosen to mail its DVDs at First-Class Mail flats rates. Netflix, on the other hand, mails at letter rates. It is the alleged treatment given to Netflix DVDs in processing First-Class Mail letters that creates the basis for GameFly's discrimination complaint.

The Postal Service believes that these facts should control disposition of GameFly's discrimination claims. GameFly has not in fact been injured, since it has voluntarily chosen to mail at a different rate. Not only is there no harm, but there is no causal link between the Postal Service's alleged treatment of Netflix and its treatment of GameFly. Finally, notwithstanding its claims to the contrary, GameFly has not credibly established on the record that, even if it were to receive comparable treatment, it would choose to mail at letter rates. GameFly's "response" to the Postal Service's May 17 offer is instructive in this respect.

GameFly attempts to evade the issue of its status as a mail user through a combination of unsupported or unwarranted conclusions and hypotheticals. First, it asks the Commission to conclude that its decision to mail at flats rates constitutes harm. Under this view, GameFly asserts that, hypothetically, if it were to mail at letter rates, it would be entitled to the same mail processing as Netflix and the same degree of breakage experienced by Netflix letters. According to GameFly, the extra postage cost it must incur to purchase allegedly comparable processing and comparable freedom from risk of damage represents the injury. Second, it asks the Commission to conclude that the Postal Service's processing decisions have unreasonably forced GameFly to make this choice, and consequently have caused the harm. Third, it asks the Commission to accept its representation that, if the Postal Service were to be required to replicate for GameFly the same mail processing that Netflix experiences, it would choose to mail letters rather than flats.

Even if the Commission were not to rely on GameFly's status as a mailer as a jurisdictional defect in this proceeding, the similarities and differences between GameFly and Netflix have a critical bearing on all of the allegations and assumptions that create the foundation for GameFly's complaint. As the Postal Service has testified, GameFly's decision to mail as flats, rather than letters, is a business choice related to its distinct status and identity. In this regard, GameFly's identity as a mailer and as a business have influenced its decision to choose flats rather than letters. In its brief, GameFly recognizes these differences, including those related to the cost and composition of the DVDs it

mails, but argues that they are immaterial, and that considering them "would amount to blaming the victim." GameFly Brief at 62. To the contrary, a fair comparison of GameFly and other DVD mailers, including Netflix, is highly material to evaluation of the reasonableness, and credibility, of the hypothetical foundation of GameFly's complaint. In this regard, the Postal Service believes that it relies on sound evidence and testimony to contradict the assumptions on which GameFly's hypothetical status is based, and to call into question whether it is realistic.

The most important respect in which differences between GameFly and Netflix are material, however, relate to an evaluation of the reasonableness of the alleged discriminatory conduct which is the central element of this complaint. The courts and Commission precedents that have interpreted claims of discrimination under section 403(c) have taken a realistic, fact-based approach to assessing the reasonableness of alleged discriminatory conduct and policies. Under this approach, the Commission should carefully weigh the differences between GameFly and Netflix to determine whether unreasonable discrimination, i.e., irrationally different treatment exists. In this regard, there is abundant evidence in the record pertaining to why the Postal Service might cull Netflix mail in a letter operating environment in which substantial machine processing is utilized. There is no evidence, however, showing how the Postal Service processes GameFly's letters, because they don't exist. Rather, if GameFly's Complaint is to be empirically-based, it must depend on evidence demonstrating disparate treatment of the handful of anonymous DVD mailers, other than

Blockbuster, who, like Netflix, mail DVDs as letters. There is virtually no evidence on the record, however, that demonstrates this practice and experience.

Alternatively, GameFly's complaint rests on its contention that, hypothetically, it would receive different treatment, if it were to mail letters. Inquiry into this proposition equates to the second stage of the Supreme Court's standing analysis. What is the causal link between the alleged discriminatory conduct (the hypothetical distinction between the treatment GameFly's letters would receive compared to the treatment Netflix letters receive) and the harm that would hypothetically be experienced by GameFly (not getting the benefit of manual culling)? Through unsupported inference and innuendo, GameFly attempts to establish that link by proving the existence of irrational favoritism toward a large, influential DVD mailer (Netflix). Failing to establish that connection, however, it must rely on discrediting the practical justifications offered by the Postal Service's operations witnesses. This is an awkward comparison, since there is no empirical evidence demonstrating how GameFly pieces would be treated. In the absence of any national directive dictating discrimination, furthermore, GameFly must resort to attacking the reasonableness of the fundamental operations policy of deferring to local decision-making. GameFly, however, has not established through credible evidence that no reasonable justification for this policy exists.

Section 403(c) creates a relatively simplistic, practical formula for evaluating discriminatory conduct. Discrimination is permitted unless it is

unreasonable. Whether it is reasonable will depend on the facts and the logic of the conduct in practice.

B. Realistic Factual Distinctions and the Sound Logic of the Postal Service's Operations Policies and Practices Establish the Reasonableness of the Postal Service's Conduct.

As discussed in the Postal Service's brief, courts and the Commission have taken a relatively straightforward approach to assessing the reasonableness of differences in Postal Service treatment of mail users. Differential treatment will be upheld, if it is logically connected to empirically established practical differences, in light of the Postal Service's authorities and responsibilities under title 39, United States Code, and Postal Service regulations. See Postal Service Brief, at 38-56. Many of the judicial interpretations of section 403(c) rely on the Postal Service's general authority to ensure effective and efficient operations in processing and delivering the mail. Accepting this as the legal foundation for exercising the Postal Service's authority, the courts and the Commission have looked to whether the logic of the Postal Service's reasoning, supported by credible evidence establishing relevant facts, would uphold the rationality of the Postal Service's conduct.

As discussed above and in the Postal Service's initial brief, the Postal Service has presented substantial evidence from witnesses with considerable experience and current knowledge of postal operations to support the logic of local decisions dictating the processing of DVD mail. Rather than relying on broad conclusions, these witnesses have provided detailed descriptions of the operational environments in which DVDs are processed and delivered, as well as

specific justifications for the processing choices elected. Furthermore, they have described and explained the framework of administrative and financial controls that provide discipline and accountability. In large part, field operations decisions are made to further the overall goals of effectiveness and efficiency of operations. In daily practice on the workroom floor, and in the collection of mail, these decisions are soundly based in the logical determination that culling and consolidating mail at an early stage in the mailflow avoids the need for sortation and distribution downstream. Culling saves time and subsequent effort; time equates to cost; the low-cost solution is pursued consistently; and administrative and financial controls ensure the quality of the results. At the same time, efficiency is not the sole consideration in these decisions. Service and performance must be appropriately balanced in making local processing decisions. In this respect, critical review of local decisions at higher levels of administration ensure that the proper balances are struck.

Unable to counter the expertise and experience of the Postal Service's operations witnesses, GameFly essentially makes two arguments: (1) postal managers may have reasons for their decisions, but they are not the *main* reasons; the main reasons relate to the Postal Service's program of favoritism toward Netflix, namely, avoidance of jams caused by nonmachinable Netflix mailers, and the desire to avoid damage to Netflix's mailpieces; and (2) even if efficiency is an objective, postal managers do not make the *right* decisions; average quantitative cost estimates (Christensen study) establish that culling Netflix is more costly than machine processing. Both conclusions, however, are

directly and specifically contradicted by the testimony of the Postal Service's operations witnesses. GameFly has not successfully rebutted their testimony with credible evidence or testimony from equally competent and experienced experts.

Even if GameFly were able to cast doubt on the Postal Service's testimony (and it has decidedly failed to do so), the central issue is, not whether Postal Service treatment of Netflix can be justified, but whether the hypothetical treatment of GameFly could be justified. In this regard, GameFly has offered no credible evidence to demonstrate that a hypothetical decision not to cull GameFly letters would not be justified, in light of GameFly's significantly different mailing profile, characterized by lower volumes, lower densities, lower visibility, and in light of GameFly's significantly different mailing practices.

In this regard, the reasonableness of the Postal Service's conduct need not be unquestioned. As long as there is a logical connection between the justification expressed to support alleged discriminatory conduct and relevant and credible considerations assessed by the Postal Service in exercising its authority, the reasonableness of the Postal Service's decisions can be upheld. In this regard, the court's decision in *Mail Order Association of America v. United States Postal Service*, 2 F3d 408 (D.C. Cir. 1993), is instructive. In that case, the Commission's decision to discriminate among mail users by declining to zone the second-class editorial pound charge was challenged as discriminatory, in part, because it was inconsistent with efficiency goals embodied in the Postal Reorganization Act. While the court acknowledged the logic of the challenges to

the Commission's decision, it found that the Commission's reliance on a policy justification within its statutory authority to apply was sufficient to overcome the claim that its recommendation was arbitrary. *Id.* at 437.

The Commission's other precedents considering claims of unlawful discrimination under section 403(c) are also useful guides. In the Red Tag proceeding, PRC Op. MC79-3, Docket No. MC79-3 (May 16, 1980), the Commission addressed claims of discrimination involving mail users paying the same rates but receiving different service. In Docket No. R77-1, the Commission concluded that a finding of discrimination would be warranted if different rates were recommended for essentially the same service. Neither situation prevails here, where GameFly does not occupy the same status as a mailer compared to Netflix, and its complaint is solely hypothetical. Furthermore, in both cases, the Commission's recommendations were influenced by differences resulting from cost allocation methodology. While GameFly might concoct an argument that cost allocation could create the basis for distinctions between GameFly and Netflix within First-Class Mail, in fashioning a remedy in this case, absolutely no record has been created to permit a determination that the alleged undue discrimination in Postal Service operations is related to any disparity in cost allocation. Nor has GameFly provided reliable evidentiary support for its proposed alternative remedy of lowering the First-Class Mail flats rates that it pays.

As discussed above, GameFly's suggestion that other alleged preferences that favor Netflix represent unlawful discrimination must fall for lack of evidentiary

support. GameFly concentrates most ardently on the Postal Service's determination not to follow the OIG's recommendation that the Postal Service's machinability criteria for First-Class Mail be revised. GameFly itself, however, has not provided evidence that would support a conclusion that the Postal Service's decision not to change the criteria, and not to impose a nonmachinability surcharge on Netflix mail, amounts to unreasonable discrimination that disadvantages GameFly. The OIG did not make a finding of discrimination under section 403(c). Nor did it conclude that the one instance of inconsistency in applying existing criteria that it observed was unreasonably discriminatory.

Similarly, no record has been created to conclude that the Postal Service's alleged failure to reclassify First-Class Mail for DVDs represents unlawful discrimination. Other than unfounded speculation and innuendo expressed in GameFly's pleadings no information on the record would support that conclusion. By contrast, the only credible evidence on the issue consists of the Postal Service's discovery responses explaining the Postal Service's decision not to pursue that option as a matter of pricing policy.

Finally, GameFly's allegations that the Postal Service has unreasonably discriminated in favor of Netflix by giving it unwarranted access to postal managers and facilities is directly contradicted by testimony from the Postal Service's operations experts. GameFly has not rebutted that testimony.

C. The Filed Rate Doctrine Does Not Invalidate Existing Rates and Classifications for First-Class Mail.

In its initial brief, the Postal Service addressed GameFly's unfounded arguments that the Filed Rate Doctrine requires the Postal Service to incorporate specific processing requirements or specific damage guarantees into the published product descriptions for First-Class Mail. Postal Service Brief at 58-63. GameFly's arguments are unsupported by sound logic or applicable authorities.

Beyond this lack of support, GameFly's argument makes little practical or theoretical sense. Consider the real world in which remittance mail is frequently dropped in a collection box for transport and delivery to billing agents. Based on local conditions, some remittance mail might be culled and segregated as a first step in processing. Other remittance mail might flow throughout the processing and delivery network like other First-Class Mail letters, as if it had no distinct content or address identity. As local conditions changed, furthermore, the patterns of culling and segregation of remittance mail might also change, in order to allow the Postal Service's facilities to achieve maximum efficiencies in utilizing their personnel and automation equipment. Absolutely nothing in title 39 or Commission regulations, however, would require these variations to be encompassed in product descriptions or published. Nor would such a requirement make any practical sense. To the contrary, a determination that the inapplicable Filed Rate Doctrine would require such results would open a pandora's box of unintended consequences, if allowed to extend logically to other subcategories within the inclusive classification represented by First-Class Mail.

IV. The Remedies GameFly Seeks Make No Sense and Would Open the Door to Further Undue Discrimination Complaints.

As described in the Postal Service's initial brief, considerable uncertainty surrounds any relief GameFly seeks should remediation of its Complaint be warranted. Postal Service Brief at 76-84. GameFly's conduct before filing the Complaint, and its lack of knowledge regarding the feasibility of mailing its discs as letters, suggest that GameFly has no intention of ever entering its DVD mail in the letter mail stream; rather all is really seeks is a lower rate for its flat-shaped mail. *See id*. GameFly's request for an alternate remedy of a lower rate (GameFly Brief at 88) simply confirms this understanding. The remedy GameFly purports to seek has shifted from its initial purported goal to of service on the same terms as Netflix to service superior to that afforded to Netflix return mail.[25] *See* Postal Service Brief at 76-84.

GameFly proposes two remedies – (1) a Postal Service offer to "every DVD rental company manual culling and manual processing of DVD mailers entered at machinable letter rates to the same extent that Netflix receives" or (2) a lower two ounce DVD flat rate. GameFly Brief at 87-88. With respect to the first proposed remedy, equal processing cannot equate to "at least 80 percent of the customer's DVD volume diverted from automated processing" (*see* GameFly Brief at 87), since there has been no definitive showing that such service is provided to any customer. The Postal Service makes no such commitment to any mailer—including Netflix—and cannot accordingly make such a commitment to GameFly, since that would likely be viewed to constitute an undue preference in favor of GameFly compared to all mailers, especially others who mail two

[25] GameFly has never even pretended that it is interested in mailing its outbound flat shaped mail as First-Class Mail automation letters.

ounce First-Class Mail flats. Any Postal Service commitment to an 80 percent level could be deemed to constitute undue discrimination in favor of GameFly over all other mailers.[26] Since any such commitment would be unprecedented, it might also constitute undue discrimination in itself, because of favoritism to GameFly. *See* Postal Service Brief at 76-84. A commitment to GameFly based on any percentage would also interfere with local management's discretion and disrupt the efficient processing methods described by Postal Service witnesses. *See also,* Postal Service Brief at 84-93. Processing operations vary across the country, and a national directive to meet an eighty percent target at every facility would result in many instances where GameFly would receive superior treatment to all other mailers, including Netflix. Postal Service Brief at 84-86.

The Commission cannot realistically consider GameFly's alternative remedy of a reduced, single piece two ounce First-Class Mail flat rate, because it does not address the purported discrimination within First-Class Mail single ounce letter rates, upon which this entire case has supposedly focused . *See, e.g.,* Complaint at ¶ 49. The record contains virtually no evidence relevant to the First-Class Mail flats processing market, and were the Commission to create a remedy based upon First-Class Mail flats rates and/or the processing of such mail, undue discrimination would be immediately patent—and lacking in substantial record evidential support. The imposition of any remedy applicable to First-Class Mail flats processing would also deny other First-Class Mail flats

[26] Of course, GameFly's unwillingness to make its mailpieces obvious, and therefore visually identifiable to postal employees—because that would increase theft rates—constitutes an additional preclusive reason for this purported remedy.

mailers, and perhaps also the Postal Service, notice and due process, because GameFly's Complaint appeared to extend only to First-Class Mail letter rates and not to First-Class Mail flats rates.

As explained in the initial brief, GameFly is probably unique among disc mailers thanks to its utilization of a higher cost rate and a DVD product whose replacement cost exceeds that of other disc mailers many times over. This difference makes any remedy GameFly identifies problematic. *See* Postal Service Brief at 63-76. Based on the record in this case, other disc mailers have shown no interest in mailing DVD discs as First-Class Mail flats; moreover, there is no reason to think any would be interested in doing so because they do not share the characteristics that make GameFly distinct as a mailer of First-Class Mail flats.

Any imposition of a lower flats rate as a remedy would also illustrate the illogic of GameFly's Complaint, allowing GameFly, a party uninjured by the alleged discrimination, to gain preferential treatment in a market distinct from where the discrimination allegedly occurred. Because this remedy does not address alleged discrimination in the First-Class Mail letter processing market, it is likely that selection of such a remedy would only generate additional complaints alleging undue discrimination.

The policy implications, moreover, would be substantial. This case would provide a blueprint for any mailer alleging wrongful conduct by the Postal Service to seek a lower rate through the complaint procedures regardless of whether the lower rate remedy had any connection to the alleged wrongful conduct.

For these reasons (also addressed in previous sections), the Postal Service opposes strongly GameFly's proposed remedies. The proposed remedies do not address the alleged discrimination, and they lack any foundation in substantial record evidence. GameFly's proposed remedies accordingly illustrate why the Commission should not find merit in GameFly's claims of undue discrimination.

V. Public Policy Concerns Suggest GameFly's Approach To Proof of Undue Discrimination Claims under 403(c) Should be Foreclosed in any Future Proceedings.

As the Commission recognizes, this case has consumed substantial resources and time of the Commission and the Postal Service. Tr. 5/673 ("It's a case that's gone on much longer, and I think not necessarily useful motions") (Chairman Goldway); and 674 ("I do not believe that Congress[,] when giving the Postal Regulatory Commission the authority to have enhanced complaint opportunity hearings[,] really had in mind that cases would go on as long as they have.") (Commissioner Langley). GameFly's decisions regarding how to approach litigation in this matter have required the Postal Service and the Commission to devote excessive and unnecessary resources to this case.

One early procedural development, the directive in Order No. 235 (July 1, 2009) that the parties work to produce a joint stipulation in advance of the prehearing conference, seemed to hold forth the prospect of Commission control over progress in this docket. The consequent stipulation (Joint Statement Of Undisputed And Disputed Facts (July 20, 2009)), which appeared to narrow the scope of issues separating the parties, unfortunately had no consequent impact

limiting discovery. GameFly was thereafter allowed discovery without any of the limits called for by the Federal Rules of Civil Procedure.[27] GameFly took full advantage of the absence of any meaningful constraint on discovery by embarking on excessive, unnecessary, and virtually unlimited discovery, issuing over seven hundred discovery requests, including subparts, and creating a discovery period that began in July 2009 and continued largely unabated for over a year.[28]

GameFly's license to consume unlimited resources was then compounded through its evasion of the customary approach to development of an evidentiary record in Commission proceedings, refusing to enter evidence through testimony or even sponsor the documents it sought to submit as evidence. Public policy and Commission precedent both fail to support this approach; as things now stand, the Commission has opened the door wide to future such approaches. The Postal Service believes that this harmful precedent can only lead to

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[27] While a host of changes were made recently to the Federal Rules of Civil Procedure to accommodate challenges presented by electronically stored information (ESI) which by its voluminous nature can overwhelm parties' resources and the stakes in a given matter, FRCP 26(g) has long contained an enforceable provision requiring proportionality in civil discovery. The courts have begun to notice and enforce proportionality. *See Mancia v. Mayflower Textile Servs. Co.,* 253 F.R.D. 354 (D.Md. 2008) (heralded as the first indication that federal judges are becoming aware that overly aggressive discovery demands are contributing to the electronic discovery blight). As discussed, *infra,* the scope of discovery in this matter was essentially unlimited. Lessons are available here for the Commission's future case management, should it choose to follow them.

[28] *See, e.g.,* the range of GameFly's discovery which started with First Discovery Requests of GameFly, Inc., to the United States Postal Service (GFL/USPS-1 through -65) (July 31, 2009), and culminated with Twelfth Discovery Requests of GameFly, Inc., to the United States Postal Service (GFL/USPS-225-235) (August 16, 2010).

prolonged, adversarial, resource-consumptive consequences in future complaint proceedings.

Almost immediately, GameFly signaled its intention to engage in a litigation strategy that would require the Commission and the Postal Service to expend their time and resources at a level never seen before in a Commission complaint proceeding. GameFly served over seven hundred discovery requests, including subparts, on the Postal Service. The discovery period began in July 2009 and continued until as recently as October 8, 2010, contemporaneous with oral cross-examination of witnesses. *See* First Discovery Requests of GameFly, Inc., to the United States Postal Service (GFL/USPS-1 through -65) (July 31, 2009); Compelled Responses of the United States Postal Service to Discovery Requests of GameFly, Inc. (October 8, 2010).

The Postal Service endeavored repeatedly to limit the burden on its scarce resources, which also drains the Commission's resources. In one attempt to narrow discovery and avoid wasting of time and resources (including those of the Commission) GameFly and the Postal Service met to review tens of thousands of Postal Service documents potentially responsive to GameFly's over seven hundred discovery requests. After a short review of the documents, GameFly declared that it wanted them all. GameFly's excessive and unnecessary discovery demands forced the Postal Service and the Commission to expend their resources unreasonably in dealing with discovery responses, objections, and motions practice.

In contrast, counsel for GameFly sought to avoid involvement of GameFly's own resources in discovery or case presentation. GameFly took the incredible position that, as Complainant,, its own documents had no relevance to the case. *See* Tr. 5/912-913 (indicating GameFly witness' belief that, because it was not a defendant in any case, GameFly had no obligation to preserve its documents through a litigation hold); Tr. 5/765-766 (GameFly Response to USPS/GFL-67, asserting belief that "information relevant to the complaint … [was limited to] … information that was likely to [be] found only in the Postal Service's possession"). Even GameFly's counsel appeared to take this position – despite its inconsistency with fundamental principles of due process – by declining to instruct GameFly to impose a litigation hold that would have protected relevant documents from destruction. *See* Tr. 5/914-916 (conceding that GameFly counsel was responsible for decision not to impose a litigation hold). When GameFly finally issued a document retention policy, for reasons ostensibly unrelated to the litigation with the Postal Service, this policy covered only emails and omitted many other documents relevant to GameFly's business. *See* Tr. 5/918-919 ("We have no policies other than an email retention policy as it relates to documents … and we have no policy as it relates to physical files"). GameFly admitted that it destroyed documents relevant to this case, and that it had no knowledge regarding the content of the destroyed documents. Tr. 5/918-920; Tr. 5/738-740 (GameFly Responses to USPS/GFL-43, 44, and 45).[29] GameFly even

[29] Federal court judges would infer from this deliberate spoliation of evidence inferences adverse to Complainant up to and including a default judgment against Complainant, with prejudice. *See, e.g.*, cases summarized at

resisted the Postal Service's request that GameFly offer an institutional witness to face oral cross-examination on its own institutional discovery responses, notwithstanding a long history of Commission directives granting such requests. Answer of GameFly Inc. to Motion of USPS to Postpone Hearing (June 8, 2010); Answer of GameFly Inc. to Motion of the USPS for Another Opportunity to Cross-Examine an Institutional GameFly Witness (June 23, 2010) ("GameFly IW Answer").

When the Postal Service succeeded in obtaining an opportunity to cross-examine GameFly on its institutional discovery responses, GameFly maintained that the cross-examination should be narrowly limited, and that its legal consultant be allowed to accompany the institutional witness on the stand during oral cross-examination. Tr. 5/677-680, 876-878.

GameFly's obstructionist and resource-draining litigation approach continued after discovery with the filing of evidence. Instead of submitting evidence through testimony that could offer sponsorship of the evidence while facing customary cross-examination as to its foundation, authentication and reliability, as normally occurs in Commission proceedings, GameFly chose to present its evidence in a non-evidentiary trial brief that made sweeping, misleading and inaccurate factual claims about documents that it cited. *See* Memorandum of GameFly, Inc., Summarizing Documentary Evidence (April 12, 2010) ("GameFly Memo"); GameFly IW Answer at 7 FN8 (referring to GameFly Memo as "trial brief" or legal memorandum").

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http://www.ediscoverylaw.com/admin/mt-xsearch.cgi?blog_id=266&search_key=keyword&search=spoliation.

The GameFly Memorandum misrepresents opinions as facts and concessions of guilt, and its submission in the place of testimony induced eight rounds of motions practice to determine the admissibility of hundreds of documents relied upon, but not authenticated, sponsored or supported by any testimony. *See* Answer of GameFly, Inc., in Opposition to Motion of USPS to Strike Rebuttal Testimony of Sander Glick (GFL-RT-1) (November 3, 2010) at 1, 1 FN1. The admissibility of these documents, as well as their reliability and the basis for their admissibility, is still in dispute. *See* Postal Service Brief at 125-127.

GameFly attempted to enter new documents into evidence as late as October 29, 2010, the day after its surrebuttal witness faced oral cross-examination during the last hearing in this case, and less than two weeks before the filing of initial briefs. Motion of GameFly, Inc. to Admit Certain Postal Service Documents into the Record (October 29, 2010). Because of GameFly's conduct, the Presiding Officer was unable to issue a ruling on the evidentiary status of the new documents until the day initial briefs were due. Presiding Officer's Ruling Granting the October 29, 2010 Motions of GameFly and the Public Representative, POR No. C2009-1/45 (November 8, 2010).

GameFly could have avoided the motions practice regarding admissibility by taking the legal system's and Commission's former standard legal approach to use testimony to support its characterizations of, authentication for, credibility of, and significance of documents. GameFly's use of a "memorandum" or "trial brief" in the place of testimony continues to prejudice the Postal Service even at the

briefing stage of this litigation, as reflected in the Public Representative's almost exclusive citation to the GameFly Memorandum as if it is evidence rather than legal argument. *See* Public Representative Initial Brief (November 8, 2010).[30]

It is not clear why GameFly chose an unorthodox litigation posture that required such a lengthy, inefficient procedure to reach a decision. One might speculate that the approach owes much to its adoption as a litigation strategy designed to limit exposure of GameFly's positions to discovery and subsequent review. GameFly's direct testimony addressed an issue with a limited role in the case, and admittedly did not address any elements of discrimination under 39 U.S.C. § 403(c). Tr. 3/116 ("I don't believe [my testimony] … address[es any of the elements of discrimination under 39 USC 403(c)"). To describe documentary evidence consisting exclusively of documents obtained from the Postal Service via discovery, GameFly counsel wrote a trial brief and avoided testimony that would require the involvement of any GameFly employee or executive. *See* GameFly Memo.

As described in section I.D. of this Reply Brief, the cross-examination of GameFly witness Hodess confirmed that GameFly employees and executives knew little about the Complaint, the underlying facts, or the industry subject to the alleged discrimination. Witness Hodess testified that he had virtually no knowledge regarding most of the major issues in the case, including the composition of GameFly's own product and the disc mailing industry as a whole.

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[30] This PR pleading could well have been written as soon as GameFly filed its direct case, relying as it does exclusively upon those materials while ignoring everything else.

Tr. 6/1184 **REDACTED**); Tr. 5/892 ("I do not [have any sources of knowledge about the industry standard for DVDs or the composition of DVDs]"). At points during the oral cross-examination, witness Hodess blatantly called on his counsel to answer questions directed to him by Postal Service counsel. *See* Tr. 5/953 (stating "Can I talk to [GameFly counsel]" in response to question "Did you take [the May 17 Letter] as an invitation from the Postal Service to discuss the contents of the [May 17] letter?") GameFly counsel was happy to testify on behalf of witness Hodess, and witness Hodess adopted counsel's testimony as his own. *See* Tr. 5/930-931 (allowing GameFly counsel, and not GameFly witness, to testify in response to question about what problem the Complaint sought to resolve, and agreeing with "testimony from counsel"); Tr. 5/954-954 (agreeing with "counsel's testimony" in response to question directed to the GameFly witness and asking about the GameFly witness' understanding of the May 17 Letter).

In light of the above discussion, the Postal Service is concerned about the precedents for procedure and evidence set through the course of this proceeding. It is especially troubling that potential future complainants under 39 U.S.C. § 403(c) may conclude that they may build a complaint on a hypothetical construction, contrary to their current status and existing conditions, and count on the opportunity to conduct extensive fishing expeditions through discovery in an endless quest to find a "smoking gun." The Postal Service is also deeply concerned that the omission may abandon the standards for proof and technical rigor and support that have evolved in previous commission proceedings, and

may abandon the Commission's long-held views regarding the responsibilities of proponents to prove their cases through testimony and evidence under procedures that afford due process to all parties.

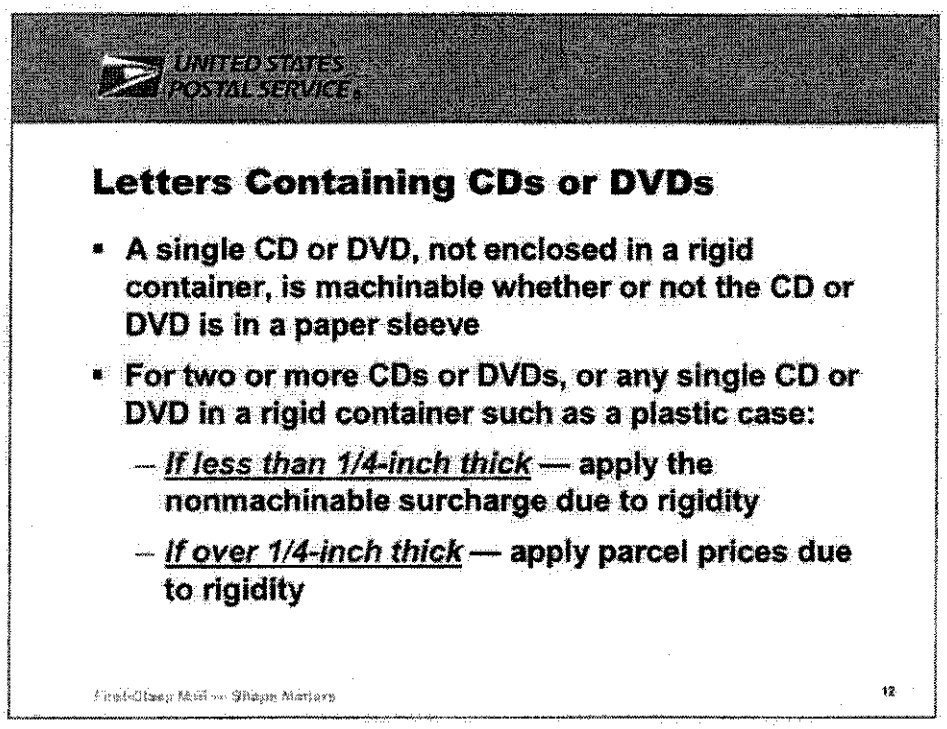
Regarding the effort and delay caused by unnecessary procedural wrangling and motions practice, the Postal Service agrees that more should be done to contain the litigation through good-faith cooperation between parties. In light of the strongly held, sometimes emotional postures of litigants in a discrimination complaint proceeding, however, optimism on that score may not be entirely warranted. In this regard, the Postal Service submits that outcomes of disputes that rest on the Postal Service's "waiver" of arguments and challenges, and blind reliance on "the law of the case" in that respect, do little to encourage such cooperation.

CONCLUSION

For the reasons set forth above, the Postal Service respectfully requests that the Presiding Officer deny GameFly the relief it seeks in its Complaint.

APPENDIX TO THE REPLY BRIEF OF THE UNITED STATES POSTAL SERVICE

(Document referenced on page 51)



Letters Containing CDs or DVDs

A First-Class Mail letter-size paper envelope containing a single CD or DVD — whether the CD or DVD is in a paper sleeve or not — is usually machinable and priced accordingly, as long as it has no other nonmachinable characteristics, such as a rigid container. The inclusion of a single CD or DVD does not itself make the mailpiece nonmachinable.

However, the same letter-size paper envelope containing two or more CDs or DVDs, or any CD or DVD in a rigid container such as plastic case or cardboard box, is nonmachinable due to rigidity. If the mailpiece is no more than 1/4-inch thick, apply the nonmachinable surcharge in addition to letter postage. If the mailpiece is over 1/4-inch thick, apply the parcel prices.

Rarely, are these pieces priced as flats.