

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

Before Commissioners:

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

Competitive Product List
Adding Round-Trip Mailer

Docket No. MC2013-57

REPLY COMMENTS OF NETFLIX, INC.

(August 22, 2013)

Netflix, Inc. (Netflix) submits these Reply Comments to address two issues:

(1) whether the Commission should affirm its decision in Order No. 1807¹ not to mandate that “all DVD mailers ... **must** mail their DVDs at the round-trip DVD rate,” and
(2) whether the Postal Service may recognize GameFly’s rate decrease in the cap calculations for the next annual price adjustment. Netflix supports the Commission’s decision to refrain from imposing such a mandate and asks the Commission to confirm that the Postal Service can recognize GameFly’s rate decrease in the next annual price adjustment.

¹ Order No. 1807, Docket No. C2009-1R, Order on Reconsideration and Clarification, August 13, 2013 (Order No. 1807) at 11.

I. THE COMMISSION PROPERLY DECIDED NOT TO MANDATE THAT DVD MAILERS MUST USE THE PROPOSED ROUND-TRIP MAILER.

In its Comments,² GameFly requested that the Commission “reconsider” its decision in Order No. 1807 not to impose a requirement that “all DVD mailers, including Netflix, **must** mail their DVDs at the round-trip DVD rate.”³ Netflix opposes GameFly’s request and urges the Commission to affirm its initial decision.

In Order No. 1807, the Commission first addressed the question whether the Round-Trip Mailer category would apply to “all round-trip DVD mailers that enter their mail as one-ounce letters or two-ounce flats.”⁴ Just as “the remedy in Order No. 718 ... established categories for round-trip DVD mailers that were available to all senders of qualifying mail,” the Commission determined that the new category would be “**available** to all senders of qualifying mail.”⁵ But “the Commission [was] not prepared to impose ... a requirement” that all DVD mailers “**must** mail their DVDs at the round-trip DVD rate.”⁶

A. A Mandate That DVD Mailers Must Use the Proposed Round-Trip Mailer Would Deprive Mailers of Flexibility to Respond to the Changing Operational Environment.

The Commission wisely refrained from deciding prematurely an issue that is based on specific facts in a changing operational environment. Locking Netflix—or indeed any qualified mailer—into a particular MCS category would deprive both the

² Comments of GameFly, Inc. on USPS Proposal to Reclassify DVD Mailers as Competitive Products, Docket No. MC2013-57, August 15, 2013 (GameFly Comments) at 32-34.

³ Order No. 1807 at 11 (emphasis in the original).

⁴ *Id.* at 10.

⁵ *Id.* at 11 n. 16 (emphasis added)

⁶ *Id.* at 11 (emphasis in the original).

Postal Service and the mailer of the flexibility needed to respond to changing operations resulting from the current Postal Service retrenchment. As the Postal Service evolves with increased consolidation and decreased overnight service, Netflix must adapt its operations. Netflix works hard to achieve one-day service for both delivery and returns via its network of over 130 entry points and has invested in additional transportation to assist in this effort. The size and complexity of the networks of Netflix and GameFly differ greatly and contribute to different service expectations and outcomes. Netflix should not be locked into the same MCS category with GameFly.

Operational processes at both the Postal Service and Netflix have not remained static since Order No. 718⁷ was issued in 2011. The Postal Service has moved forward with network realignment and is completing the roll-out of AFCS200 processors, which make manual culling more difficult. One possibility is that the Postal Service determines at some point in the not-too-distant future that special handling of return DVDs is not the best option. Another is that the Postal Service's network realignment plans result in changes to entry times and processing and pick-up times which prompt Netflix to make operational adjustments to continue providing 95 percent of its members one-day delivery. For example, if the Postal Service changes its service standards or ceases overnight delivery in certain locations, Netflix may consider using the Full Service Intelligent Mail Barcode© (IMb) to track return DVDs (through scans taken in the automation process) so that a second DVD can be mailed out before Netflix actually receives the first. In these situations, if Netflix return mail meets all specifications and

⁷ Order No. 718, Docket No. C2009-1, Order on Complaint, April 20, 2011.

can be automated like ordinary First-Class Mail letters,⁸ then that mail could qualify without reservation for the ordinary First-Class rate.

No party—not even GameFly—will be harmed if the Commission refrains from issuing a mandate, especially one that is not currently needed. As Order No. 1807 explains, “If, in the future, the Postal Service proposes to adjust rates for round-trip DVD mail, it will be required to file a notice of rate adjustment with the Commission. Under the Commission’s rules, a notice of rate adjustment must include sufficient information to allow the Commission to determine whether the planned rates are consistent with the policies of title 39 Interested persons may also submit comments on whether the proposed rates conform with Commission orders,” including its orders to remedy discrimination.⁹ If and when the Postal Service files a notice of rate adjustment, GameFly will have the opportunity to raise any and all of its concerns in the context of specific up-to-date facts regarding costs and operational processes.¹⁰

⁸ Presently, all of Netflix’s outgoing pieces are viewed as fully machinable and are processed on automated delivery bar code sorter (DBCS) equipment. A considerable number of return pieces are processed on automation.

⁹ Order No. 1807 at 11.

¹⁰ Because the mandate would limit the operational flexibility both of Netflix to restructure its operations to take advantage of other mail categories and of the Postal Service to increase the efficiency of its consolidated network, imposing such a mandate could be seen as inserting an operational element to the GameFly remedy. The Commission has already declined to reopen the record in Docket No. C2009-1R because of “the apparent likelihood of potentially prolonged proceedings needed to develop an adequate record to support an operational remedy,” which could result in further delay and injury to GameFly. Order No. 1763, Docket No. C2009-1R, Order on Remand, June 26, 2013, at 17-18, 24-25. Furthermore, if and when the Postal Service actually proposes the rate increases referred to by GameFly, key facts may have changed and another factual inquiry may be necessary.

B. Forcing a DVD Mailer to Use the Proposed Round-Trip Mailer Precludes That Mailer from Using First-Class Mail and Thus Deprives the Mailer of the Option to Send Its Mail Sealed Against Inspection.

Closing the door to Netflix's future use of First-Class Mail raises the broader question whether a mailer may be deprived of the opportunity to avail itself of a class of mail that is sealed against inspection under 39 U.S.C. § 404(c).¹¹ That section provides:

The Postal Service shall maintain one or more classes of mail for the transmission of letters sealed against inspection. The rate for each such class shall be uniform throughout the United States, its territories, and possessions. One such class shall provide for the most expeditious handling and transportation afforded mail matter by the Postal Service. No letter of such a class of domestic origin shall be opened except under authority of a search warrant authorized by law, or by an officer or employee of the Postal Service for the sole purpose of determining an address at which the letter can be delivered, or pursuant to the authorization of the addressee.

First-Class Mail is the class of mail that fulfills the requirements of Section 404(c).¹² In a unanimous Supreme Court decision, *United States v. Van Leeuwen*, 397 U.S. 249 (1970), Justice Douglas likened the protection for sealed letters to the "the right of the people to be secure in their papers against unreasonable searches and seizures":

It has long been held that first-class mail such as letters and sealed packages subject to letter postage -- as distinguished from newspapers, magazines, pamphlets, and other printed matter -- is free from inspection by postal authorities except in the manner provided by the Fourth Amendment. As stated in *Ex parte Jackson*, 96 U. S. 727, 96 U. S. 733, decided in 1878:

¹¹ GameFly's Comments also raised the issue that "[t]he proposed round trip DVD mailer product would not be sealed against inspection....This is not a trivial or harmless change." GameFly Comments at 36.

¹² The Postal Service may not deliver mail which does not meet certain physical limitations or is deemed nonmailable matter under 39 U.S.C. §§ 3001 *et seq.*, but neither type of restriction is relevant in this case.

"Letters and sealed packages of this kind in the mail are as fully guarded from examination and inspection, except as to their outward form and weight, as if they were retained by the parties forwarding them in their own domiciles. The constitutional guaranty of the right of the people to be secure in their papers against unreasonable searches and seizures extends to their papers, thus closed against inspection, wherever they may be. Whilst in the mail, they can only be opened and examined under like warrant, issued upon similar oath or affirmation, particularly describing the thing to be seized, as is required when papers are subjected to search in one's own household. No law of Congress can place in the hands of officials connected with the postal service any authority to invade the secrecy of letters and such sealed packages in the mail, and all regulations adopted as to mail matter of this kind must be in subordination to the great principle embodied in the fourth amendment of the Constitution."

The course of events since 1878 has underlined the relevance and importance of the Post Office to our constitutional rights. Mr. Justice Holmes, in *Milwaukee Pub. Co. v. Burlison*, 255 U. S. 407, 255 U. S. 437 (dissenting opinion), said that "the use of the mails is almost as much a part of free speech as the right to use our tongues."¹³

The proposed Round-Trip Mailer is not "sealed against inspection."¹⁴ While a DVD mailer may use the proposed Round-Trip Mailer voluntarily, a class of mail that is sealed against inspection should remain available to it. This arrangement is consistent with Commission precedent.¹⁵ For example, some mailers may have pieces that qualify to be mailed in the Periodicals class. However, these mailers are not *required* to use the Periodicals class, and they do not give up their right to use First-Class (some periodicals are, in fact, sent First-Class). In its Motion for Reconsideration and Clarification, the Postal Service referred to Media Mail and Library Mail as "content

¹³ 397 U.S. at 251.

¹⁴ Section 2140 (d) of the proposed MCS language states: "Round Trip Mailer items are not sealed against postal inspection. The mailing of matter as Round Trip Mailer items constitutes consent by the mailer to postal inspection of the contents, regardless of the physical closure." Request of the United States Postal Service under Section 3642 to Create Round-Trip Mailer Product, Docket No. MC2013-57, July 26, 2013 (USPS Request), Appendix B, at 3.

¹⁵ The instant question of the legality of a mandate that a DVD mailer *must* use the DVD Round-Trip Mailer is unrelated to the question whether the Postal Service may create alternative classifications or preferred rates based on content. *Cf.* Order No. 1807 at 6-7.

based classifications,” “statutorily required under 39 U.S.C. § 3621(a).”¹⁶ However, no piece is required to be sent in these categories, and all pieces in these categories retain the option of using First-Class Mail.¹⁷

In Order No. 1807, the Commission declined to mandate that a DVD mailer “must” use the proposed Round-Trip Mailer, and there was thus no need to address the issue whether a mailer could be deprived of the option to send mail sealed against inspection. The Commission need not reach that issue now.

II. THE COMMISSION PROVIDED APPROPRIATE GUIDANCE ON THE APPLICATION OF THE CAP RULES TO THE RATE DECREASE REQUIRED BY THE GAMEFLY REMEDY.

In its Motion for Reconsideration and Clarification,¹⁸ the Postal Service requested clarification on how the cap applies.¹⁹ In Order No. 1807, the Commission provided that clarification.²⁰ Subsequently, GameFly added observations in its Comments in this docket.²¹ Order No. 1807 addressed two cap questions: First, does implementing the GameFly remedy require immediate withdrawal of accruing CPI authority²² and banking

¹⁶ USPS Motion for Reconsideration and Clarification of Order No. 1763, Docket No. C2009-1R, July 25, 2013 (USPS Motion) at 7 n. 9.

¹⁷ Also distinguishable are mail pieces such as bills, statements of account, or personal correspondence, which *must* be sent First-Class. If they do not contain such items, they *may* be sent using other classes. Domestic Mail Manual §133.3.2.

¹⁸ See USPS Motion at 7-10.

¹⁹ See USPS Request at 4.

²⁰ Order No. 1807 at 7-10.

²¹ See GameFly Comments at 30-31.

²² Note that contrary to popular presumption, the operation of the CPI bank, even under the best of circumstances, does not preserve authority for the Postal Service. In fact, it is generally a losing proposition, not what would be expected from a “bank.” To see this, consider the following hypothetical, simplified for clarity. Suppose the CPI is 100 at the beginning of the year, 104 on July 1, and 108 on December 31. The increase for the year is clearly 8%. For

of the residual.²³ Second, if the answer is *no*, how is the rate reduction to be recognized in the next annual adjustment?

The first question relates to how the cap rules are applied at this time, i.e., when the GameFly remedy is implemented. The rate change required by the GameFly remedy involves a decrease (or no change) in all affected rate cells, is a mid-year adjustment, and is permanent. The most similar case thus far is the price reduction for High-Density Flats.²⁴ In it, the cap implications were neglected. The Commission cited that case, among others, and explained that “the Postal Service has the option to exclude the rate decrease from the calculation of the price cap.”²⁵ The answer to the first question is thus that implementing the GameFly rate reduction does not require immediate withdrawal of accruing CPI authority and banking of the residual.

The second question relates to how the cap rules apply at the time of the next annual price adjustment. If the regular annual price adjustment takes place, the Postal Service will file a notice of adjustment in October. It is likely to adjust most or all rates, including the rates implemented in the GameFly remedy. For illustrative purposes, we

purposes of example, suppose a notice of rate adjustment is filed on July 1, and CPI authority of 4% is withdrawn. Now suppose no rate adjustment is actually made and 4 percentage points of authority are put into the bank. Then on December 31, suppose another notice is filed. The increase in the CPI from July 1 to December 31 is 3.8462% ($108/104 = 1.038462$, which is an increase of 3.8462%). If the 4 percentage points in the bank are also used, the total available authority will be 7.8462%. But if the Postal Service had not withdrawn CPI authority on July 1, but had waited until December 31 and withdrawn the full year, it would have had authority of 8%. Authority of 0.1538% has been lost. It is understandable, then, that the Postal Service would want to avoid withdrawal and banking in the middle of the year.

²³ For a rate decrease, the residual would be larger than the CPI authority withdrawn. For a rate increase, where some of the withdrawn authority is used, the residual would be smaller than the authority withdrawn.

²⁴ Order No. 236, Docket No. R2009-4, Order Approving Price Adjustment for Standard Mail High Density Flats, July 1, 2009.

²⁵ Order No. 1807 at 9-10.

will assume that the recently proposed 46-cent rate for 2-ounce DVD flats, currently at 92 cents (due to the Order No. 718 remedy), could be increased to 47 cents. For clarity, we will use these numbers, mindful that companion rates are also involved.

How are the cap calculations to be handled in the next annual price adjustment?

The Commission answered this question as well: “If the Postal Service chooses to extend a price decrease into a future year, it may opt to incorporate the reduced price into the calculation of the percentage change in rates at that time.”

In our illustration, the 47-cent rate would be thought of in 2014 as the reduced rate associated with the GameFly remedy. Therefore, when the Commission said “If the Postal Service chooses to extend a price decrease into a future year, it may opt to incorporate the reduced price into the calculation of the percentage change in rates at that time,” it is clear that the “reduced price” that is being “extend[ed]” and “incorporate[ed]” in the cap calculation is the difference between 92 cents and 47 cents. It cannot be the difference between 47 cents and 46 cents, for that would not be a “decrease” being “extend[ed]” “into a future year.”

The clarification provided by the Commission involves two steps. In the first step, covering the period between now and the next annual adjustment, the cap is neglected. In the second step, at the time of the annual adjustment, the rate reductions in the Gamefly remedy are recognized. Even if there is no precedent that fits exactly, these steps represent a reasonable exercise of the Commission’s complaint authority under 39 U.S.C. §3662(c). While the cap rules can sometimes be confusing, we believe that Order No. 1807 offers the Postal Service the necessary guidance to implement the

GameFly remedy as a rate change on the Market-Dominant side. Nevertheless, we respectfully request that Commission confirm the above exposition of the cap discussion in Order No. 1807 in order to remove any uncertainty on the cap issue.

CONCLUSION

For the foregoing reasons, Netflix requests that the Commission (1) affirm its decision in Order No. 1807 **not** to mandate that all DVD mailers **must** use the proposed Round-Trip Mailer, and (2) confirm that the Postal Service can recognize the GameFly rate decrease in the cap calculations for the next annual price adjustment.

Respectfully submitted,

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