

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

COMPLAINT OF GAMEFLY, INC.

Docket No. C2009-1R

COMPETITIVE PRODUCT LIST
ADDING ROUND-TRIP MAILER

Docket No. MC2013-57

COMPETITIVE PRODUCT LIST
ADDING ROUND-TRIP MAILER

Docket No. CP2013-75

**UNITED STATES POSTAL SERVICE ANSWER TO MOTION OF
GAMEFLY, INC. FOR RELIEF WITH RESPECT TO THE
AUGUST 22 “REPLY” COMMENTS OF THE POSTAL SERVICE**
(August 30, 2013)

On August 26, 2013, GameFly, Inc. (“GameFly”) filed a motion with the Postal Regulatory Commission (the “Commission”) requesting: (1) dismissal of the Postal Service’s July 26, 2013 request to reclassify DVD mailers as a competitive product; (2) striking the Postal Service’s reply comments filed August 22, 2013; or (3) allowing GameFly 20 days to file sur-reply comments. For the reasons set forth below, the Commission should deny GameFly’s motion in its entirety.

Preliminary Statement

In its initial filing, the Postal Service outlined the market for digitized entertainment content, identified the channels by which such content was distributed to consumers, identified some of the companies operating in the relevant market and the channels used by those companies, identified the trend toward the internet as the primary channel in the market, and noted, as a consequence, the precipitous decline in the volume of mail associated with this entertainment content. In response, GameFly, contrary to basic principles of competition law, attempted to limit the relevant market to a single distribution channel—that is, the mail—and

claimed that the Postal Service possesses complete power over that channel, and thus the entire market. GameFly also presented the declaration of David Hodess, President and CEO of GameFly, to support the claims that streaming, video-on-demand (VOD), downloading and kiosks are not substitutes for digitized entertainment content sent through the mail. As is evident from the rebuttal evidence provided by the Postal Service, Mr. Hodess's claims are factually inaccurate.

In its reply comments, the Postal Service pointed out the deficiencies in GameFly's summary of competition, the mischaracterization of the market outlined in Mr. Hodess's declaration, and the lack of understanding by GameFly and Sander Glick of the Postal Service's cost analysis. With two exceptions, the Postal Service entirely relied on publicly available information, including SEC filings, statements by industry analysts, product introductions and descriptions by game console manufacturers, and media reports on current and future entertainment content distribution to rebut the claims by GameFly and Netflix. The first exception was mail volume data concerning Netflix and GameFly itself. This information should not be surprising to GameFly. GameFly can certainly be expected to be familiar with its own mailing volume, and Netflix's shift from using the mail to streaming content has been widely reported at both the national and industry level. Furthermore, because most of GameFly's comments on the Postal Service's filings were, curiously enough, directed to Netflix's business model and practices, it is reasonable to conclude that GameFly was, and is, familiar with Netflix's business strategies and volume trends. The second exception was a report by IBISWorld on the DVD, Game and Video Rental industry. This report was not commissioned by the Postal Service. Rather, it is one of a series of reports on various business sectors that may be purchased through the IBISWorld website. It would be surprising if GameFly, or Netflix for that matter, was not already in possession of the report.

As such, GameFly's claim that it was "sandbagged" is unsupported by the facts of this docket and demonstrates a fundamental misunderstanding with respect of the market in which it

operates. The claim by GameFly to be “sandbagged” as to the public information presented by the Postal Service in rebuttal is difficult to seriously entertain.

Argument

GameFly’s motion relies on two assumptions that are wholly inconsistent with the reality of the present docket and GameFly’s prior filings with the Commission. . First, weeks after the Postal Service’s initial filing in this matter and after several rounds of comments and reply comments GameFly now argues that the Postal Service’s initial filing was defective and should be dismissed. Second, GameFly contends that the Postal Service’s presentation of rebuttal evidence directly contradicting the comments filed by GameFly and Netflix was extraordinary and unexpected by GameFly and resulted in unfair “sandbagging.” Thus, GameFly requests an unreasonable period of time in which to file sur-reply comments. The Postal Service will address each of these three claims in turn.

I. The Postal Service’s Initial Filing Satisfied All Statutory and Regulatory Requirements for Establishing a New Round-Trip Mailer Competitive Product

GameFly now contends that the initial filing of the Postal Service to establish¹ the Round-Trip Mailer competitive product, filed more than a month ago, was fatally deficient and the Commission should “[d]ismiss the product transfer request.”² That GameFly delayed making this argument until after it filed its initial comments and after the Postal Service filed its reply comments suggests it is based more in desperation as opposed to any substance. Clearly, the argument lacks any merit.

¹ It may be that the proposed Round-Trip Mail competitive product is better classified as a product establishment rather than a product transfer. This distinction, however, is irrelevant, as the Postal Service’s statutory and regulatory obligations are the same regardless of whether the change is a transfer or establishment.

² The Postal Service is unaware of the Commission ever dismissing a product transfer or establishment request. The relief requested by GameFly in its motion would be unprecedented.

In filing to establish a competitive product, the Postal Service is required by 39 U.S.C. § 3642(b)(1) and 39 C.F.R. § 3020.32(d) to establish that the Postal Service does not exercise sufficient market power so that it can, without risk of losing a significant level of business to other firms offering similar products: (1) set the price of such product substantially above costs; (2) raise prices significantly; (3) decrease quality; or (4) decrease output. In the Statement of Supporting Justification, filed July 26, 2013 as an attachment to the Postal Service's request, Steven W. Monteith, Manager of Transactions and Correspondence, attests that there has been a "precipitous decline in DVD-by-mail volumes in recent years . . . largely due to the availability of other technological methods for delivering access to digital movie and game content." (Statement of Supporting Justification at 3-4.) He further explains that these alternatives include "online streaming and/or download services provided by companies such as Amazon®, Blockbuster, iTunes®, and Netflix, and other physical DVD rental services such as Redbox®." (*Id.* at 4.) Based on these trends, the Postal Service concluded that "were the Postal Service to raise prices, degrade service, or decrease output, it would likely suffer declines in volume. Therefore, the Postal Service does not exercise de facto monopoly power over the delivery of digital movie and video game content to consumers." (*Id.*) Given this evidence, it is beyond dispute that the Postal Service request satisfies all statutory and regulatory requirements of 39 U.S.C. § 3642(b)(1) and 39 C.F.R. § 3020.32(d) for establishing a competitive product.³

In their comments, both Netflix and GameFly disagree with the Postal Service's assessment of the market and provide evidence in support of their positions on the DVD-by-mail distribution channel and the market for entertainment content as a whole. While their positions and the declarations they present are factually opposed to the evidence and conclusions of the Postal Service, neither GameFly nor Netflix allege in their comments that the statements of Mr.

³ The Statement of Supporting Justification with respect to the Round-Trip Mailer is substantially similar to all such statements filed when establishing or transferring competitive products. The Postal Service acknowledges that GameFly is rarely a party to such proceedings and likely has limited knowledge on standard practice, but this unfamiliarity with Commission practice cannot constitute a basis for claiming insufficiency by the Postal Service.

Monteith are procedurally defective or that the parties lack an understanding of the Postal Service's position as stated in Mr. Monteith's statements.⁴ The arguments raised by GameFly in this current motion are new and wholly inconsistent with its previous comments.

II. The Postal Service's Reply Comments Provide Rebuttal Evidence Directly Contradicting Assertions Made by Netflix and GameFly

A. The Rebuttal Evidence in the Postal Service's Reply Comments Responds Directly to Allegations of Netflix and GameFly Concerning the Relevant Market

GameFly claims that because of the length of the Postal Service's reply comments and supporting documents, the Postal Service should have provided this evidence in its direct case and not in rebuttal. This claim ignores the fact that the evidence and statements in the Postal Service's reply comments are not supplying new, undisclosed information but are instead directly refuting the claims made by Netflix and GameFly using evidence from a multitude of reputable, independent sources. GameFly characterizes this solid legal and factual analysis as strategic "sandbagging." However, GameFly's provides no showing⁵ that the Postal Service actually developed and/or withheld evidence from its initial filing and waited until its reply comments to provide "preliminary evidence." In fact, the reality of the situation is just the opposite. Such is not the case. The fact is that the Postal Service provided a thorough rebuttal of the weak market evidence GameFly presented in its comments. Now GameFly seeks a second chance to make up for the deficiencies in its comments. GameFly's inability to proffer

⁴ GameFly's cites to 28 pages of its August 15, 2013 comments in an attempt to support its claims of market inelasticity. (GameFly Motion at 5.) This 28 page citation is unhelpful in directing the Postal Service or the Commission to any cognizable argument as to market elasticity previously made by GameFly, which is irrelevant to this motion as well. What can be gained from this broad citation, however, is that within those 28 pages, not once does GameFly argue that the Commission should dismiss the Postal Service request for failing to establish a *prima facie* case as it does now after receiving the Postal Service's reply comments.

⁵ GameFly makes the conclusory, uninformed and incorrect statement that the Postal Service commissioned its rebuttal evidence before GameFly and Netflix filed their August 15 comments. Such a self-servicing and inflammatory assertion has no basis in reality or in a motion filed before the Commission.

evidence of its claims at the appropriate time cannot and should not be the basis of a motion to dismiss, strike, or for leave to file additional evidence.

As explained previously, the Postal Service provided more than sufficient evidence in its initial filing about the market, competition and trends. The initial filings explained, with cited sources, how alternative delivery channels compete directly with entertainment content sent through the mail. As expected, GameFly and Netflix countered these assertions with their own “evidence” that the entertainment content market is actually different depending on the type of media and the channel of delivery. GameFly, for example, submitted the declaration of Mr. Hodess, who attempted to explain that the distinct distribution channels must constitute different markets because of how difficult it has been and would be for GameFly to adapt its product offerings to changing technologies and distribution channels. (Hodess Declaration at 3-7, 10, 13) GameFly also presented numerous unsupported statements such as “[i]n reality, most of those households consider streaming video a poor substitute” (GameFly Comments at 14-15) and “[b]ut building a Redbox-like distribution network would not be a viable substitute for DVD-by-mail even if the Postal Service greatly raised the price of DVD mail service” (*Id.* at 21) as “evidence” that different distribution channels must constitute different markets. Together, the “evidence” and allegations presented by GameFly and Netflix attempted to paint a picture directly opposite to the claims made in the Postal Service’s initial filings.

However, many of the assertions in GameFly’s comments and supporting documents were so unfounded and unsupported by reputable industry leaders that the Postal Service was obliged to offer significant rebuttal evidence to counter GameFly’s “evidence.”⁶ As such, the Postal Service filed the well cited declaration of Mark Shoeman and the IBISWorld report to directly counter the points raised in the comments of Netflix and GameFly and ensure that the

⁶ As is evident from the Postal Service reply comments and supporting documents, a significant disagreement exists between GameFly and the rest of the video game industry regarding the current state of the market for entertainment market, including the future use of DVD-by-mail for video game distribution and rentals.

Commission is not swayed by inaccurate and unsubstantiated information. The overwhelming volume of the Postal Service's evidence was obtained from public sources, mainly through internet research. GameFly is more than capable of doing its own research on the changing technologies associated with its business of video game and movie sales, rentals and distribution. GameFly's claim of surprise in this regard is implausible at best. While some of the evidence submitted by the Postal Service was filed under seal, including the IBISWorld report, which was purchased by the Postal Service and is subject to copyright restrictions, the Postal Service has a right to use the report in support of its reply comments to specifically counter those points raised by GameFly. The IBISWorld report presented did that and nothing more. Moreover, for GameFly to not be unaware of this industry report seems dubious.

Ultimately, however, GameFly has failed to show that the Postal Service presented any comments or evidence except to specifically rebut the allegations and evidence raised by Netflix and GameFly. Thus, GameFly's misguided attempt to circumvent Commission practice and procedure must fail.

B. The Cost Analysis Rebuttal Evidence in the Postal Service's Reply Comments and the Declarations of Ms. Mayes and Mr. Bozzo Responds Directly to the Declaration of Mr. Glick

GameFly's assertions about the cost analysis are also without merit. The Postal Service provided a cost analysis in response to Commission Order No. 1794. (Postal Service Response to Order No. 1794 dated August 5, 2013 and LR USPS-MC2013-57/NP1.) In response, GameFly offered the declaration of Mr. Sander Glick. Mr. Glick testified that the cost analysis submitted by the Postal Service should be given no weight by the Commission. (Glick Declaration ¶13.) As discussed in detail in the Postal Service's reply comments, Mr. Glick's statements are factually inaccurate and misconstrue the very nature of the current proceedings. (Postal Service Reply Comments at 25.) In order to rebut these inaccuracies by Mr. Glick, the Postal Service filed the expert declarations of Virginia J. Mayes and Thomas Bozzo with its reply comments. These declarations were presented solely in response to Mr. Glick's critiques

of the cost model. The information from Ms. Mayes and Mr. Bozzo confirm the Postal Service's prior data in the cost analysis and directly contradict the statements by Mr. Glick. For example, Ms. Mayes states:

Mr. Glick's criticism that the cost estimates are inappropriate because they are "generic cost data for mail of the same shape and, in some instances, machinability" is unfounded. (Mayes Declaration ¶6.)

Mr. Glick's characterization of the Postal Service's "pervasive reliance on system-average data instead of DVD-specific data" as being inappropriate is misguided and inconsistent with his criticism in paragraph 11 wherein he berates the Postal Service for trying to use data that is DVD-specific. (*Id.* ¶7.)

It is unclear why Mr. Glick would want to discuss shape-specific costs at all as the Postal Service's analysis did not include shape-specific cost coverage estimates. If that analysis were revised to include shape-specific cost coverage estimates, the flat-shaped cost coverage values would fall well short of 100 percent, and it is doubtful that the modifications of any proxy costs would change that outcome. (*Id.* ¶17.)

Mr. Bozzo states:

The purpose of this declaration is to respond to comments in the August 15, 2013 Declaration of Sander Glick, particularly the "concerns about the accuracy" of the IOCS-based PRM costs raised in paragraphs 11 and 12 of Mr. Glick's declaration. The Declaration of Virginia Mayes, submitted simultaneously to my own, critiques various other points made by Mr. Glick. I have read Ms. Mayes' declaration and agree with her analysis and conclusions. (Bozzo Declaration ¶2.)

Mr. Glick's stated concerns stem from the fact that PRM constitutes a small portion of the First-Class Single Piece Letters product. He contends that IOCS data are "particularly prone to error" in such cases, and cites several purported examples either directly or by reference to GameFly's November 26, 2010 Motion to Strike in Docket No. C2009-1. As I discuss below, when carefully examined, these examples do not support Mr. Glick's concerns regarding PRM. (*Id.* ¶3.)

In contrast to the examples Mr. Glick raises, measuring PRM letter costs does not, in principle, raise issues of unobservable rate applicability or definitional differences between data systems. (*Id.* ¶7.)

Both Ms. Mayes and Mr. Bozzo focus their testimony on directly refuting the statements by Mr. Glick. They are not presenting new evidence but instead countering the assertions made by GameFly's witness. Once again, GameFly cannot establish, nor has it even alleged, that the Postal Service's reply comments or the declarations of Ms. Mayes or Mr. Bozzo were anything but rebuttal of the arguments and "evidence" GameFly presented in its comments and supporting documents.

III. The Commission's Ability to Regulate the Schedule of its Dockets Extinguishes GameFly's Timing Concerns

GameFly requests that it be granted at least 20 days to file a response to the Postal Service's reply comments and subsequently claims that with the time period it proposes, there is insufficient time for the Commission to issue a reasoned decision. We disagree. GameFly cannot be permitted to create a timing dilemma by making an extension request that is unreasonable on its face. If GameFly is permitted to file a sur-reply (and we believe such permission should be denied) 20 days is far too much time. GameFly's assertion that the schedule is *per se* unworkable assumes the Commission is incapable of managing its own docket and determining reasonable time periods for the parties to file comments and issue a decision. The Postal Service is convinced that because no further filing by GameFly is necessary, the Commission's schedule in this docket is not at issue. If sur-reply is permitted, however, the Postal Service is confident that the Commission can establish deadlines for a workable calendar.

It should also be noted that the Postal Service had 7 days to review substantial comments and supporting documents from both Netflix and GameFly before issuing its reply comments. As evident from its filing, the Postal Service had ample time to review the evidence submitted by the parties, identify contradictory facts, and file its comments and supporting evidence. If the Commission grants sur-reply, a similar time period would be more than reasonable for GameFly to respond to comments from just the Postal Service. The nearly three

weeks proposed by GameFly to respond to the Postal Service's reply comments simply is unnecessary and unreasonable. Accordingly, even if the Commission determines that sur-reply comments are both proper and necessary, establishing a reasonable time period under which the Commission can still issue a reasoned opinion by September 30, 2013, should not be difficult.⁷

Conclusion

For the reasons stated above, the Commission should deny GameFly's motion. In the alternative, if the Commission grants GameFly the ability to file sur-reply comments addressing the rebuttal evidence submitted by the Postal Service in its reply comments, the Postal Service respectfully requests that the time for response be properly limited and that the Postal Service be permitted as of right to respond to any new issues or facts raised by GameFly.⁸

Respectfully submitted,

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⁷ The Postal Service reaffirms that it is entirely unnecessary for GameFly to file additional comments to reiterate its views on the entertainment content market, as it clearly described its understanding of the market and its belief that a shift from DVD-by-mail to other distribution channels has a minimal effect on its business model and is not likely to be a continuing trend.

⁸ The Postal Service notes that it is available to respond to any questions that the Commission may present regarding the establishment of the Round-Trip Mailer product.