

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

COMPETITIVE PRODUCT LIST  
ADDING ROUND-TRIP MAILER

Docket No. MC 2013-57

COMMENTS OF THE PUBLIC REPRESENTATIVE  
IN RESPONSE TO ORDER NO. 1827

(September 11, 2013)

Pursuant to Order No. 1827, the Public Representative respectfully submits these comments to address the United States Postal Service Reply Comments<sup>1</sup> in support of its request to create a Competitive Round Trip DVD Mailer Product.<sup>2</sup>

The Reply Comments contains 28 pages of legal discussion and 37 pages of additional declarations. This is in stark contrast with the 9 page declaration in support of the Postal Service's Request filed on July 26, 2013. The Postal Service has explained more fully the legal framework the Postal Service believes should be used by the Commission to evaluating the germane request. However, the Postal Service has not provided sufficient information for the Commission to determine the Round Trip DVD mailer is a competitive product. Notably, the Postal Service has not provided: an elasticity for the Round Trip DVD product; a cross elasticity between DVD by mail products, streaming media products, and retail DVD rental products; or an explanation why the DVD mail market is not a captive market protected by the CPI cap as envisioned by the PAEA.

The Postal Service has touched on a major issue of first impression for the Commission. This is the first instance where the Postal Service has argued that the competition from digital and retail options limits its pricing power to a point that renders the CPI price cap introduced by the PAEA irrelevant. The Postal Service attempts to

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<sup>1</sup> United States Postal Service Reply to Comments. August 22, 2013. (Reply Comments)

<sup>2</sup> Docket No. C2009-1R, Request of the United States Postal Service Under Section 3642 to Create Round-Trip Mailer Product, July 26, 2013, at 2 (Request)

render the protection provided to mailers by the CPI cap as an impediment to the ability of the Postal Service to compete with alternatives to the mail effectively.

While the financial impact of the PAEA is logically reasonable and widely understood, price cap regulation is the bedrock of the PAEA. The arduous process of the C2009 docket has led to an interesting position by the Postal Service. In the early 2000s (roughly 2002), the Postal Service made an institutional decision to give a major mailer lower rates and improved service. In this docket, the Postal Service argues that “if the Round-Trip Mailer product is classified as “market-dominant,” the Postal Service would be forced to apply part of its price cap authority to the Round-Trip Mailer to avoid losses as the unit costs increase as a result of volume declines.”<sup>3</sup> The Postal Service further states this would lead “to inefficient business decisions and (restrict) the Postal Service’s ability to increase revenue.”<sup>4</sup>

As detailed in the August 26, 2013 Motion of GameFly Inc., For Relief With Respect to the August 22 “Reply” Comments of the Postal Service, the Postal Service Reply Comments contain much more detail and argument than the initial filing, at least as measured in terms of pages. Most of the agreements discussed by the Postal Service are peripheral to the key issue in this docket. The key issue is whether non-mail competition in the DVD market is sufficient to restrain the Postal Service’s pricing power. The Public Representative understands the Postal Service’s argument as follows:

1. Section 3642 allows the Postal Service to transfer (or create) Competitive Products. Section 3642(1) states:

The market-dominant category of products shall consist of each product in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other

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<sup>3</sup> Reply Comments at 25.

<sup>4</sup> Reply Comments at 25.

firms offering similar products. The competitive category of products shall consist of all other products.

The Postal Service believes that DVD Round-Trip Mailers meet the requirements to be classified as a competitive product. In the Request, the Postal Service stated: <sup>5</sup>

[E]vidence suggests that newer and increasingly dominant forms of digital content delivery compete against the Postal Service's Round-Trip Mailer product. Thus, 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.

2. The "Postal Service does not know of another shipping company that provides door-to-door delivery of optical discs such as DVDs."<sup>6</sup>
3. The definition of "the relevant market" should be broad. "The Postal Service's "market-dominance," or lack thereof, thus must be analyzed within the context of the downstream markets in which GameFly and Netflix compete. Properly construed, the relevant market in which GameFly and Netflix operate is the market for the provision of access to digitized entertainment content."<sup>7</sup>
4. DVDs by mail compete in the "provision of access to digitized entertainment" market.<sup>8</sup> The terms "market power" and "similar products" in 3642 (1) refer to the market of "provision of access to digitized entertainment" and products that provides "access to digitized entertainment."
5. "Both GameFly and Netflix face increasing competition from providers of access to digitized entertainment content that use less expensive and arguably more convenient delivery methods."<sup>9</sup>
6. Consumers consider the distribution methods for the "provision of access to digitized entertainment" "reasonably interchangeable,"<sup>10</sup> and "federal courts

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<sup>5</sup> Request Attachment A at 4.

<sup>6</sup> Request Attachment A at 3.

<sup>7</sup> Postal Service Reply at 8.

<sup>8</sup> Postal Service Reply at 5.

<sup>9</sup> Postal Service Reply at 9.

<sup>10</sup> Postal Service Reply at 13.

have repeatedly rejected attempts to define markets in terms of distribution methods when those methods are employed to distribute products that consumers consider equivalent.”<sup>11</sup>

The Postal Service wants the Commission to take a broad view of the market for the “provision of access to digitized entertainment.” Considering the many methods of distribution, and the number of players in this market, the Postal Service concludes that the market is highly competitive, and thus all of the players in this market (and their suppliers) are also competitive. With the full force of competition at work, no player in this market has the ability to raise prices, degrade service, or decrease output, without suffering declines in volume. The Postal Service repeatedly states that “the Postal Service is not market dominant in this product, and the product therefore should be added to the competitive product list.”<sup>12</sup> And the “Postal Service Does Not Exercise “Market-Dominance” with Respect to Round-Trip DVD Mailers.”<sup>13</sup> Simply repeating the position of the Postal Service is not sufficient to prove or construct the powers of the alleged competition in this market.

The Postal Service suggests that the Commission view its Request using the lens of federal antitrust principles. The approach suggested by the Postal Service is reasonable, but it has the burden of proof backwards. Instead of requiring the user of the mail (GameFly, NetFlix, CafeDVD, MMAVault, etc.) to show that the product is market-dominant, the burden of proof is on the Postal Service to show that the product does not have market power (even in the broadest possible market). The evidence provided by the Postal Service is scant.

1. The Supreme Court has declared that “[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.” *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962); see also *F.T.C. v. Whole Foods Mkt., Inc.*, 548 F.3d 1028, 1038 (D.C. Cir. 2008).
2. “GameFly’s protestations that current (remaining) demand for first-class mail is purportedly “inelastic” are not to the contrary. GameFly Comments at 11-

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<sup>11</sup> Postal Service Reply at 12.

<sup>12</sup> Postal Service Reply at 6.

<sup>13</sup> Postal Service Reply at 8

14. The only evidence that GameFly cites in support of this claim is a Postal Service study that found that the demand for first-class mail generally was inelastic. It may be true that the present demand for First-Class Mail—as a general, broad class of mail—is inelastic.”<sup>14</sup>
3. DVDs by mail are a small portion of the “provision of access to digitized entertainment” market, with Netflix accounting for a 24.3 percent market share of major service providers of physical media rentals of movies and games.<sup>15</sup> DVDs by mail account for 34 percent of Netflix’s revenue, or an 8.3 percent market share.<sup>16</sup>

The Postal Service has not provided an elasticity estimate for the DVD Round Trip Mailer product. It states that the First Class elasticity cannot be used, for that would suggest significant market power, but provides no alternative. The Postal Service cites the Supreme Court’s declaration that cross elasticity estimates between substitutes are important to determine the interchangeability to products, but no cross elasticity estimate is provided. The Commission needs to determine this important case on the facts. The Postal Service has provided only one fact regarding the “provision of access to digitized entertainment,” that it currently is a supplier to a company with roughly 10 percent market share (as an obscure combination of revenue and volume). The Postal Service has not explicitly stated this 10 percent figure, nor has it argued that 10 percent market share always implies a lack of pricing power.

To adequately assess the Postal Service’s place in a complex market, the Commission needs to ascertain if the Postal Service maintains pricing power. The Postal Service has significant pricing power over GameFly, as is detailed by the 4 year complaint docket. It is not clear how much pricing power the Postal Service exerts on NetFlix, but it has yet to exempt NetFlix from a Market Dominant price increase. NetFlix has steadily increased the price of discs by mail charged to consumers. The Postal Service hurts its own argument regarding the impact of competition when it states that the classification of the Round-Trip Mailer as competitive “could have severe negative

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<sup>14</sup> Postal Service Reply at 23.

<sup>15</sup> Postal Service Reply Attachment A at 2.

<sup>16</sup> Postal Service Reply Attachment A at 3.

consequences for the Postal Service.”<sup>17</sup> If competition restrains the ability of the Postal Service to increase the price of DVD mail, than the CPI cap should not be a problem. In fact, if competition limits the ability of the Postal Service to increase the price of DVD mail by the CPI cap, then including the DVD mail within Market Dominant First Class INCREASES the ability of the Postal Service to increase prices on all other mail. If the Postal Service plans on increasing the price of Round Trip DVD mail by more than the price cap, the protection of the competitive market is insufficient as compared to the PAEA CPI price cap.

The Commission’s determination in this docket is of the utmost importance. In the Postal Service’s filing, if the relevant product is changed from “DVD Round-Trip Mailers” to “Advertising mail” and the relevant market is changed from the “provision of access to digitized entertainment” to “provision of marketing materials,” the same document could be used to transfer almost all of the volume currently in the Postal Network to competitive products. The Postal Service appears to strongly believe that digital delivery and retail networks are sufficient competition to limit its pricing power.

In 2006, the PAEA introduced the CPI price cap to limit the prices charged by the Postal Service. The Postal Service appears to believe that sufficient market exist to mitigate the need for the CPI cap. This major issue deserves more exposition, thought, and fact than has been provided by the Postal Service in this docket.

Respectfully submitted,

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<sup>17</sup> Reply Comments at 24