

## **PUBLIC (REDACTED) VERSION**

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

COMPETITIVE PRODUCT LIST )  
ADDING ROUND-TRIP MAILER ) Docket No. MC2013-57  
)

COMPETITIVE PRODUCT LIST )  
ADDING ROUND-TRIP MAILER ) Docket No. CP2013-75  
(MC2013-57) )

### **SUPPLEMENTAL DECLARATION OF DAVID HODESS**

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September 12, 2013

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## **SUPPLEMENTAL DECLARATION OF DAVID HODESS (September 12, 2013)**

1. My name is David Hodess. I am President and CEO of GameFly, Inc., with offices at 6080 Center Drive, Los Angeles, California 90045. I testified in in Docket No. C2009-1 in 2010, and submitted a declaration in Docket Nos. C-2009-1, MC2013-57, and CP2013-75 on August 15, 2013.

2. I submit this supplemental declaration in response to the reply comments filed by the Postal Service in this case on August 22, 2013, including the supporting declaration of Mark Schoeman (Attachment A to the Postal Service's reply comments) and report by Jesse Chiang, an analyst for IBISWorld, a market research firm (filed by

the Postal Service as nonpublic Library Reference USPS-LR-MC2013-57-NP6). I respond in particular to the claims of these declarants that competition for the rental of DVDs from “digital entertainment content” available via streaming and downloading from the Internet, and DVDs available for rental from Redbox self-service kiosks, effectively constrains how much the Postal Service may charge GameFly and other DVD rental companies for carrying DVDs to and from consumers.

3. Based on my decade of experience as president and CEO of GameFly, I believe that these claims are incorrect. First, whatever competition exists between (1) DVD-by-mail and (2) content delivery from the Internet and Redbox does not constrain the price that the Postal Service can charge GameFly to deliver DVDs to and from consumers. Rather, GameFly will simply have to absorb any postal price increases by accepting smaller margins.

4. DVD rental companies have no countervailing buyer power over the price of their mail service because—as the USPS concedes—no other carrier delivers DVDs to and from households. USPS Request (July 26, 2013), Attachment A (Monteith Statement) at 3. To reach the core group of consumers who prefer the video entertainment or game content available on DVDs over the content available over the Internet or from Redbox kiosks, the Postal Service is the only game in town. Even the Postal Service ultimately concedes this: “Certainly, in the short term, GameFly may find it difficult simply to abandon mail delivery.” USPS reply comments at 24.

5. Let me assure that Commission that, if GameFly enjoyed any of the competitive alternatives that the Postal Service claims our company has, we would have long ago switched to another method of content distribution rather than spend the four-

plus years and hundreds of thousands of dollars in legal and consultant fees, and the diversion of management time and attention, that GameFly has been forced to spend in litigation with the Postal Service.

6. Second, and in any event, the Postal Service has also analyzed incorrectly the competition that GameFly and other DVD rental companies face in our own product markets. The Postal Service has treated these product markets as a single undifferentiated market for the “provision of access to digitized entertainment content for consumers” by *any* delivery channel, including the Internet (streaming and downloading) and the Redbox network of self-service kiosks. This broad market definition is inappropriate for the core group of consumers that have chosen to continue renting DVDs by mail from GameFly. These customers have confirmed by their actions that they do not consider the content available via the Internet or Redbox an acceptable substitute for the extensive library of high-performance, multi-gigabyte console video games offered on rental DVDs by GameFly. These customers, not the ones that have migrated to the Internet or Redbox, or never rented DVDs in the first place, define the relevant product markets for determining the competition faced by DVD rental companies.

7. As I explained in my August 15 declaration, the availability of video games through the streaming or downloading from the Internet proves nothing about their substitutability for DVD-by-mail for the core group of consumers that have chosen to continue subscribing to video games offered for rental by GameFly through DVD-by-mail. Video game streaming requires a high-speed broadband Internet connection and the installation of specialized equipment. Bandwidth limitations and interruptions cause

undesirable latency (i.e., delay in the computer's response) when the games are played. Adapting console games for streaming requires extensive recoding—at the publisher's expense. Content creators are reluctant to license video games for streaming, a problem that the First Sale Doctrine obviates for games on DVDs. Likewise, the First Sale Doctrine does not cover resale of streamed content, a fact that greatly burdens the economics of licensing content for streaming, and eliminates the potential recovery of any of this investment by reselling the game when it is retired from rental service. Furthermore, entering the streaming business on a national scale would require huge capital investment. For all of these reasons, streaming is not a viable alternative to DVD-by-mail rental for the large library of complex, graphics-rich console games that GameFly's rental subscribers demand.

8. The downloading of the high-powered video games available for consoles on DVDs faces similar obstacles. The file size of many console games causes very long downloading times, creates storage problems, and requires the use of a PC with above-average processing power. Many console games are unavailable in PC format. Content developers are unwilling to license many games for downloading, an issue obviated for DVDs by the First Sale Doctrine. Finally, the failure of the First Sale Doctrine to cover resale of downloaded content greatly burdens the economics of licensing content. For these reasons, downloading is not a viable alternative to DVD-by-mail rental for the large library of complex, graphics-rich console games that GameFly's rental subscribers demand.

9. The Postal Service's August 22 comments largely ignore these problems, and the resulting segmentation of the market for video games between consumers who

demand a large selection of data-intensive console games (many of which can be rented only by mail), and consumers who are satisfied with the games that are available from other distribution channels.

10. Mr. Schoeman's claim that consumers do not need expensive specialized equipment to play streamed games (Schoeman Decl. at 10) is uninformed. Achieving the full potential experience of a console game requires a large TV that supports PC functionality and a specialized wireless controller. Moreover, because PC games are not made for controllers, they cannot be used without substantial recoding of the software, a costly task that publishers perform for only a limited number of titles.

11. While Mr. Schoeman notes correctly that the average rated speed of broadband connections has been increasing, he offers no evidence that "gamers" have faster-than-average connection speeds. Schoeman Decl. at p. 11-12. Moreover, broadband providers often throttle down actual broadband speeds to levels much slower than the rated speeds. See GameStop Form 10-K for FY 2012 at p. 17 (although "downloading technology is becoming more prevalent and continues to evolve rapidly," downloading is still "constrained by bandwidth capacity.").

12. Mr. Schoeman claims that GameFly has overstated the actual file sizes of downloadable games. Schoeman Decl. at 12. This is incorrect. While console games can be smaller, the PC versions of the games—i.e., the downloadable versions—are typically quite large. The current PC versions of Total War: Rome II, Max Payne 3, and BioShock Infinite, for example, have files of 35 gigabytes, 32 gigabytes and 30 gigabytes, respectively.

13. Mr. Schoeman's observation that downloading delivers games faster than First-Class Mail (Schoeman Decl. at 12) is true but meaningless. As previously noted, most customers who prefer to play data-intensive console games do not consider downloadable PC games to be adequate substitutes.

14. While it is true that many PC games can be downloaded (Schoeman Decl. at 12), PC games are *not* identical to DVD console games (*cf.* Schoeman Decl. 10). The PC game library differs considerably from the console game library. Among other differences, PC games are often released months after the console version. For example, the console version of the current release of Grand Theft Auto, a popular console game, will be released on September 17. The release date for the PC version has yet to be announced.

15. The bulk of Mr. Schoeman's declaration is a series of citations to press releases, news stories, and other items purportedly identifying games, game equipment or vendors that supposedly have entered, or are about to enter, the business of distributing video games by streaming or downloading. USPS Reply Comments at 18, 24; Schoeman Decl. at 2-13. Analysis of these companies and products reveals, however, that most of them (1) are still vaporware, (2) have entered the market but failed to achieve commercial success, or (3) are not regarded by GameFly's DVD rental customers as acceptable substitutes for high-powered console video games.

16. **CiiNow:** CiiNow is a privately-held company that is currently partnering with various operators, publishers and distributors to test streaming games. Despite issuing multiple press releases touting these partnerships, CiiNow has had no

commercial success, and has released only a handful of titles, most of them still in the testing stage.

17. **Gaikai:** Before being acquired by Sony, Gaikai used its streaming technology as a demo platform. Gaikai did not offer streaming of full games as part of its business model. Since the acquisition, Sony has announced that its PlayStation 4 console will use Gaikai's streaming technology for demos. Since PlayStation4 has not yet launched, however, it is impossible to predict how it might use Gaikai, what content the company will offer commercially, or how consumers will respond. At this point, the competitive significance of Gaikai is speculative.

18. **GameFly (Direct2Drive):** GameFly acquired Direct2Drive to supplement GameFly's downloadable PC games business. (Direct2Drive did not provide video game streaming.) Direct2Drive has been rebranded and absorbed into GameFly. Few users of DVD console games, however, regard downloadable PC games as good substitutes for console games on DVDs. Indeed, only 6.5 percent of current GameFly DVD-by-mail subscribers have ever bought a PC download game from GameFly.

19. **GameStop:** GameStop is the largest *seller* of DVD console games in the United States. Although GameStop offers some casual games through its Kongregate division and PC games for download through its Impulse acquisition, and is testing streaming through Spawn Labs, the company believes that the "digital transition" is "overhyped," and the "vast majority of content will remain on discs." Bank of America analyst report on GameStop (July 24, 2013) at 1. In a recent meeting with investment analysts, the CEO and president of the company gave three reasons for this conclusion: "(1) gamers place a value on trade-in which is no available digitally; (2) bandwidth



speeds are too slow; and (3) content discoverability is still lacking on gaming networks.” *Id.* “Ultimately, [GameStop] believes content delivery will be determined by consumers and at the moment digital is not a high priority.” *Id.* In the fiscal year that ended on February 2, 2013, GameStop and its subsidiaries earned only \$630 million in revenue from the company’s so-called digital products category (which actually includes downloadable content (“DLC”) and other products in addition to games). Even the aggregate \$630 million figure amounts to only about seven percent of GameStop’s net consolidated sales. GameStop Form 10-K for year ending February 2, 2013 at 6 & 37.

20. **G-cluster:** G-cluster is a privately-held Finnish cloud gaming provider that is currently teaming up with various publishers, distributors and operators to test games through a streaming service. G-cluster offers some popular console titles, but most of its games are aimed at the mobile and casual markets. G-cluster has a small commercial business in Europe and Asia, but no commercial presence in the United States.

21. **Impulse:** Impulse was a company that offered games for downloading. GameStop bought Impulse from Spawn Labs, integrated Impulse’s digital offerings into GameStop’s site, and then shut down the separate Impulse desktop client. According to GameStop, the “downloadable content typically available today [from GameStop] consists of add-on content developed by publishers for *existing* games.” GameStop Form 10-K for FY 2012 (March 2013) at 14.

22. **Kongregate:** Kongregate is a division of GameStop that offers casual flash games to be played online. Subscribers to DVD-by-mail console games do not

regard online casual games as good substitutes. GameStop Form 10-K for the year ending Feb. 2, 2013 ((March 25, 2013) at 4:

Casual games are generally defined as simple, easy-to-use, free or very low-priced games played through the internet in Web browsers, on dedicated gaming Web sites or on mobile phones or other mobile devices. Casual games cost less to develop and distribute than a traditional console video game and are often supported by in-game advertising or user-purchased premium content. The typical casual gamer is predominantly female and older than a traditional console video game player.

23. **Microsoft Xbox.** The Xbox is Microsoft's primary DVD-based console game. Mr. Schoenfeld states that the Xbox supports downloadable video games, and that a Microsoft digital distribution site, Xbox Live Marketplace, offers "hundreds of downloadable games." Schoeman Decl. at 10-11. In fact, the catalog for full games available for downloading from the Xbox Live Marketplace is still limited, and the primary purpose of the Xbox Live Marketplace is to facilitate the purchase of downloadable add-on content for DVD-based games.

24. Microsoft provides a telling example of the distaste of most console gamers for other game formats. As originally announced, Microsoft's next generation game console, the Xbox One, the Xbox would have required a live connection to the Internet to play DVDs and limited console gamers' ability to share games or trade them in. These proposed requirements set off a firestorm of criticism by console gamers, and Microsoft was forced to abandon these changes. Andrew Goldfarb, "Xbox One Will Not Require Internet, Restrict Used Games," IGN (June 19, 2013) ([www.ign.com/articles/2013/06/19/microsoft-reversing-xbox-one-internet-used-game-policies](http://www.ign.com/articles/2013/06/19/microsoft-reversing-xbox-one-internet-used-game-policies)); Ben Gilbert, "Microsoft reverses Xbox One DRM policy, kills required online

check-in and used game complications,” Engadget (June 19, 2013) ([www.engadget.com/2013/06/19/xbox-one-drm-used-games-reversal/](http://www.engadget.com/2013/06/19/xbox-one-drm-used-games-reversal/)).

25. **OnLive:** OnLive laid off all of its employees in August 2012 and was sold for \$4.8 million after burning through \$500 million in cash. GameFly Comments at 25-26; Hodess Decl. ¶ 29. Whether the purchasers of the company’s assets will succeed in reviving operations is unclear. The successor owners have released only two console games since February, and none since the end of June. The other five releases in 2013 have been casual games.

26. **Panasonic VIERA.** Mr. Schoeman claims that “Panasonic has numerous video games available for download to televisions through their VIERA program.” Schoeman Decl. at 10. The next two sentences in his declaration, which appear to be a comment that he neglected to delete when finalizing the document, are more accurate: **“There are only 42 games on the site. Is this the best example?”** *Id.* (emphasis added) The VIERA site offers only casual games, which most consumers who play DVD console games do not consider to be good substitutes (“reasonably interchangeable”). See [http://panasonic.net/avc/viera/global/connect\\_apps/category/4/0/](http://panasonic.net/avc/viera/global/connect_apps/category/4/0/).

27. **Spawn Labs:** Spawn Labs is a wholly-owned subsidiary of GameStop the company purchased in March 2011. GameStop has stated that Spawn Labs “is developing a streaming service which the company *may* deploy in fiscal 2013 depending on consumer demand and other factors.” GameStop Form 10-K for year ended February 2, 2013 at 12 (emphasis added). As of today, Spawn Labs has achieved no commercial success.

28. **Steam:** Steam is the leading distributor of downloadable PC video games. Steam does not, however, offer downloading to video game consoles.

29. **Twitch:** Twitch is a video platform that allows gamers to broadcast, watch and chat about games. These activities involve spectatorship, not actual playing. Twitch is not “web based game delivery,” and has nothing to do with actual gaming. *Cf.* USPS reply comments at 24 with <http://www.twitch.tv/p/about>.

30. **Valve:** Valve is a game publisher that also operates the Steam PC game download service. Contrary to Mr. Schoeman’s belief, Valve does not offer streaming.

31. The bottom line is that streaming and downloadable games, for all of their recent hype, are still regarded by the core subscribers to GameFly rental DVDs as poor substitutes for the data-intensive DVD console games that those consumers like to play. Objective confirmation of this fact appears in the surveys that GameFly periodically takes of subscribers who cancel. **[BEGIN GAMEFLY PROPRIETARY]**

32.

**[END GAMEFLY PROPRIETARY]**

33. For similar reasons, the consumers who rent DVDs by mail from GameFly do not regard the video games available at self-service kiosks as adequate substitutes. The availability of a small selection of video games through Redbox self-service kiosks proves nothing about the substitutability of those games for the core group of consumers that have chosen to continue subscribing to video games offered for rental by GameFly through DVD-by-mail.

34. First, self-service kiosks are too small to hold more than a tiny fraction of GameFly's product catalog, thereby foregoing one of GameFly's biggest selling points for its core customer base. GameFly Comments at 28; Hodess ¶ 18.

35. The limited substitutability of kiosks is confirmed by GameFly's unsuccessful experience in deploying this alternative channel, and by Redbox's policy of devoting only a small share of its limited kiosk capacity to video games. GameFly Comments at 28-29 ¶¶ 17-18.

36. A spot check of some Redbox locations in the Los Angeles and the Washington DC areas revealed the following breakdown between video entertainment DVDs and video game DVDs:

Redbox Location	Movie Titles in Kiosk	Game Titles in Kiosk
Walmart, 701 W. Cesar E. Chavez Avenue, LA	287	0
Ralph's, 645 West 9 <sup>th</sup> Street, LA	310	22
7-Eleven, 1800 W. Olympic Boulevard, LA	221	17
Food 4 Less, 4910 Huntington Drive South, LA	203	23
Walgreens, 5451 W Sunset Boulevard, LA	293	10
CVS Pharmacy, 3751 Wilshire Boulevard, LA	333	19
Ralphs (indoor), 15120 W Sunset Blvd, Pacific Palisades	296	21
Vons (indoor), 29211 Heathercliff Road, Malibu	319	4
Ralphs (indoor), 30019 Hawthorne Blvd., Palos Verdes Peninsula	262	0
Ralphs (indoor), 2700 N Sepulveda Blvd, Manhattan Beach	447	23
Walgreens, 807 7 <sup>th</sup> St., NW, DC	254	15
Safeway, 490 L St., NW, DC	304	16
Capitol Supermarket, Kiosk A, 1231 11 <sup>th</sup> St, NW, DC	225	17
U.S. Navy, Kiosk A, Room 2E1087, The Pentagon	195	51
7-Eleven, 514 19 <sup>th</sup> St., N.W., DC	219	19

GameFly, by contrast, has approximately **8,000** game titles in its catalog. If Redbox were truly successful in distributing console games, they would be much more heavily represented in the inventories of Redbox kiosks.

37. The Postal Service suggests in its reply comments that GameFly faces competition from Amazon and other Internet retailers that offer video games for *sale*. USPS reply comments at 17, 18. It is true that Amazon and several other companies (including the game manufacturers) offer game DVDs for sale. So do GameStop (the largest seller of video games) and GameFly. Rental and sales, however, are largely

distinct markets. The reason is cost: a new video game costs up to \$60 new at retail. Many players of console video games prefer to rent rather than buy certain games. This enables the consumer to play a wide variety of games at a much lower cost than buying them all. Stated otherwise, rental and sales are complements for GameFly's core group of subscribers: the vast majority of the company's subscribers do both. A typical subscriber buys a core collection of perhaps 3-5 games in a given year, and plays another 15-20 games by renting.

38. Finally, I want to respond to the Commission about the Postal Service's suggestion that the analysis in my August 15 declaration of the Postal Service's market power is "simplistic," "unfounded and unsupported by reputable industry leaders," "factually inaccurate," "weak," "analytically flawed," or a "mischaracterization of the market." USPS Reply Comments at 5, 11; USPS Opposition to GameFly Motion for Relief (August 30, 2013) at 2, 5, 6. I do not take comments like these personally; I have worked enough with lawyers to realize that litigators often use poetic license. Given the technical nature of the issues that the Postal Service has raised, however, the relative qualifications of the supposed experts on each side may have more than usual importance.

39. On my own credentials, I will note only that I have spent ten years as the President and CEO of the largest subscription video game rental company in the United States. During my tenure, GameFly, the company has purchased more than seven million console games, and shipped more than 50 million console games to over three million consumers. GameFly has delivered the goods and services it promised to its customers, provided hundreds of jobs for the company's employees, safeguarded the



capital invested by its investors, and generated a positive return to its shareholders in a competitive and rapidly evolving industry. Moreover, we have accomplished all of this despite the handicap of the price and service discrimination by the Postal Service throughout this period.

40. The individuals offered as witnesses by the Postal Service, Mr. Chiang and Mr. Schoeman, appear to possess no comparable expertise. Neither one is employed by a firm that engages in the sale or rental to consumers of DVDs or any other form of “digital entertainment content.” Neither individual appears to have any discernible knowledge, skill, experience, training or education in the specialized matters at issue here.

41. **[BEGIN USPS PROPRIETARY]**



**[END USPS PROPRIETARY]**

47. Mr. Schoeman, the Postal Service's other purported "industry expert," has no apparent training or experience in video entertainment, movies, TV content or distribution, video games or content distribution over the Internet, or antitrust law or economics. This lack of expertise shows in Mr. Schoeman's sources. His primary source is the IBISWorld report; Mr. Schoeman cites it 16 times in his declaration, more than any other individual source. The rest of Mr. Schoeman's declaration is a hodgepodge of snippets about the filmed entertainment and video game industries that he appears to have scavenged from the Internet. His sources consist largely of brief news reports by anonymous or uncredentialed authors, corporate press releases, postings on Internet discussion boards by anonymous or uncredentialed individuals, web blogs by anonymous or uncredentialed individuals (see, e.g., Schoeman Decl. at 9 n. 13 (<http://popcultureatemyonkey.com>)), and other items of uncertain provenance. None of these sources appear to have been filtered or screened by Mr. Schoeman for relevance or reliability.

48. Mr. Schoeman's ignorance of his subject is also revealed by his opinions and conclusions. Anyone with even a passing knowledge of the video game industry, much less actual expertise, would not have:

- Declared that *World of Warcraft*, a game whose GAAP revenues peaked in the first quarter of 2011 and have declined ever since, is "growing in popularity." Schoeman at 8.

- Been unaware that GameStop shut down the Impulse service. Schoeman at 4, 5, 9.
- Been unable to differentiate the characteristics of the casual game market (e.g., Kongregate) from the console and PC game markets. Schoeman at 4, 9.
- Cited Gaikai, OnLive, Ciinow and G-cluster as successful examples of streaming when, in fact, none is commercially viable. Schoeman at 5, 9, 11, 13.
- Repeatedly portrayed streaming and cloud gaming as separate markets when, in fact, they are identical. Schoeman at 2 (“These channels are physical delivery by mail, streaming, online downloads, the cloud, kiosks, and retail chains.”); *id.* at 2 (“the physical distribution of movies and games competes with streaming, downloads, the cloud and kiosks”); *id.* at 7 (“Streaming, the cloud, online downloads, and on-demand services are the next iteration of digital entertainment products.”); *id.* at 9, lines 5-10 (discussing digital downloading and streaming) vs. *id.* at 9, lines 11 (“Clouding [sic] gaming is another form of digital distribution.”).
- Portrayed Twitch as a video game service, when in fact it only allows consumers to watch videos of previously played games. USPS reply comments at 24 (citing Schoeman Decl.).

49. Further declarant sayeth not.

## VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct. Executed on September 11, 2013.



A handwritten signature in blue ink is written over a horizontal line. The signature is cursive and appears to read "D. J. H. S.".