Postal Regulatory Commission
Submitted 12/26/2013 8:00:00 AM
Filing ID: 88648
Accepted 12/26/2013

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 PRICES ROUND-TRIP MAILER (MC2013-57)	))	Docket No. CP2013-75

SUPPLEMENTAL COMMENTS OF GAMEFLY, INC.
ON USPS PROPOSAL TO RECLASSIFY DVD MAILERS
AS COMPETITIVE PRODUCTS

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September 12, 2013
(refiled December 26, 2013)

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(September 12, 2013)

Pursuant to Order No. 1827, GameFly, Inc. respectfully submits these comments on the Postal Service's August 22 reply comments in support of its request to transfer round-trip DVD mailers from the market dominant product list to the competitive product list under 39 U.S.C. § 3642.

INTRODUCTION AND SUMMARY

The additional material filed by the Postal Service on August 22 has merely highlighted the gaps in the Postal Service's case. Indeed, the filing raises the question of whether competition from the Internet, and similar forms of competition in the end markets of the Postal Service's customers, should *ever* be accepted as justification for reclassifying a mail product as competitive under 39 U.S.C. § 3642(b)(1).

The Postal Service's case may be summarized as follows:

- There admittedly is no competition for the delivery of DVD mail to and from households by competing private carriers such as UPS or FedEx ("intramodal" competition).

- The price of DVD mail is, however, constrained by *product* competition. Netflix, GameFly, and smaller DVD rental companies face competition from a broad product market that encompasses not only DVDs delivered by mail, but also 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 product competition not only constrains what Netflix, GameFly and their smaller peers may charge consumers to rent DVDs by mail, but also indirectly constrains what the Postal Service may charge Netflix, GameFly and their smaller peers for transporting and delivering those DVDs.

- In any event, even if the Postal Service has some market power over the price of DVD mail, the Postal Service will refrain from raising the price high enough to force the DVD rental companies out of business.

USPS Reply Comments at 6-24; *id*. at Attachment A (Declaration of Mark Schoeman) ("Schoeman Decl."); USPS Library Reference USPS-LR-MC2013-57-NP6 (Jesse Chiang, *DVD, Game & Video Rental in the US*, IBISWorld Industry Report 53223 (June 2013)) ("Chiang Report").

There are several major flaws in this reasoning. The first is the Postal Service's assumption that product competition for DVD-by-mail will in turn constrain the price that the Postal Service can charge Netflix, GameFly and other DVD rental companies for delivering DVDs to and from consumers. The Postal Service simply *assumes* that this premise is valid ("economic theory suggests"). The proposition, however, is not self-evident, and the Courts of Appeals have made clear that it must be proven, not just assumed, whenever a regulated carrier relies on downstream product competition to show that its own rates are effectively constrained by competition. In fact, all available evidence indicates that product competition for DVDs-by-mail, to the extent effective, will simply force DVD rental companies to absorb any postal price increases by accepting smaller margins. The ability of the Postal Service to capture its customers' rents in this way is a hallmark of market dominance, and is an independent reason that maximum rates of postage on DVD mail may not be deregulated under 39 U.S.C. § 3642(b). Indeed, the Postal Service's failure of proof on this issue, and the inherent difficulties of evaluating product competition in cases of this kind, warrant seriously considering the adoption of a categorical rule that evidence of product competition will not be considered in product transfer cases under Section 3642(b)(1).

Second, the absence of effective competition for DVD *mail service* (as opposed to the DVDs themselves) is underscored by the Postal Service's own price elasticity data. The data indicate that the demand for the categories of First-Class Mail used for DVDs is price inelastic, and that a significant increase in the price of DVD mail would be profitable for the Postal Service. This fact has devastating implications for the Postal Service's case, since the presence of effective competition, of any kind, should make the demand for a mail product too price-sensitive for a price increase to improve the Postal Service's net contribution. The Postal Service has no coherent response.

Third, even if (contrary to fact) proof of effective competition for video entertainment and game DVDs from the Internet and Redbox could suffice to establish that the Postal Service is effectively constrained from raising the price of *carrying* the DVD mail, the Postal Service has failed to prove that DVDs face effective competition from the Internet and Redbox. In analyzed the downstream competition for rental DVDs, the Postal Service has lumped together the product markets in which DVD rental companies compete into 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 Netflix and GameFly. These customers have confirmed by their marketplace behavior that they do not consider the content available via the Internet or Redbox an acceptable substitute for the enormous catalog of video entertainment offered on rental DVDs by Netflix, or 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, define the relevant product markets for determining the competition faced by DVD rental companies.

Fourth, the non-competition policies advanced by the Postal Service as grounds for deregulating the maximum price of DVD mail are factually unsupported and legally irrelevant. The Postal Service argues that deregulating the maximum price of DVD mail, and allowing the Postal Service to increase its price faster than inflation, would benefit the public by (1) inducing DVD mailers to innovate more, thereby “better embody[ing] the process of creative destruction”; (2) allowing the Postal Service to negotiate special deals with individual DVD rental companies; and (3) allowing the Postal Service to recover its costs more effectively by raising the price of DVD mail above the rate of inflation without drawing on the Postal Service’s aggregate CPI cap authority. These supposed public policy benefits are legally irrelevant: the only question legally before the Commission under Section 3642(b)(1) is whether the Postal Service has market power over DVD mail. The Postal Service’s invocation of the first and third of these benefits, however, gives away the game. The necessary premise of both of these “benefits” is that the Postal Service can make more money by raising the price of DVD mail. *That* is the textbook definition of market power.

ARGUMENT

I. THE POSTAL SERVICE HAS FAILED TO SHOW THAT COMPETITION FOR THE ENTERTAINMENT CONTENT OF RENTAL DVDS, EVEN IF EFFECTIVE TO CONSTRAIN THEIR DELIVERED PRICE, WOULD EFFECTIVELY CONSTRAIN THE PRICE OF THE MAIL INPUT SUPPLIED BY THE POSTAL SERVICE.

The Postal Service’s case for deregulation of maximum rates on DVD mailers founders on a crucial threshold issue that the Postal Service has largely ignored: whether the competition from the Internet and Redbox for rental DVDs delivered by mail (i.e., the product offered by DVD rental companies in *their* end markets) would constrain the price of the mail *input* supplied by the Postal Service. The importance of this issue stems from the indirect nature of the asserted competition on which the Postal Service relies. As the Postal Service concedes, no private carrier such as UPS or FedEx competes with the Postal Service to deliver rental DVDs to and from households. USPS Request, Attachment A, Monteith Statement at 3. Instead, the Postal Service asserts that its prices are constrained by competition between DVDs-by-mail, the *delivered product* at issue here, and digital entertainment content available via the Internet and self-service kiosks. A critical premise of this reasoning is that the competition for the end product (DVDs-by-mail) will actually constrain not only the price of the delivered goods (i.e., the rental DVDs) but also the price of the Postal Service's mail *input*.

The case law makes clear that this link must be proven, not merely assumed. GameFly comments at 23 (citing *Coal Exporters Ass'n of United States v. United States*, 745 F.2d 76, 84-85, 93, 95, 99 (D.C. Cir. 1984) (citations omitted; emphasis added), and *General Chemical Corp. v. United States*, 817 F.2d 844, 854 (D.C. Cir. 1987)). As the D.C. Circuit explained in *Coal Exporters Association*, 745 F.2d at 85:

> Even if there is a "price cap" [imposed by product or geographic competition] that prevents raising the delivered price of export coal, a railroad could still use monopoly power to raise rates to coal shippers and appropriate to itself an unreasonable portion of the profits generated by each shipment. Because of the cap [on delivered prices for coal imposed by product or geographic competition], a captive shipper would be forced to lower its share of the total coal revenues if confronted with a rail rate increase. Although the existence of a world price cap for delivered U.S. coal means that foreign consumers will not have to pay a higher price, it does not assure that the division of revenues between the railroads and U.S. shippers will be a reasonable one.

To a similar effect is *Telecor Communications, Inc. v. Southwestern Bell Telephone Co.,* 305 F.3d 1124 (10th Cir. 2002). In that case, independent pay phone service providers brought an antitrust action against Southwestern Bell for monopolizing the market for locations where pay phones could be installed. Southwestern Bell argued that the product market should be evaluated from the perspective of consumers of phone services, and should therefore include both pay phones and cell phones, which Southwestern Bell argued were reasonably interchangeable for consumers. *Id.* at 1129. The Tenth Circuit rejected that argument, holding that regardless of the interchangeability of pay phones and cell phones for *end users*, pay phones and cell phones are not interchangeable for the owners of locations that might be rented to telephone companies for pay phones ("location owners"). "Although Southwestern Bell is correct that antitrust laws were 'especially intended to serve consumers,' that hardly suffices to prove that a monopolist may act with impunity so long as end-use consumer prices are unaffected." *Id.* at 1133.

The Postal Service, instead of offering evidence to support this critical premise, simply *asserts* that it holds. The Postal Service *asserts* that competition for the delivered DVD product will effectively constrain the price of the postage. USPS Reply Comments at 9-10. The Postal Service *asserts* that GameFly and Netflix would try to "pass part or all of that cost increase onto consumers," that "economic theory suggests they would," and that the Postal Service's net profits would decline as a result. *Id*. at 20-21. Finally, the Postal Service *asserts* that Netflix and GameFly could exercise countervailing monopsony power (i.e., buyer monopoly power), or "may decide to simply shift to newer and more popular delivery methods." *Id*. at 22-23.

In fact, “economic theory suggests” none of these things. 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.[1]

All four of the DVD rental companies that have commented on the product transfer—including the largest, Netflix—have expressed concern that deregulation of the price of DVD mail would force DVD rental companies to absorb postal rate increases. *See* Netflix Form 10-K report for 2012 at 10 (“We rely exclusively on the U.S. Postal Service to deliver DVDs from our shipping centers and to return DVDs to us

[1] The Postal Service gains nothing by speculating that changes in technology or market conditions may enable DVD rental companies to “shift [their] business model over the medium- and long-term.” USPS reply comments at 24. The “medium- and long-term” are irrelevant: the Postal Service is asking the Commission to exempt DVD mail from maximum rate regulation now. *See also Coal Exporters Ass’n*, *supra*, 745 F.2d at 88 (ICC could not base finding of effective competition on the potential entry of coal slurry pipelines that had not yet been built); *United States v. Microsoft,* 253 F.3d 34, 51-54 (D.C. Cir. 2001) (*per curiam*) (rejecting Microsoft’s claim that, “because middleware could usurp the operating system's platform function and might eventually take over other operating system functions (for instance, by controlling peripherals), the district court erred in excluding Navigator and Java from the relevant market”; the test of “reasonable interchangeability . . . required the District Court to consider only substitutes that constrain pricing in the reasonably foreseeable future, and only products that can enter the market in a relatively short time can perform this function.”).

from our subscribers. Increases in postage delivery rates could adversely affect our Domestic DVD segment's contribution profit."); *accord*, GameFly comments at 22-23, 29; Hodess Decl. ¶¶ 19, 32, 43; Hodess Supp. Decl. ¶¶ 3-5; *see also* CafeDVD comments (August 22, 2013); MMAVault comments (August 22, 2013). In this regard, GameFly agrees with the Postal Service's observation that industry perceptions of markets and competition should be given considerable weight. USPS reply comments at 15; *see also Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 219 (D.C. Cir. 1986) ("The industry or public recognition of the submarket as a separate economic unit matters because we assume that economic actors usually have accurate perceptions of economic realities"); *FTC v. Staples*, 970 F. Supp. 1066, 1079 (D.D.C. 1997) (quoting *FTC v. Coca-Cola Co.*, 641 F.Supp. 1128, 11332 (D.D.C. 1986)) ("Analysis of the market is a matter of business reality—a matter of how the market is perceived by those who strive for profit in it.").

Finally, the Postal Service gains nothing from its fallback argument that the Postal Service, even if it has some market power over the DVD rental companies, has an incentive not to charge them so much that they reduce their sales or exit the market. USPS reply comments 23. This is essentially the same argument that the railroad industry advanced, and the Interstate Commerce Commission accepted, in a closely analogous case involving the extent of the railroads' market power over the transportation of Appalachian coal to Hampton Roads, Virginia, for export:

> [S]o long as coal shippers are not forced to reduce production (i.e., so long as the rail rate leaves them with a share of the revenue that covers their costs, including their costs of capital), and so long as they are not wholly excluded from any economic rents above that level, their rate is "reasonable" and there is no "abuse of market power."

Coal Exporters Ass'n, *supra*, 745 F.2d at 93-94 (summarizing ICC position). The D.C. Circuit rejected the ICC's position as an "unreasonable" interpretation of the statute. *Id*. at 99. The ICC standard, the court noted, effectively "views the distribution of economic rents between carriers with market power and shippers to be largely a matter of regulatory indifference, so long as shippers get some bare minimum," even though "the situation envisioned would be one in which market power would exist and indeed determine the distribution of rents." *Id*. at 95. Under this standard, "any shipper bargaining power, over a bare minimum, is legally sufficient." *Id*. The court unsurprisingly struck down the ICC's approach on the ground that it "largely ignores the protections Congress meant to guarantee shippers." *Id*. at 99. The same conclusion is warranted here.

* * *

The Postal Service's failure of proof on this issue raises the broader question of whether the Commission should *ever* accept evidence of downstream competition in postal customers' markets as evidence of effective competition sufficient to justify a product transfer under Section 3642(b)(1). Experience with similar claims of product competition by railroads under the Interstate Commerce Act taught that product competition alone, in the absence of effective direct competition from a competing carrier between the same origins and destinations, was rarely if ever found in adjudicated cases to be effective to protect ratepayers from the appropriation of monopoly rents by the incumbent carrier. For this and related reasons, the Surface Transportation Board, after nearly two decades of experience adjudicating product competition claims under 49 U.S.C. § 10707(a), a counterpart of 39 U.S.C. § 3642(b), adopted a categorical rule excluding consideration of product competition in market dominance cases. *Market Dominance Determinations*, 3 S.T.B. 937 (1998), on reconsideration, *Market Dominance Considerations—Product and Geographic Competition*, 4 S.T.B. 269 (1999), on further reconsideration, *Market Dominance Determinations—Product and Geographic Competition*, 5 S.T.B. 492 (2001). In reaching this result, the STB found that consideration of indirect forms of competition has "impose[d] substantial burdens on both the parties and this agency"; had generated costly discovery and frequent discovery disputes; and had forced the agency to "address matters outside of our areas of expertise," 5 S.T.B. at 493-94, and "delve deeply" into "esoteric" aspects of "industrial operations that are far removed from the transportation industries that we oversee," 4 S.T.B. 276; *see generally*, 4 S.T.B. at 274-277.

The STB also found "unlikely that a shipper with obvious product or geographic competition alternatives would pursue a costly and time consuming rate complaint before the Board, because either the railroad would keep its rates at reasonable levels or the shippers would take advantage of the alternatives available to them." 5 S.T.B. at 494; *see also Ass'n of American Railroads v. STB*, 237 F.3d 676, 680 (D.C. Cir. 2001) (noting that the experience of the ICC and the STB since the ICC began considering product and geographic competition in 1981 has "confirmed" the "court's prediction" in 1978 that "administrative delay . . . would inevitably result from litigating 'the highly complex issues of geographic and project competition").

On judicial review, the D.C. Circuit affirmed. *Ass'n of American Railroads*, *supra* (remanding case for reconsideration of an issue of statutory interpretation), on remand, *Market Dominance Determinations—Product and Geographic Competition*, 5 S.T.B. 492 (2001), *aff'd*, *Ass'n of American Railroads v. STB*, 306 F.3d 1108 (D.C. Cir. 2002). Since then, product competition has been deemed irrelevant in railroad market dominance cases.

The Commission has ample basis to adopt a similar categorical exclusion of product competition under 39 U.S.C. § 3642(b). Nothing in Section 3642(b)(1) requires the Commission to consider product competition. The instant product transfer proposal has "impose[d] substantial burdens on both the parties and this agency," and threatens to require the Commission, like the STB, to resolve complex technical "matters outside of [its] areas of expertise," such as the video game performance characteristics demanded by players of video games, and the technical requirements for streaming and downloading video games. Finally, to paraphrase the common-sense observation of the STB in 2001, it is "unlikely that a [mailer] with obvious product or geographic competition alternatives would pursue a costly and time consuming rate complaint before the [Commission], because either the [Postal Service] would keep its rates at reasonable levels or the [mailers] would take advantage of the alternatives available to them." If any of the competitive alternatives conjured up by the Postal Service in its August 22 reply comments were in fact available to GameFly, the company would have long ago switched to another method of content distribution rather than squander the four-plus years and hundreds of thousands of dollars that GameFly has spent in litigation with the Postal Service. Hodess Supp. Decl. ¶ 5.

GameFly does not ask the Commission to adopt such a general exclusionary rule in this docket. The present litigation has continued too long already, and consideration of a general rule is better suited for a notice-and-comment rulemaking. But the existing record provides ample basis for the Commission to find that, at least in *this* case, the Postal Service has failed to establish that competition for rental DVDs in consumer end markets effectively constrains the price of round-trip DVD mail. This failure of proof by itself requires denial of the product transfer request.

II. THE POSTAL SERVICE'S OWN PRICE ELASTICITY DATA CONFIRM THE ABSENCE OF EFFECTIVE COMPETITION FOR THE MAIL INPUT SUPPLIED BY THE POSTAL SERVICE.

The ineffectiveness of the product competition relied on by the Postal Service is underscored by the available elasticity data. The ultimate question in this case, the parties agree, is whether the Postal Service could profitably raise the price of DVD mail. GameFly Comments (Aug. 15, 2013) at 5-6 (citing cases); *accord*, USPS Reply Comments (August 22, 2013) at 6-7 (citing cases). The answer appears in the own-price elasticity of demand for round-trip DVD mail. GameFly Comments at 7; USPS Reply Comments at 23-24.

The own-price elasticity data published by the Postal Service a few months ago for First-Class Mail, if remotely close to accurate, establish an overwhelming presumption that the Postal Service has market dominance over DVD mail. GameFly Comments at 11-14. The data indicate that the demand for every category of First-Class Mail in which DVD mail is entered is highly price inelastic:

First-Class Mail Single-Piece Letters and Cards:	- 0.090
First-Class Mail Workshared Letters, Cards, and Flats:	- 0.392

First-Class Mail Single-Piece Flats	- 0.265

Id. at 11 (citing USPS sources). These elasticity values imply that a ten percent price increase for these First-Class products would cause volume to decrease by only 0.9 percent, 3.92 percent, and 2.65 percent, respectively. The net result of the price increase would be an increase in total contribution for the Postal Service, since the percentage increase in per-piece revenue would greatly exceed the percentage decline in volume. (The variable cost savings produced by the decline in decline in volume would add further to the gain in contribution.)

The Postal Service's elasticity data are fundamentally at odds with the Postal Service's claim in this docket that the categories of First-Class Mail used by DVD mail face effective competition. If effective competition existed in any form, demand would be too elastic for a price increase above competitive levels to be profitable. *CF Industries, Inc. v. Surface Transportation Board*, 255 F.3d 816, 821-24 (D.C. Cir. 2001) (citing judicial precedent and antitrust treatises). Moreover, the same Postal Service data also contradict the Postal Service's claim that diversion to the Internet has made DVD mail more price elastic than other products within First-Class Mail: the data show that *all* significant categories of First-Class Mail have suffered significant diversion of volume to the Internet, yet all remain quite price inelastic. GameFly Comments at 12-14 (citing USPS data).

The Postal Service provides no coherent response to these facts. While conceding that the demand for First-Class Mail is "generally" inelastic, the Postal Service offers only the feeble rejoinder that "there are certainly at least sub-classes of mail within the broad class with more or less price elasticity." USPS Reply Comments at 23-24. The issue, however, is not whether all categories of mail within First-Class Mail have *identical* elasticity of demand (a claim that no one is asserting here), but whether any subset of First-Class Mail (and, in particular, DVD mail) is *sufficiently* elastic to make a price increase *unprofitable*. The Postal Service offers no evidence that DVD mail, or any other category of First-Class Mail, has price elastic demand.[2]

[2] The Postal Service also quibbles that the SSNIP ("small but significant nontransitory increase in price") test, the standard approach to estimating whether a price increase would be profitable, may be used only to define markets, not to test for market power, at least when the existing price charged by the regulated firm is regulated. USPS Reply Comments at 19-20. This objection is baffling. 39 U.S.C. § 3642(b)(1) specifically requires the Commission to consider whether the Postal Service "exercises sufficient market power that it can effectively set the price of such product substantially above costs" or "raise prices significantly." Quantitative analysis of whether a hypothetical price increase would produce a net increase in contribution for a regulated firm is a standard method for answering this question when the firm seeks to exempt a service from maximum rate regulation on grounds of effective competition. *See CF Industries, Inc. v. Surface Transportation Board*, 255 F.3d 816, 821-24 (D.C. Cir. 2001) (citing judicial precedent and antitrust treatises). To conduct this analysis, the analyst must assume some hypothetical price increase; and the Postal Service offers no alternative to the standard assumption, an increase that is "small but significant." And, when the existing rates are the product of rate regulation, it is customary to use those rates as the starting point for the hypothetical rate increase on the ground that regulated rates are designed to approximate a long-run competitive price. *See*, *e.g*., *SFPP, L.P*., 121 FERC ¶ 61,240 at P 14 (2007). As the D.C. Circuit noted in an analogous case, "[i]t is certainly reasonable for FERC to use a cost-of-service computation as an approximation for a pipeline's economic circumstances; the purpose of a cost-of-service rate, after all, is to simulate what a pipeline's economic behavior would be in a competitive market." *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 961 (D.C. Cir. 2007); *accord*, FERC Stats & Regs. ¶ 31,007, 69 FERC ¶ 61,103 at 31,007 (1994) ("Order No. 572") (*quoting Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (1990) ("*Tejas*") , order on reh'g, Order No. 572-A, 69 FERC ¶ 61,412 (1994), pet. for review denied, *Ass'n of Oil Pipelines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1998)); *SFPP, L.P*., 121 FERC ¶ 61,240 at P 14 (2007) ("*SFPP*"); *Buckeye Pipe Line Company, L.P*., 53 FERC ¶ 61,473 (1990), order on reh'g, 55 FERC ¶ 61,084 (1991) ("*Buckeye*").

These precedents cannot be distinguished on the theory that the existing rates for DVD mail, or the equalized rates scheduled to take effect on September 30, are noncompensatory. The Postal Service stated in its August 5 filing in response to Order

Neither does the only authority cited by the Postal Service, a paper presented three months ago by A. Thomas Bozzo and four colleagues within the Postal Service and its consultant, Christensen Associates, at the Center for Research on Regulated Industries ("CRRI") conference on postal regulation in Portmarnock, Ireland.[3] To the contrary, Bozzo *et al*. broadly assert in their paper that, "while demands for market dominant postal products have shifted substantially" in recent years "due to a combination of factors other than postal prices, *they remain own-price inelastic.*" *Id*. at 13 (emphasis added). Bozzo *et al*. also contend that they "find no evidence that recent events such as the Great Recession *and the mass adoption of broadband Internet services* have led to material increases in the own price elasticities of demand for market dominant products of USPS." *Id*. at 2 (emphasis added). Indeed, the authors argue that a decrease in demand resulting from these causes could leave the residual demand *less* elastic if the departing customers were "more price sensitive" than the ones remaining. *Id*.

Finally, the notion that the demand for DVD mail is too price-elastic to make a price increase profitable is also at odds with the Postal Service's claim that DVD mail should be exempted from maximum rate regulation so that the Postal Service can raise the price of DVD mail above the CPI without drawing on the Postal Service's CPI cap authority under 39 U.S.C. § 3622(b). USPS reply comments at 25; *id*., Attachment B

No. 1794 that "the proposed Round-Trip Mailer product will more than cover its attributable costs." USPS Response to Order No. 1794 (Aug. 5, 2013) at 2.

[3] A. Thomas Bozzo, Kristen L. Capogrossi, B. Kelly Eaken, John Picket and Mithua Srinivasan, "Is Demand for Market Dominant Products of the United States Postal Service Becoming More Own Price Elastic?" (presented at CRRI 21st Conference on Postal and Delivery Economics, Portmarnock, Ireland, May 30, 2013) (cited in USPS Reply Comments at 23-24).

(declaration of Virginia J. Mayes) at ¶¶ 25-26. This is a telling admission. If the Postal Service can increase its net contribution by raising the price of DVD mail faster than inflation, the Postal Service has market power over DVD mail.[4]

As previously noted, the Postal Service has the burden of proving that a mail product that is the subject of a transfer request under 39 U.S.C. § 3942(b)(1) in fact faces effective competition. GameFly Comments at 10 (citing authorities). The proposition that the Postal Service faces effective competition for DVD mail (USPS reply comments at 8-21) is inconsistent with the Postal Service's recent representations to the Commission that the demand for all categories of First-Class Mail is highly inelastic (and, by implication, that price increases on First-Class Mail would be profitable), and the Postal Service's representation *in this case* that the Postal Service could face "severe negative consequences" without the right to increase the price of DVD mail faster than inflation (USPS reply comments at 24). The Postal Service's failure to provide a satisfactory explanation for the internal contradictions among these representations to the Commission is an independent ground for denying the product transfer request.

[4] The Postal Service's disclaimer that it would not "exercise undue vigor in raising [DVD mailers'] prices" (*id*. ¶ 26), apart from its irrelevance under Section 3642(b)(1), is meaningless doubletalk. Either the elasticity of demand for DVD mail allows the Postal Service to increase its net contribution by raising prices on DVD mail faster than inflation, or not. If so, the Postal Service has market power over DVD mail, and the Commission's inquiry under 39 U.S.C. § 3642(b)(1) is at an end. If not, then no "negative consequences," severe or otherwise, can result from continuing to include DVD mail in the products whose price increases are subject to the CPI cap. *Cf*. USPS reply comments at 24. The Postal Service cannot have it both ways.

III. THE CORE GROUP OF CONSUMERS WHO STILL RENT DVDS BY MAIL DO NOT REGARD THE "DIGITIZED ENTERTAINMENT CONTENT" AVAILABLE FROM OTHER CHANNELS AS AN ACCEPTABLE SUBSTITUTE.

Even if (contrary to fact) proof that DVD rental companies faced effective competition for *their* products from the Internet and Redbox were sufficient to establish that the Postal Service is effectively constrained from raising the price of DVD *mail*, the Postal Service has failed to establish this premise as well.

The Postal Service concedes that other forms of "digitized entertainment content" may be considered to be in the same product market as DVDs offered for rental by mail, and may be found to provide effective competition for DVD-by-mail, only if consumers of the latter products regard the former products as good substitutes ("reasonably interchangeable"). USPS Reply Comments at 8, 12-14 (citing cases); *accord*, GameFly Comments at 7-9 (citing cases). Indeed, nearly every case cited by the Postal Service on this point is a reliable authority.[5] The Postal Service's factual analysis, however, poses the right questions to the wrong group of consumers. The Postal Service's analysis of the substitutability (or interchangeability) of DVD-by-mail for other channels of "digitized entertainment content" considers without differentiation *all* consumers of

[5] *See, e.g., Newcal Indus., Inc., v. Ikon Office Solution,* 513 F.3d 1038 (9th Cir. 2008); *FTC v. Whole Foods Mkt.,* 548 F.3d 1028 (D.C. Cir. 2008); *S. Mo. Hosp. v. C.R. Bard, Inc.,* 642 F.3d 608 (8th Cir. 2011), *United States v. Dentsply Int'l, Inc.,* 399 F.3d 181 (3rd Cir. 2005); *AD/SAT, Div. of Skyylight, Inc. v. Assoc. Press,* 181 F.3d 216 (2d Cir. 1999). Each of these cases correctly notes that the focus of the test is on whether the proposed substitutes are "reasonably interchangeable by consumers for the same purposes." *FTC v. Whole Foods,* 548 F.3d 1028, 1037 (D.C. Cir. 2008). "Whether one product is reasonably interchangeable for another depends not only on the ease and speed with which customers can substitute it and the desirability of doing so, but also on the cost of substitution, which depends most sensitively on the price of the products." *United States v. Microsoft Corp.,* 253 F.3d 34, 52-54 (D.C.Cir.2001) (en banc).

"digitized entertainment content," including consumers that have already abandoned DVD-by-mail for other forms of "digitized entertainment content," and consumers that never rented DVD-by-mail.

As explained below, the consumers whose preferences and demands are legally relevant to the competition analysis are the core group of consumers that continue to rent DVDs by mail today. The record makes clear that the current customers of DVD rental companies do not consider the video entertainment and video game content available via Internet delivery and Redbox kiosks as reasonable substitutes for the comprehensive back catalog of titles available from Netflix DVD-by-mail, the broad range of data-intensive console games available from GameFly DVD-by-mail, or the specialized content available from smaller DVD-by-mail rental companies. This fact is a further and independent reason that the Postal Service's product transfer request must be denied.

A. The Postal Service's Purported Experts Are Unqualified.

Before delving into these legal and technical issues, it is useful to begin by considering the credibility of the purported experts offered by each side of the debate—an issue that the Postal Service has raised quite pointedly in its August 22 reply comments. The Postal Service derides the market analysis sponsored by GameFly's CEO, David Hodess, in his August 15 declaration as "evidence" (scare quotes in original) that is "simplistic," "unfounded and unsupported by reputable industry leaders," "factually inaccurate," "weak," "analytically flawed," and 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. By contrast, Mr. Schoeman, the author of the declaration submitted as Attachment A to the Postal Service's reply comments, is portrayed as an "Expert" (USPS reply comments at 18, 21, 24); and Mr. Chiang, the author of the IBISWorld report, is identified as "industry analysts" (plural in original) (*id*. at 14 and 21 at n. 7).

The reality is quite the opposite. Mr. Hodess is a Harvard MBA with more than 18 years of experience designing and marketing products and services for consumers, including ten years as the President and CEO of GameFly, the largest subscription video game rental company in the United States. Hodess Decl. (Aug. 15, 2013) at 1-2. During the decade he has been at the helm of GameFly, the company has purchased more than seven million console games, and shipped more than 50 million console games to over three million consumers. Mr. Hodess has delivered the goods and services promised by GameFly to its customers, provided hundreds of jobs for the company's employees, safeguarded the capital invested by GameFly's investors, and generated a positive return to GameFly's shareholders in a competitive and rapidly evolving industry. Moreover, Mr. Hodess has accomplished this despite the handicap of the illegal price and service discrimination by the Postal Service throughout this period. Hodess Supp. Decl. ¶ 39. By virtue of his "knowledge, skill, experience, training [and] education," Mr. Hodess is amply qualified as an expert to his opinions on competition in the DVD rental industry. Fed. R. Evid. 702.

Mr. Chiang and Mr. Schoeman possess no such expertise. Neither individual is employed by a firm that engages in the sale or rental to consumers of DVDs or any other form of "digital entertainment content." Rather, the two individuals, and their employers, earn their livings by writing reports on *other* people's businesses. While this is not an illegitimate line of work, neither individual appears to have any discernible knowledge, skill, experience, training or education in the specialized matters at issue here. If this were a federal trial court, Mr. Chiang's report and the declaration of Mr. Schoeman would properly be stricken because of the authors' lack of qualification to opine about their subjects for which the Postal Service is offering these writings. *See*, *e.g.*, *Wilson v. Woods*, 163 F.3d 935, 937 (5th Cir. 1999); *United States v. Paul*, 175 F.3d 906, 912 (11th Cir. 1999); *Prado Alvarez v. R.J. Reynolds Tobacco Co., Inc.*, 405 F.3d 224, 227 (5th Cir. 2007); *Sigler v. American Honda Motor Co.*, 532 F.3d 469, 478-79 (6th Cir. 2008); *Sundance, Inc. v. Demonte Fabricating Ltd.,* 550 F.3d 1356, 1361-62 (Fed. Cir. 2008); *Barrett v. Rhodia, Inc.*, 606 F.3d 97, 982-83 (8th Cir. 2010); *United States v. Redlightning*, 624 F.3d 1090, 1115 (9th Cir. 2010). While the Commission may decide to deal with the expertise (or lack thereof) of a declarant through the weight rather than the admissibility of his or her statements, the reasons that follow warrant giving the opinions of Messrs. Chiang and Schoeman no weight at all.

1. Mr. Chiang

The IBISWorld report identifies its author as Jesse Chiang. According to the biography that he has posted on LinkedIn (Attachment A, *infra*), he graduated from UCLA slightly over a year ago with a B.A. in political science and government. He has been employed at IBISWorld for the past eight months. Before that, he had brief stints at a variety of paid or unpaid positions, including two months earlier this year as a "Fellow" at Learn Capital, eight months as a freelance sportswriter for an on-line newspaper, seven months as an "education consultant," and two years as a "project liaison director" for the "Community Service Commission" at UCLA. Neither the

IBISWorld website (www.IBISWorld.com) nor Mr. Chiang's biography on www.linkedin.com (Attachment A, *infra*) attribute to him any training or experience in law, economics, logistics, the Postal Service, DVDs, digital entertainment, video games, antitrust, or the standards for determining market power or defining relevant markets.

It would be tempting to describe the IBISWorld report as a high-priced term paper. That, however, would be unfair to term papers, which are expected to provide footnote references to the sources relied on by the author for his or her conclusions. The IBISWorld report provides no citations to any public or verifiable third party sources for any of the data or conclusions in the report. The only source footnoted in the report is IBISWorld itself.

The analysis offered in the IBISWorld report is as superficial as its provenance and lack of citations suggest. For example:

- The report does not consider whether product competition for rental DVDs from other channels of digitized video entertainment, if effective, would discipline the prices that the Postal Service could charge for its carriage of the DVDs, or whether, as both GameFly and Netflix have stated, they would just absorb increases in the price of postage and accept smaller margins for themselves. This omission is unsurprising, since the report clearly was designed as a generic document to be marketed to a broad range of potential subscribers, and was not prepared for the purpose of determining whether the Postal Service has market power. Hodess Supp. Decl. ¶ 42.

- The report does not discuss the demand elasticities published by the Postal Service for First-Class Mail, and what those elasticities might imply about the Postal Service's market power.

- The report does not consider the possibility that the video digital entertainment market may have segmented itself into distinct product markets, based on the value assigned by the consumer to the breadth and depth of the content library offered in each channel. Hodess Supp. Decl. ¶ 43.

- The report does not consider the possibility that that the core group of seven million households that still subscribe to DVDs by mail from Netflix—most of which households do so even they also subscribe separately to streaming video from Netflix or other companies—may not consider streaming video (or the videos available from Redbox rental kiosks) reasonably interchangeable with the content available from Netflix's exhaustive DVD rental library. Hodess Supp. Decl. ¶ 44.

- The report does not consider the possibility that the product market for video games may have segmented itself into separate product markets for the content available on rental DVDs and the content available from the Internet or Redbox kiosks, depending on the value assigned by the consumer to the thousands of data-intensive console games that are available via DVD-by-mail from GameFly but unavailable over the Internet or from Redbox, or are impractical or inconvenient to access via streaming or downloading. Indeed, the report does not mention

GameFly, the largest subscription DVD video game rental company, at all. Hodess Supp. Decl. ¶ 45.

Unlike Mr. Hodess, who subscribed and submitted his declaration under penalty of perjury, the author and publisher of the IBISWorld report have disclaimed any responsibility for the completeness or accuracy of their work:

> IBISWorld makes no representation to any other person with regard to the completeness or accuracy of the data or information contained herein, and it accepts no responsibility and disclaims all liability (save for liability which cannot be lawfully disclaimed) for loss or damage whatsoever suffered or incurred by any other person resulting from the use of, or reliance upon, the data or information contained herein.

IBISWorld report (last page). On this point, the IBISWorld report deserves to be taken on face value. The IBISWorld report was written to be sold to anyone willing to pay the $995 (or less) that IBISWorld charges for a copy. It is not a document that any responsible business person or government official could rely on for any decision with consequences in the real world.

2. Mr. Schoeman

Mr. Schoeman, the Postal Service's other purported "industry expert," is, unlike Mr. Chiang, a seasoned professional. His expertise, however, is in transportation and logistics—in particular, the "expedited package transportation market." (He worked at UPS before joining his present employer.) Schoeman Decl. at 1. He has no apparent training or experience in the specialized subjects at issue here: e.g., video entertainment, movies, TV content or distribution, video games or content distribution over the Internet, or antitrust law or economics. Hodess Supp. Decl. ¶ 46.

Mr. Schoeman's lack of expertise, like Mr. Chiang's, shows in his sources and his conclusions. 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 essentially a clip job—a jumble of items relating to 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://popcultureatemymonkey.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. Hodess Supp. Decl. ¶ 46.

Mr. Schoeman's ignorance of his subject, like Mr. Chiang's, is betrayed 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.).

Hodess Supp. Decl. ¶ 47.

3. 10-K reports and other filings with the SEC and investors by industry participants

The Postal Service does offer several citations to 10-K reports, other filings with the Securities and Exchange Commission ("SEC"), and other statements by industry players to investors or securities analysts in circumstances where false or misleading statements could lead to liability. The Postal Service touts these statements, particularly the ones made under penalty of falsehood "under federal securities law," as "highly probative." USPS reply comments at 15, 17. GameFly certainly agrees that statements made under the penalties of the securities laws by actual market participants have more credibility than the opinions of uninformed outsiders such as Messrs. Chiang and Schoeman. But even statements from Form 10-K reports and similar documents lose their probative value when misquoted.

The excerpts from Netflix's Form 10-K report for 2012 that the Postal Service quotes in its reply comments (at 16-17) illustrate this. The Postal Service quotes several passages from pages 5-6 of the 10-K report as proof that Netflix has "resoundingly rejected" GameFly's "approach to market definition." Id. at 15. The quoted statements support no such conclusion. Netflix competes through a variety of content distribution channels, including streaming. The context of the quoted passages makes clear that they referred to competition for Netflix's business generally, not the DVD rental business in particular, let alone Netflix's bargaining strength with the Postal Service over the price of postage.

Netflix specifically discussed the latter questions *elsewhere* in the same 10-K report, and in other statements to the SEC and the investment community. In *those* statements, Netflix made clear its belief that the subscribers to DVD-by-mail and the subscribers to video streaming seek very different attributes from the video entertainment content offered through the two channels and, by necessary implication, that the seven million households that still subscribe to DVD-by-mail do not regard video streaming (which most of them also pay to subscribe to) as an adequate substitute. GameFly comments at 15-19 (citing and quoting Netflix Form 10-K and other statements to investors). Netflix also made clear—on page 10 of the same Form 10-K report that the Postal Service cites—the company's concern that it would have to absorb any postal price increase on DVD mail, and "our contribution margin could be adversely affected." Netflix 2012 Form 10-K at 10. These statements go to the heart of why the Postal Service's product transfer request should be denied. GameFly quoted them at length in its August 15 comments (at 22-23). The Postal Service, in its reply comments, ignores them.

B. The Relevant Product Markets Of DVD-By-Mail Rental Companies Are Defined By The Preferences Of The Core Group of Consumers Who Still Rent DVDs By Mail.

The competitive analyses offered by the Postal Service and its purported experts, Messrs. Schoeman and Chiang, are undermined by their failure to focus on the relevant group of consumers. The Postal Service and its declarants, instead of considering the core group of consumers who continue to rent video entertainment DVDs by mail today, have lumped together without differentiation all consumers of "digitized entertainment content," including those who have already abandoned DVD-by-mail for content distribution via the Internet or Redbox, or never used DVD-by-mail in the first place. Including the latter consumers in the product market almost tautologically "proves" that the Internet and Redbox kiosks compete with DVDs-by-mail as distribution channels.

This market definition is incorrect as a matter of law. Antitrust precedent holds that, where product markets are split into sub-markets by differences in product characteristics or consumer preferences, a "core group of particularly dedicated, 'distinct customers,' paying 'distinct prices,'" may constitute a distinct market that must be analyzed separately. *FTC v. Whole Foods*, 548 F.3d 1028, 1039 (D.C. Cir. 2008); *FTC v. Staples, Inc.*, 970 F.Supp. 1066, 1078-79 (D.D.C. 1997); *Meredith Corp. v. SESAC, LLC*, 2011 WL 856266 (S.D.N.Y. 2011). *Accord*, *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962) (emphasis added):

> The 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. However, within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. *United States v. E. I. du Pont de Nemours & Co*., 353 U. S. 586, 593-595. *The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.*

The facts of *Whole Foods* and *Staples* are particularly germane. *Whole Foods* involved an FTC challenge to the proposed merger of the two largest chains of "Premium Natural and Organic Supermarkets" ("PNOS"). The District Court declined to enjoin the merger on the ground that the combined entity would have only a small share of the overall supermarket and grocery store market, and that many of the same items sold in PNOS stores were also available for sale in ordinary supermarkets and grocery stores. The D.C. Circuit reversed on the ground that the merged entity would, in many metropolitan areas, dominate the submarket for PNOS stores. In limiting the product market to PNOS stores, and thereby excluding mass market supermarkets and convenience stores, the D.C. Circuit held that the "core customers" of PNOS stores defined a relevant product market. *Whole Foods,* 548 F.3d at 1038-1040 ("In short, a core group of particularly dedicated, 'distinct customers,' paying 'distinct prices,' may constitute a recognizable submarket, … whether they are dedicated because they need a complete 'cluster of products,' … because their particular circumstances dictate that a product 'is the only realistic choice,' or because they find a particular product 'uniquely attractive.'"). The Court of Appeals gave particular weight to the evidence that PNOS stores offered a "much larger selection of natural and organic products" and a "much greater concentration of perishables" than did mass market supermarkets. *Id*. at 1039; *accord*, id. at 1044-45 (Tatel, concurring) ("if conventional stores offer only a narrow range of organic products, customers with a high demand for organic items refuse to shop there").

FTC v. Staples is to the same effect. The case arose from an FTC suit to enjoin the proposed merger of two chains of office products superstores, Staples and Office Depot. The defendants argued that the merged entity would have only a small share of the overall market for office products. The District Court, enjoining the merger, rejected this product market definition in favor of a narrower market consisting of the office products superstores. Acknowledging that a high degree of functional interchangeability existed between the office supplies sold by the PNOS stores and other retailers of office supplies, the court nonetheless found that the "unique combination of size, selection, depth and breadth of inventory offered by the superstores distinguishes them from other retailers" of office supplies, including clubs, mass merchants such as Wal-Mart, and computer stores. 970 F.Supp. at 1079.

The same market segmentation has occurred within the markets for the distribution of "digitized entertainment content." A core group of consumers who particularly value the exhaustive content library offered by Netflix in DVDs-by-mail, or the extensive library of high-powered console games offered by GameFly in DVDs-by-Mail, or the specialized collections offered by smaller DVD rental companies continue to rent DVDs despite the availability of other "digitized entertainment content" over the Internet or from Redbox. The same is true of consumers, typically in rural areas, who lack access to broadband service. GameFly comments at 14-29. These consumers, not the consumers who have stopped renting DVDs by mail, define the bounds of the relevant product market in which DVD rental companies operate. Hodess Supp. Decl. ¶¶ 6-7.

Some of the Postal Service's own declarants have agreed. Mr. Bozzo, in his recent joint paper with several other employees of Christensen Associates and the Postal Service that the Postal Service has cited for other purposes in its reply comments,[6] argued that the diversion of communications volume from a mail product to the Internet may cause the remaining mail volume to become more or less elastic in demand, depending on the demand characteristics of the customers that remain. *Id*. at 2. The relevant demand elasticities, he argues, are those of the remaining customers. "The net effect is an empirical question and the answer will be in the data." *Id*. at 3.

[6] A. Thomas Bozzo, Kristen L. Capogrossi, B. Kelly Eaken, John Picket and Mithua Srinivasan, "Is Demand for Market Dominant Products of the United States Postal Service Becoming More Own Price Elastic?" (presented at CRRI 21st Conference on Postal and Delivery Economics, Portmarnock, Ireland, May 30, 2013) (cited in USPS Reply Comments at 23-24).

Even Mr. Chiang noticed that some local DVD rental companies have survived by offering specialized video collections that streaming services do not:

> Stores may focus on collecting movies filmed locally or certain genres that are popular in that area. For instance, a store could set itself apart with an extensive collection of Westerns or educational collection seminars for the local community. In Chicago, Odd Obsession, a store named for its specialty, rents rare and out-of-print titles and has incorporated its catalog into its website. Such stores remain in demand because their movie selections are not generally found in the catalogs of competing streaming services like Netflix or Hulu.

IBISWorld report at 9; *id*. at 24 (noting that one-store local retailers "primarily compete based on customer service and unique media offerings"). The same, however, is true of national DVD-by-mail operators such as GameFly and the DVD rental business of Netflix.

Although GameFly dealt with this threshold market definition issue in detail in its August 15 comments, the Postal Service has failed to deal seriously with the issue. The Postal Service's suggestion that GameFly's market definition is purely as tautological or semantic is dispelled by even a cursory review of GameFly's actual analysis. *Compare* USPS reply comments at 11 (asserting that GameFly relies on a "single sentence" noting "that the Postal Service is the only firm offering round-trip DVD mailers" to conclude that "the Postal Service is a monopolist in the provision of round-trip DVD mailers"); GameFly comments at 14-29 (analyzing the viability of Internet delivery and Redbox as a substitute distribution channel for DVD-by-mail).

The Postal Service's related argument that a firm cannot be deemed to monopolize its own "product" or "brand" (USPS reply comments at 18-19) is another attack on a straw man. The argument would be pertinent if (1) UPS and FedEx actually competed with the Postal Service in the round-trip delivery of DVDs, and (2) GameFly were actually claiming that the Postal Service *brand name* made the competition from the two private carriers ineffective.[7] But those are not the facts or the GameFly claim here. GameFly's point is that the "digitized entertainment content" available from DVDs-by-mail has distinctive product characteristics that differ from those of the "digitized entertainment content" available from the Internet or self-service kiosks, and consumers who still rent DVDs by mail regard these product differences as important. The Postal Service has not answered this, the real argument.[8]

In the remainder of this section, we explain how the Postal Service's failure to focus its competition analysis on the product characteristics demanded by the core

[7] Each of the cases cited by the Postal Service involved a supplier in a competitive market who was alleged to have market power *over its own brand. See, e.g., PSKS, Inc. v. Leegin Creative Leather Prods.,* 615 F.3d 412, 418 (5th Cir. 2010) (explaining that "a single brand of a product or service can constitute a relevant market for antitrust purposes only in "situations in which consumers are 'locked in' to a specific brand by the nature of the product"); *Green Country Food Market, Inc. v. Bottling Group,* 371 F.3d 1275, 1282-1283 (10th Cir. 2004) ("Pepsi branded beverage products cannot alone comprise a relevant product market"); *Tanaka v. Univ. of S. Cal.,* 252 F.3d 1059, 1065 (9th Cir. 2001) ("[b]y attempting to restrict the relevant market to a single athletic program in Los Angeles based solely on her own preferences, [plaintiff] has failed to identify a relevant market for antitrust purposes").

[8] The Postal Service's claim that GameFly has contradicted its claim in Docket No. C2009-1 of being "similarly situated to Netflix" by contending now that the two companies compete in different product markets (USPS reply comments at 17) is equally dishonest. GameFly's claim of being similarly situated to Netflix did not rest on a claim that the two companies were direct competitors, and the Commission specifically held in Order No. 718 that GameFly was "not required to demonstrate that it is a competitor of either Netflix or Blockbuster to establish that it is similarly situated to either of those companies." Order No. 718 at ¶ 4096; *see also id*. at ¶ 2002 (noting that GameFly and Netflix do not compete); *GameFly, Inc. v. PRC*, 704 F.3d 145, 146 (D.C. Cir. 2013) ("the companies are not direct competitors").

customers of DVD-by-mail has fatally undermined the Postal Service's conclusions about the substitutability of (1) streaming video as a substitute for Netflix DVDs-by-mail; (2) self-service kiosks as substitute for Netflix DVDs-by-mail service; (3) streaming and downloading of video games as substitute for GameFly DVDs-by-mail; and (4) self-service kiosks as substitute for GameFly DVDs by mail. Finally, we discuss briefly the Postal Service's offhand claim that the GameFly faces effective competition from the *sale* of games by Internet-based vendors such as Amazon.

C. The Core Group of Consumers Who Still Rent Entertainment Video DVDs By Mail Do Not Regard The Content Available By Internet Streaming As An Adequate Substitute.

As GameFly explained in its August 15 comments, the recent decline in the volume of video entertainment distributed through DVD-by-mail rentals volume proves nothing about the substitutability of streaming, downloading or rental kiosks for the core group of consumers that have chosen to continue subscribing to Netflix DVD-by-mail. In fact, those core consumers consider alternative channels of distribution to be poor substitutes. GameFly Comments at 14-15. There are several reasons for this. First, streaming requires broadband service, which many rural consumers lack. *Id*. at 15-16. Second, the entertainment library available from streaming is much more limited than Netflix's enormous back catalog of rental DVDs. *Id*. at 16. Third, the selection of titles available via streaming is likely to remain much smaller than DVD-by-mail catalog for the foreseeable future because of the high cost and incomplete availability of digital distribution rights. *Id*. at 16-17.

The result is that millions of households have continued to subscribe to the DVD-by-mail service, drawn by its vast library and superior user experience, despite Netflix's efforts to get consumers to migrate to streaming by offering exclusive content in streaming. In fact, the rate of decline of the DVD-by-mail subscriber base has slowed. *Id*. at 17-19. The ultimate proof of the limited substitutability of alternative channels of distribution is the reality that two-thirds of the households that subscribe to DVD-by-mail from Netflix do so despite paying separately for streaming from Netflix as well. GameFly Comments at 15; *accord*, USPS at 15 ("In fact, many customers purchase content from multiple providers that use different delivery technologies. For example, a family may use Netflix both to receive DVDs through the mail and to stream other content, yet it may also order videos from Amazon (which it receives either over a broadband connection or by mail) and/or rent them from a Redbox kiosk."). As the Postal Service acknowledges, "[c]onsumer behavior is a core component of market definition." USPS reply comments at 13.

The Postal Service, in its August 22 reply comments, does little more than double down on its original claims. The Postal Service reiterates that Netflix's DVD-by-mail volume has fallen, and the volume of video entertainment internet delivery has risen. USPS reply comments at 14, 20; Schoeman Decl. at 9 (streaming up). The Postal Service also asserts (without providing any citations, data, or explanatory methodology) that it expects this volume trend to continue, *id*., and further asserts that "industry analysts"—i.e., Mr. Chiang—"recognize" that DVD-by-mail will be phased out within five years. USPS 21 n. 7; *see also* IBISWorld report at 4, 6, 7, 8, 11, 13.

The Postal Service's failure to confront the distinctive characteristics of video entertainment DVD by mail, particularly the much greater selection of titles available from Netflix, and the precedent set in *Whole Foods*, *Staples* and related cases, warrant

Commission findings that (1) the residual subscribers to DVD-by-mail video entertainment define a separate “core” product market, (2) Internet streaming does not offer content that is reasonably interchangeable with DVD-by-mail for those core subscribers, and (3) alternative distribution channels therefore are not in the same product market as DVD-by-mail entertainment videos and do not provide effective competition for it.

D. The Core Group of Consumers Who Still Rent Entertainment Video DVDs By Mail Do Not Regard The DVDs Available From Redbox Self-Service Kiosks As Adequate Substitutes.

As GameFly also explained in its August 15 comments, the recent increase in the volume of video entertainment distributed through the Redbox network of self-service rental kiosks proves nothing about the substitutability of self-service kiosks for the core group of consumers that have chosen to continue subscribing to video entertainment offered for rental by Netflix through DVD-by-mail. In fact, those core consumers consider Redbox a poor substitute. First, full-service brick-and-mortar retail outlets have insuperable cost disadvantages, as demise of Blockbuster proves. GameFly Comments at 19-20; Hodess Decl. ¶¶ 13-17. Second, self-service kiosks offer a much smaller selection than does the Netflix DVD-by-mail catalog. GameFly Comments at 20-21; Hodess Decl. ¶¶ 18-19.

The Postal Service, in its August 22 reply comments, simply reiterates its original point—that Redbox is profitable and growing—while ignoring the real issues: (1) Redbox’s gains have come from consumers who value low price and immediate availability; (2) consumers who place greater value on the comprehensive back catalog of DVDs available for rental from Netflix by mail have continued to subscribe to the latter; and (3) there is no indication that this market segmentation will change for the foreseeable future. Postal Service reply comments at 24; IBISWorld report at 21-22; Schoeman Decl. at 3. Here again, the record warrants findings that (1) self-service rental kiosks do not offer content that is reasonably interchangeable with DVD-by-mail for its core subscribers, and (2) self-service rental kiosks therefore are not in the same product market as DVD-by-mail entertainment videos and do not provide effective competition for it.

E. The Core Group of Consumers Who Rent Video Game DVDs By Mail Do Not Regard The Video Games Available Via Streaming Or Downloading From The Internet As Adequate Substitutes.

As GameFly also explained in its August 15 comments, 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. GameFly Comments 23-24; Hodess Decl. ¶¶ 22-23. Bandwidth limitations and interruptions cause undesirable latency (i.e., delay in the computer's response) when the games are played. GameFly Comments at 24; Hodess Decl. ¶ 24. Adapting console games for streaming requires extensive recoding—at the publisher's expense. GameFly Comments at 24; Hodess Decl. ¶ 25. Content creators are reluctant to license video games for streaming, a problem that the First Sale Doctrine obviates for games on DVDs. GameFly Comments 25; Hodess Decl. ¶ 26. 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. GameFly Comments 25; Hodess Decl. ¶ 27. Moreover, entering the streaming business on a national scale would require huge capital investment. GameFly Comments 25; Hodess Decl. ¶ 28. For all of these reasons, streaming is not a viable alternative to DVD-by-mail rental for the large, complex, graphics-rich console games that GameFly's rental subscribers demand. GameFly Comments 26; Hodess Decl. ¶ 31; Hodess Supp. Decl. ¶ 7.

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. GameFly Comments 26-27; Hodess Decl. ¶¶ 35-36. Many console games are unavailable in PC format. GameFly Comments 27; Hodess Decl. ¶ 37. Content developers are unwilling to license many games for downloading, an issue obviated for DVDs by the First Sale Doctrine. GameFly Comments 27; Hodess Decl. ¶ 38. Finally, the failure of the First Sale Doctrine to cover resale of downloaded content greatly burdens the economics of licensing content. GameFly Comments 27-28; Hodess Decl. ¶ 39. 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. GameFly Comments 28; Hodess Decl. ¶ 40; Hodess Supp. Decl. ¶ 8.

As with video entertainment, 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 available from other channels. *See* USPS reply comments at 14 (asserting that "industry analysts"—i.e., Mr. Chiang—recognize that growing compatibility of "gaming consoles and tablets" with "streaming media" will "suck revenue out of" DVD-by-mail.); Chiang report, *passim*; Schoeman Decl. at 7-9 (digital volume up, and trend will continue). Hodess Supp. Decl. ¶ 9.

Unlike the Postal Service and Mr. Chiang, Mr. Schoeman actually tries to refute a few of the structural problems with Internet streaming and downloading identified by GameFly. His responses, however, merely reveal his ignorance of the industry, and his failure to focus on the core group of consumers that continue to subscribe to video games via DVD-by-mail:

1. 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. Hodess Supp. Decl. ¶ 10.

2. 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 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 17 (although "downloading technology is becoming more prevalent and continues to evolve rapidly," downloading is still "constrained by bandwidth capacity."). Hodess Supp. Decl. ¶ 11.

3. 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. Hodess Supp. Decl. ¶ 12.

4. 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. Hodess Supp. Decl. ¶ 13.

5. 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. Hodess Supp. Decl. ¶ 14.

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. Hodess Supp. Decl. ¶ 15.

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. Hodess Supp. Decl. ¶ 16.

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. Hodess Supp. Decl. ¶ 17; *accord*, GameFly Comments at 26; Hodess Decl. ¶ 30.

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. Hodess Reply Decl. ¶ 18.

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; Hodess Supp. Decl. ¶ 19.

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. Hodess Supp. Decl. ¶ 20.

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. Hodess Supp. Decl. at ¶ 21. 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.

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. Hodess Supp. Decl. ¶ 22; *accord*, 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.

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. Hodess Supp. Decl. ¶ 23.

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. Hodess Supp. Decl. ¶ 24; *accord*, 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); Ben Gilbert, "Microsoft reverses Xbox One DRM policy, kills required online check-in and used game complications," Engadget (June 19, 2013) (www.endgadget.com/2013/06/19/xbox-one-drm-used-games-reversal/).

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 company's other five releases in 2013 have all been casual games. Hodess Supp. Decl. at ¶ 25.

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/; Hodess Supp. Decl. at ¶ 26.

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. Hodess Supp. Decl. at ¶ 27.

Steam: Steam is the leading distributor of downloadable PC video games. Steam does not, however, offer downloading to video game consoles. Hodess Decl. ¶ 29; Hodess Supp. Decl. ¶ 28.

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. *Compare* USPS reply comments at 24 with http://www.twitch.tv/p/about; Hodess Supp. Decl. ¶ 29.

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. Hodess Supp. Decl. ¶ 30. Indeed, the Gabe Newell, the CEO of Valve, expressed skepticism at a trade conference earlier this year that streaming would ever become a successful mainstream delivery channel for console gaming:

> As a new generation of consoles prepares to descend on us, one question on everyone's mind is: where does cloud gaming fit in?
>
> Cloud gaming services such as OnLive and Gaikai (now owned by Sony) are heavily reliant on fast Internet connections; a luxury not everyone can afford or that's even always available. That's only part of the reason that Valve CEO Gabe Newell doesn't think cloud gaming will become mainstream. Speaking at D.I.C.E., Newell said "cloud gaming works until it starts to be successful — at which point, it falls over."
>
> Wait, what? How does a more successful cloud platform become its own undoing? Look at it like this: cloud gaming is all about streaming games from a remote server to your TV, computer, tablet or phone, right? Newell says that there's a growing network cost that comes with maintaining the backend as the platform explodes, instead of an individual cost per console, or PC, or Steam Box. Therefore, the more successful cloud gaming becomes, the higher the network costs will be. And whose pockets would those costs come from? If you're guessing it'll be from the users, you're correct. That, or the supplier eats the cost, but as those costs rise, that won't be sustainable.

> Latency is another big drawback for Newell. It's not just people stuck on slow Internet that's holding cloud gaming back; it's also the fact that he and Valve think "latency sensitivity is actually going to increase in the future" when games get bigger.

Raymond Wong, "Valve's Gabe Newell skeptical that cloud gaming is the future," in DVICE (February 22, 2013) (http://www.dvice.com/2013-2-11/valves-gabe-newell-skeptical-cloud-gaming-future). What does Mr. Newell think cloud gaming will be good for? "Demos and spectating, apparently." *Id*.

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. Hodess Supp. Decl. ¶¶ 31-32. **[BEGIN GAMEFLY PROPRIETARY]** [redacted]

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Hodess Supp. Decl. ¶ 32. **[END GAMEFLY PROPRIETARY]**

F. The Core Group of Consumers Who Rent Video Game DVDs By Mail Do Not Regard The Video Games Available From Redbox Self-Service Kiosks As Adequate Substitutes.

As GameFly also explained in its August 15 comments, 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. 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. 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. A spot check of Redbox locations in Los Angeles and the DC area 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 9th 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 7th St., NW, DC	254	15
Safeway, 490 L St., NW, DC	304	16
Capitol Supermarket, Kiosk A, 1231 11th St, NW, DC	225	17
U.S. Navy, Kiosk A, Room 2E1087, The Pentagon	195	51
7-Eleven, 514 19th St., N.W., DC	219	19

Hodess Supp. Decl. ¶¶ 33-36. 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 inventory of Redbox kiosks. *Id*. at ¶ 36. The Postal Service's only response to these points is to repeat the accurate but irrelevant observation that Redbox is profitable and growing. USPS reply comments at 17-18; Chiang report at 21-22.

G. The Core Group of Consumers That Rent Video Game DVDs By Mail Do Not Regard The *Purchase* Of Games From Amazon and Other Internet Vendors As An Adequate Substitute.

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. Hodess Supp. Decl. ¶ 37.

IV. THE POSTAL SERVICE HAS FAILED TO IDENTIFY ANY BENEFIT, LEGALLY RELEVANT OR OTHERWISE, FROM DEREGULATING THE MAXIMUM PRICE OF DVD MAIL.

The Postal Service also argues in its reply comments that deregulating the maximum price of DVD mail would benefit the public in several ways: (1) allowing the Postal Service to raise the price of DVD mail would induce GameFly and other DVD rental companies to innovate more, thereby "better embody[ing] the process of creative destruction"; (2) the Postal Service could price discriminate more effectively among its DVD mailer customers; and (3) the Postal Service could raise the price of DVD mail without "wasting" CPI cap authority better reserved for products with growing volume. USPS reply comments at 22-25. These arguments are without merit.

(1) They are legally irrelevant. 39 U.S.C. § 3642(b)(1), unlike several other provisions of Title 39, does not authorize the Commission to strike a balance among competing factors. Section 3642(b)(1) asks a binary, yes-or-no question: does the Postal Service have significant market power over the product or not? If the Postal Service lacks such power, the product may be reclassified as competitive.[9] If the Postal Service still has such power, the product must remain in the market dominant list. The potential policy benefits of giving the Postal Service greater pricing flexibility may have been factors leading to the enactment of Section 3642(b), but they are not germane to individual adjudications under it.

(2) The Postal Service's appeal to "creative destruction" (USPS reply comments at 22) is essentially a backhanded reference to the Efficient Component

[9] This assumes, of course, that the product is not covered by the postal monopoly. 39 U.S.C. § 3642(b)(2),

Pricing rule, which calls for prices to cover incremental cost. The Postal Service has represented, however, that round-trip DVD mail makes a healthy contribution to institutional costs. USPS Response to Order No. 1794 (Aug. 5, 2013) at Attachment B; Library Reference USPS-MC2013-57/NP1, DVD-RT FY14 CC Forecast.xls, "DVD," cells P17 and P20.

Beyond that, the Postal Service's appeal to "creative destruction" proves too much. By the Postal Service's logic, *all* market-dominant postal rates should be deregulated, and the Postal Service should be free to exploit its market power to the full extent that the traffic will bear: the higher the price, the greater the incentive for ratepayers to devise substitutes. Congress, however, did not appoint the Postal Service as innovation czar over its customers, or give it *carte blanche* to gouge captive customers on price whenever the Postal Service decided that the resulting "creative destruction" would be good for them or society. To the contrary, Congress directed the Commission to limit the prices changed by the Postal Service on its market-dominant products to just and reasonable levels, 39 U.S.C. § 3622(b)(8), and to exempt the Postal Service from this regime only upon proof that competition was effective enough to constrain prices instead, 39 U.S.C. § 3642(b)(1).

(3) The notion that deregulation of DVD mail would benefit the Postal Service and its DVD mailing customers by allowing the negotiation of "commercial agreements with Netflix and GameFly" (USPS reply comments at 22-23) is equally unsupported. The Postal Service has been free for years to negotiate "commercial agreements" with users of any market dominant product: the agreements are called Negotiated Service Agreements. 39 C.F.R. §§ 3010.40 through 3010.44. Moreover, NSAs for market

dominant products may lawfully pass through demonstrable savings in cost. 39 U.S.C. § 3622(c)(10)((A)(i). To be sure, NSAs may not discriminate against similarly situated mailers. *Id*. But the same is true of commercial agreements involving competitive products: transfer of a product to the competitive list exempts the product from maximum rate regulation under 39 U.S.C. §§ 3621 and 3622, but not from the antidiscrimination mandate of 39 U.S.C. § 403(c), which applies without restriction to all postal products.

(4) The Postal Service's claim that DVD mail should be exempted from maximum rate regulation so that the Postal Service may recover increases in "unit costs" resulting from anticipated declines in volume without using any of the Postal Service's CPI cap authority on DVD mail (USPS reply comments at 24-25; *id*. at Attachment B (Mayes Decl.) at ¶¶ 25-26) founders on several grounds. First, the Postal Service has offered no credible evidence that future changes in the volume of DVD mail are likely to increase inflation-adjusted unit costs. The unit cost data referenced by Ms. Mayes show wide year-to-year fluctuations that have no apparent relationship to the year-to-year changes in volume. Glick Supp. Decl.

Second, the argument proves too much. Most market dominant products, according to the Postal Service, have experienced volume declines in recent years, and are expected to continue doing so. *See*, *e.g*., USPS, "Narrative Explanation of Econometric Demand Equations for Market Dominant Products Filed with Postal Regulatory Commission on January 22, 2013" (filed with the PRC on July 1, 2013). By the Postal Service's logic, most market dominant mail should be exempted from the CPI cap. Absent a showing of effective competition under Section 3642(b), however, Title

39 does not allow this outcome. Section 3642(b)(1) does not authorize the Commission to exempt market-dominant mail from maximum rate regulation merely because its volume is projected to decline.

Third, as noted above, this argument gives away the game. The notion that greater regulatory freedom to raise the price of DVD mail above the rate of inflation might improve the Postal Service's finances has no meaning unless an above-CPI rate increase on DVD mail would in fact improve the Postal Service's net contribution. If the latter assumption is correct, then the Postal Service has market dominance within the meaning of 39 U.S.C. § 3642(b)(1), and this case is over.

V. THE COMMISSION SHOULD GIVE NO CREDENCE TO THE COST STUDIES SUBMITTED BY THE POSTAL SERVICE IN THIS DOCKET.

The Commission should give no further consideration to the cost estimates submitted by the Postal Service in this docket. The ostensible purpose of the studies was to respond to the Commission's directive in Order No. 1794 to show that Round-Trip DVD Mail, if reclassified as a competitive product, would satisfy the requirement of 39 U.S.C. § 3633(a) that the product cover its attributable costs and help make an appropriate contribution to the Postal Service's institutional costs. The failure of the Postal Service to prove that DVD mail has effective competition within the meaning of 39 U.S.C. § 3642(b)(1), however, makes the cost issue moot. Moreover, even if the cost coverage of DVD mail were still relevant in this case, no party has disputed that Round-Trip DVD Mail covers its attributable costs and makes a contribution to institutional costs. *See* USPS Library Reference USPS-MC2013-57/NP1, DVD-RT FY 14 CC Forecast.xls, "DVD," cells P17 and P20.

The Postal Service may hope to use its cost studies for other purposes outside the scope of this case—e.g., to establish a record that could be used in some further proceeding to raise the rates charged GameFly vis-à-vis Netflix or other customers. The Commission should decline to accommodate such an agenda. The record raises serious and unanswered questions about the reliability of the attributable cost estimates submitted by the Postal Service in this reopened docket for GameFly DVD mail. Until the data have been adequately vetted, accepting the data for any purpose is unjustified. Glick Decl. (Aug. 15, 2013).; Glick Supp. Decl. (filed separately today).

CONCLUSION

The Postal Service's product transfer request should be denied for the reasons stated above and in GameFly's August 15 comments.

Respectfully submitted,

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September 12, 2013
(refiled December 26, 2013)

ATTACHMENT A

Jesse Chiang

Industry Analyst at IBISWorld

San Francisco Bay Area | Writing and Editing

Previous: Learn Capital, International Business Times, Inigral, Inc

Education: UCLA

Send InMail

181 connections

www.linkedin.com/in/jessechiang

Contact Info

Background

Summary

I am a passionate and hard working individual looking to utilize my writing skills. As a proven leader and skilled communicator I can be an asset in a multitude of contexts.

Experience

Industry Analyst
IBISWorld
February 2013 – Present (7 months) | Santa Monica, CA

Fellow
Learn Capital
January 2013 – February 2013 (2 months) | San Mateo, California

SportsNet Contributor
International Business Times
July 2012 – February 2013 (8 months)

• Hired as a “trusted” contributor, allowing for immediate and unlimited postings, independently
• Selected to write about the NFL, MLB and NBA, covering the 49ers, Raiders, Lakers, and Giants
• Authored articles with view counts ranging from 400 to 2000 views

Education Consultant
Inigral, Inc
July 2012 – January 2013 (7 months)

• Independently devised and developed college preparedness course to be paired with their Facebook application
• Constructed college-level lesson plans on topics such as writing, reading, and social media development
• Works directly with Chief Evangelist on special writing projects

Project Liaison Director
Community Service Commission
June 2010 – June 2012 (2 years 1 month)

• Served as primary contact between the commission and 8 of its 23 community service projects
• Planned first annual commission wide mixer where over 14 community service groups met to discuss ideas and future collaboration

People Also Viewed

Deonta Smith
Industry Research Anayst at IBISWorld


Jialu Chen
Associate at Asset Management Ventures


Anna Son
Industry Analyst at IBISWorld


Doug Kelly
Business Finance Analyst, Associate at PG&E


Daniel Feeney
Investment Associate at Mozaic, LLC

Jamie Yao
Student at UCLA

Caitlin Newsom
Industry Research Analyst at IBISWorld

Nikoleta Panteva
Senior Analyst at IBISWorld


Matthew MacFarland
Industry Analyst at IBISWorld


Rob Hutter
Managing Partner, Learn Capital


Daniel Feeney
Investment Associate at Mozaic, LLC
View

Jamie Yao
Student at UCLA
View

Co-Head Director
Casa Heiwa Angelina Mentorship Program (CHAMPs)
February 2010 – June 2012 (2 years 5 months)

• Inspired youth to seek higher education through one-on-one mentorship, planned lessons, college trips, SAT preparation, tutoring
• Developed and led funding efforts increasing the project grant from $6,000 to over $8,000 during the 2011-2012 school year
•Charged with communication and retention of staff, volunteers and service recipients, doubling the people involved in all three categories
• Spearheaded program-wide health initiative, providing education on health topics and healthy food alternatives

Marketing Intern
Teach for America
June 2011 – August 2011 (3 months) | Greater Los Angeles Area

• Composed and presented a marketing plan for college leaders to TFA marketing team.
• Created spreadsheets to enhance recruitment at the University of California, Santa Barbara
• Researched and formulated a special presentation on educational inequity in Santa Ana.

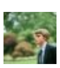
Writing and Creativity Counselor
Writing Success Program
April 2010 – June 2011 (1 year 3 months)

• Responsible for holding at least 60 one-hour writing sessions for struggling first generation college students
• Wrote weekly blog posts regarding writing tips, collectively garnering over a thousand views
• Programmed quarterly events for 20-30 students on campus to help UCLA students with writing development
• Selected to organize weekly counselor development trainings for the Writing Success Program Staff due to excellent writing skills

Intern
Inigral, Inc.
June 2010 – September 2010 (4 months)

• Represented the company at the Start-Up Roots Fellowship, a social media industry
• Worked full-time at social media company to create lesson plans for Math, General Science, History and English

1 recommendation


Michael Staton
Partner at Learn Capital
View

Languages

Chinese (Mandarin)
Limited working proficiency

English
Native or bilingual proficiency

Skills & Expertise

Most endorsed for...

2 Research
2 Youth Mentoring
2 Microsoft Office
2 Education
1 Customer Service
1 Teaching
1 Creative Writing
1 Editing

Jesse also knows about...

1 Lesson Planning | 1 Sports Writing | Market Research | Social Media Marketing | Marketing Research | Project Coordination | Workshop Facilitation | Bilingual | Leading Development... | Conflict Resolution | Staff Development | Higher Educaiton | Policy Writing | Copywriting | Copy Editing

Education

UCLA
Bachelor of Arts (B.A.), Political Science and Government, 3.7
2008 – 2012

*Graduated Cum Laude
*Hired as writing counselor to improve the writing of UCLA students. Targeted towards retention of first generation college students.
*Led CHAMPs mentorship program as Co-Head Director. Lead increase of funding, staff, volunteers, and participants.
*Spent summer of 2010 working as an intern for social media company Inigral. Represented company at social media fellowship.

Activities and Societies: Community Service Commission, CHAMPs (Casa Heiwa Angelina Mentorship Program), Writing Success Program

Westmont High School
2004 – 2008

1 recommendation


Lynn Walton
Mathematics Teacher
View

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Founder, Chopra...
+ Follow

Arianna Huffington
President and...
+ Follow

Pete Cashmore
CEO, Mashable Inc
+ Follow

Companies

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Entertainment
+ Follow

TakePart
Online Media
+ Follow

Coursera
Education Management
+ Follow

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+ Follow

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Staffing and Recruiting
+ Follow

Yahoo!
Internet
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Vox Media, Inc.
Online Media
+ Follow

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