

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

COMPLAINT OF GAMEFLY, INC.

Docket No. C2009-1(R)

COMPETITIVE PRODUCT LIST
ADDING ROUND-TRIP MAILER

Docket No. MC2013-57

COMPETITIVE PRODUCT LIST
ADDING ROUND-TRIP MAILER

Docket No. CP2013-75

UNITED STATES POSTAL SERVICE UPDATE TO RESPONSE TO COMMENTS
(January 22, 2014)

The United States Postal Service files an update to its Response to Comments filed on September 23, 2013, with the purpose of informing the Commission of a recent Federal Trade Commission (FTC) decision that addresses arguments and case authority included in GameFly's Comments. The Postal Service believes that this update is necessary because it will assist the Commission in making an informed decision based on current and accurate information.¹

I. BACKGROUND

On April 20, 2011, the Postal Regulatory Commission issued Order No. 718 in Docket No. C2009-1, finding that the United States Postal Service failed to establish reasonable and legitimate reasons for the different mail processing methods applied to GameFly, Inc. and other round-trip DVD mailers, and that its mail processing decisions

¹ The Postal Service believes that this update is an essential supplement to the record advising on an important development in the law relied upon by GameFly. To the extent that it is deemed unauthorized procedurally, it should be considered a motion to include this information in the record.

regarding round-trip DVD mail violated 39 U.S.C. § 403(c).² As a remedy, the Commission specified a “reduced rate for round-trip flat-shaped DVD mailers weighing up to two ounces” equal to the one ounce flat rate.³ On May 20, 2011, GameFly filed a Petition for Review with the United States Court of Appeals for the District of Columbia Circuit challenging the Commission’s remedy in PRC Docket No. C2009-1.⁴ On January 11, 2013, the Court issued its opinion vacating the Commission’s order and remanding the case.⁵

On June 26, 2013, the Commission issued Order No. 1763, specifying a new remedy that required the Postal Service “to equalize the rates for letter-shaped and flat-shaped round-trip DVD mailers either by establishing new equalized rates for such letter-shaped and flat-shaped round-trip DVD mailers, or by reducing the price for a two-ounce First-Class flat-shaped round-trip DVD mailer to the price for a one-ounce First-Class letter-shaped round-trip DVD mailer.”⁶ On July 26, 2013, the Postal Service provided notice of the creation of a new competitive product, tentatively titled Round-Trip Mailer, to replace the existing Round-Trip Mailer option on the Market-Dominant product list.⁷ On August 15, 2013, GameFly and Netflix filed comments in response to

² Order No. 718, Order on Complaint, Docket No. C2009-1, at 108, ¶¶ 5004-5005 (Apr. 20, 2011).

³ *Id.* at 113-115, ¶¶ 5022, 5027-5028.

⁴ Petition for Review, *GameFly, Inc. v. PRC*, 704 F.3d 145 (D.C. Cir. 2013) (No. 11-1179).

⁵ *GameFly*, 704 F.3d at 149 (D.C. Cir. 2013).

⁶ Order No. 1763, Order on Remand, Docket No. C2009-1R (June 26, 2013), at 1.

⁷ Request of the United States Postal Service Under Section 3642 To Create Round-Trip Mailer Product (“Request”), Docket No. C2009-1R (July 26, 2013).

the Postal Service's notice.⁸ On August 22, 2013, the Postal Service,⁹ the Public Representative,¹⁰ and Netflix¹¹ replied to comments submitted by the other parties.

On August 26, 2013, GameFly filed a motion requesting that the Commission deny the Postal Service's July 26 Request, or, in the alternative, strike the Postal Service Reply Comments, or, in the alternative, allow GameFly the opportunity to respond to the Postal Service Reply Comments.¹² On September 4, 2013, in PRC Order No. 1827, the Commission denied GameFly's motion with respect to denial of the Postal Service's July 26 Request and striking of the Postal Service Reply Comments, but granted GameFly leave to file additional comments by September 11, 2013.¹³ On the same day, the Commission issued PRC Order No. 1828, which imposed a new rate on the Postal Service, requiring "prices for two-ounce First-Class flat-shaped round-trip DVD mail equal to the prices for one-ounce First-Class letter-shaped round-trip DVD mail [effective September 30, 2013]."¹⁴

⁸ Comments of GameFly, Inc. On USPS Proposal to Reclassify DVD Mailers as Competitive Products ("GameFly Comments"), Docket No. C2009-1R (Aug. 15, 2013); Comments of Netflix, Inc. ("Netflix Comments"), Docket No. C2009-1R (Aug. 15, 2013).

⁹ United States Postal Service Reply to Comments ("Postal Service Reply"), Docket No. MC2013-57 (Aug. 22, 2013).

¹⁰ Reply Comments of the Public Representative in Response to Commission Order No. 1794, Docket No. MC2013-57 (Aug. 22, 2013).

¹¹ Reply Comments of Netflix, Inc., Docket No. MC2013-57 (Aug. 22, 2013).

¹² Motion of GameFly, Inc., for Relief with Respect to the August 22 "Reply" Comments of the Postal Service, Docket No. MC2013-57 (Aug. 26, 2013).

¹³ PRC Order No. 1827, Order Granting Motion for Leave to File Additional Comments, Docket No. MC2013-57 (Sept. 4, 2013).

¹⁴ PRC Order No. 1828, Order Prescribing Remedy, Docket No. C2009-1R (Sept. 4, 2013).

Pursuant to PRC Order No. 1827, on September 11, 2013, the Public Representative¹⁵ and Netflix¹⁶ filed additional comments. On September 12, 2013, GameFly filed comments in response to PRC Order No. 1827.¹⁷ On September 17, 2013, the Federal Express Corporation filed comments in this docket.¹⁸ On September 18, 2013, GameFly filed more comments in this docket.¹⁹ On September 23, 2013, the Postal Service replied to the comments submitted in response to PRC Order No. 1827.²⁰

II. FEDERAL TRADE COMMISSION DECISION REGARDING MARKET DEFINITION

In its Supplemental Comments, GameFly cites *FTC v. Staples*²¹ in support of its argument that “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.”²² In *FTC v. Staples*, the court defined the relevant product market as limited to office superstores, and excluded other competitors that sold office supplies, despite defendants’ contention that the proposed merger partners – Staples and Office Depot –

¹⁵ Comments of the Public Representative in Response to Order No. 1827, Docket No. MC2013-57 (Sept. 11, 2013).

¹⁶ Additional Comments of Netflix, Inc. Submitted Pursuant to Order No. 1827, Docket No. MC2013-57 (Sept. 11, 2013).

¹⁷ Supplemental Comments of Gamefly, Inc. on USPS Proposal to Reclassify DVD Mailers as Competitive Products, Docket No. MC2013-57 (Sept. 12, 2013) (“GameFly Supplemental Comments”).

¹⁸ Federal Express Corporation Comment on the Scope of the Postal Monopoly, Docket No. MC2013-57 (Sept. 17, 2013).

¹⁹ Reply Supplemental Comments of GameFly, Inc. on USPS Proposal to Reclassify DVD Mailers as Competitive Products, Docket No. MC2013-57 (September 18, 2013).

²⁰ United States Postal Service Response to Comments, Docket No. MC2013-57 (September 23, 2013).

²¹ 970 F. Supp. 1066 (D.D.C. 1997).

²² GameFly Supplemental Comments at 28-34.

had a small percentage of the overall market for office supplies.²³ In a decision released on November 1, 2013 regarding the potential merger of Office Depot and OfficeMax, the FTC revisited the market for office supplies, and adopted a more expansive market definition that includes the competitors excluded in *FTC v. Staples*.²⁴

In both of the proposed mergers cited above, the FTC's analysis of market definition considered the extent to which entities that sell office supplies, but do not specialize in the sale of office supplies, compete with and affect the prices of firms that specialize in the sale of office supplies. The difference in the FTC's conclusions regarding market definition in *FTC v. Staples* and the Office Depot/OfficeMax merger reflects the more recent development of competition from online commerce and non-specialized retailers in the market for office supplies, and more generally, in all markets. As explained by the FTC, the pricing analysis that supported a relevant market limited to office supply superstores in the 1990s supported a more expansive, national market when applied in 2013.²⁵

More specifically, in *FTC v. Staples*, the FTC and the court relied on pricing evidence to conclude that the prices of office supply superstores like Staples and Office Depot reflected competition from other office supply superstores located in close proximity, but that they were not impacted significantly by the local presence of non-office supply superstore retailers that sold office supplies.²⁶ Accordingly, they found

²³ *FTC v. Staples*, 970 F.Supp. at 1073-1081.

²⁴ Statement of the Federal Trade Commission Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc., FTC File No. 131-0104 (November 1, 2013).

²⁵ *Id.*

²⁶ *FTC v. Staples*, 970 F.Supp. at 1075-1078.

that office supply superstore customers would not change their purchasing decisions in response to a reduction in the price of office supplies offered by a non-office supply superstore retailer.²⁷

In considering the merger of Office Depot and OfficeMax in 2013, the FTC examined pricing evidence and determined that, in general, office supply superstores utilized national pricing practices unaffected by the local presence of office supply superstores, and marketing and advertising strategies that reflected competition from non-office supply superstore retailers.²⁸ These pricing practices and marketing and advertising strategies are consistent with the FTC's finding that customers who purchase office supplies from office supply superstores also purchase office supplies from non-specialized retailers and through online commerce.²⁹

This most recent FTC decision calls into question GameFly's arguments regarding market definition included in its Supplemental Comments. GameFly cites *FTC v. Staples* in support of its contention that firms that provide access to digitized entertainment content through mail delivery serve a distinct group of customers who prefer to access digitized entertainment content through mail delivery and primarily reside in rural areas, and that this group is the relevant market for purposes of this docket.³⁰ Notwithstanding the fact that this argument ignores the frequent consumer substitution and utilization of multiple methods of accessing digitized entertainment content that characterizes current customer activity, the pricing practices of firms that

²⁷ *Id.*

²⁸ FTC Statement re: Office Depot and Office Max.

²⁹ *See id.*

³⁰ GameFly Supplemental Comments at 28-32.

provide access to digitized entertainment content through mail delivery do not support such a limited definition of the relevant market.

Both GameFly and Netflix utilize national pricing policies.³¹ They do not offer different prices in rural areas with less access to broadband service, which represent one segment of the relevant market described by GameFly. Unless GameFly alleges that its entire customer base and any potential new customers targeted by its business model are included within its definition of the relevant market, its “core group of particularly dedicated, distinct customers” in rural areas with less access to broadband service where GameFly and Netflix face different sources of competition should be “paying distinct prices.”³² The fact that some GameFly customers “abandoned DVD-by-mail for content distribution via the Internet or Redbox”³³ indicates that not all GameFly customers fall within GameFly’s definition of the relevant market. Accordingly, GameFly’s uniform, national pricing practices undermine its argument that the relevant market for purposes of this docket is a submarket that excludes some consumers of access to digitized entertainment content, and some methods of delivering access to digitized entertainment content.

Like the market for office supplies, where competition once limited to office supply superstores expanded to include non-specialized retailers and online commerce, access to digitized entertainment content that was once available only through a recording on a cassette or DVD is now available through internet streaming, cable, and other methods. As demonstrated by the recent FTC decision regarding the merger of

³¹ Based on prices that appear on www.netflix.com and www.gamefly.com.

³² See *id.* at 29.

³³ *Id.* at 28.

Office Depot and OfficeMax, the *FTC v. Staples* decision reflects an outdated understanding of market competition focused on the geographical presence and specialization of potential competitors, and unaware of potential competition offered by online commerce and streaming. Given the important role and strong competitive force of online commerce and streaming in today's economy, GameFly's arguments regarding the relevant market, which rely on the outdated and invalid market analysis of *FTC v. Staples*, do not reflect the current state of competition.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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