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

COMPETITIVE PRODUCT LIST
ADDING ROUND-TRIP MAILER

Docket No. MC2013-57

COMPETITIVE PRODUCT LIST
ADDING ROUND-TRIP MAILER

Docket No. CP2013-75

UNITED STATES POSTAL SERVICE COMMENTS ADDRESSING RESPONSES TO CHAIRMAN'S INFORMATION REQUEST NOS. 1, 2, AND 3 (March 21, 2014)

Pursuant to Order No. 2011¹, the United States Postal Service (the "Postal Service") files its comments addressing the responses to Chairman's Information Request ("ChIR") Nos. 1, 2, and 3, which were issued on December 18, 2013.² Netflix, Inc. ("Netflix") filed its response to Chairman's Information Request No. 3 on January 16, 2014.³ GameFly, Inc. ("GameFly") filed its response to Chairman's Information Request No. 2 on January 17, 2014.⁴ These comments address the responses provided by GameFly and Netflix, and assess the significance of the information provided in these responses for purposes of the Commission's consideration of the Postal Service's request to add the Round-Trip Mailer product to the competitive product list.

¹ Order No. 2011, Order Establishing Comment Dates, Docket Nos. MC2013-57 and CP2013-75 (March 7, 2013).

² Chairman's Information Request No. 1, Docket Nos. MC2013-57 and CP2013-75 (December 18, 2013) ("ChIR No. 1"); Chairman's Information Request No. 2, Docket Nos. MC2013-57 and CP2013-75 (December 18, 2013) ("ChIR No. 2"); Chairman's Information Request No. 3, Docket Nos. MC2013-57 and CP2013-75 (December 18, 2013) ("ChIR No. 3").

³ Response of Netflix Inc. to Chairman's Information Request No. 3, Docket Nos. MC2013-57 and CP2013-75 (January 16, 2014).

⁴ Answers of GameFly, Inc., to Chairman's Information Request No. 2, Docket Nos. MC2013-57 and CP2013-75 (January 17, 2014).

I. THE DIGITAL ENTERTAINMENT MARKET IS CHARACTERIZED BY NUMEROUS COMPETITORS PROVIDING CONTENT THROUGH MULTIPLE DISTRIBUTION CHANNELS.

In its previous submissions in these dockets, the Postal Service described the numerous methods of providing consumer access to digitized entertainment content that compete with the Postal Service's delivery of that content through the mail.⁵ The experiences of both GameFly and Netflix provide examples of these various methods. GameFly rents video games through mail subscriptions; sells new and used games through the mail; sells games via downloading over the internet; and offered video games for rent through retail kiosks.⁶ Like GameFly, Netflix has provided consumer access to digitized entertainment content through multiple channels as it evolved from a subscription-based mail service to, as stated in its 10-K for fiscal year 2013, "the world's leading Internet television network."⁷ The experiences of GameFly and Netflix represent some, but not all, of the methods utilized by competitors to provide consumer access to digitized entertainment content in the robustly competitive market under consideration in these dockets.

Public statements from Netflix and other participants in the digitized entertainment content industry describe a highly competitive market with a large number of competitors that offer products and services available to customers as substitutes for

⁵ United States Postal Service Update to Response to Comments, Docket Nos. C2009-1(R), MC2013-57, and CP2013-75 (January 22, 2014); Response of the United States Postal Service to Chairman's Information Request No. 1, Docket Nos. MC2013-57 and CP2013-75 (January 17, 2014); United States Postal Service Response to Comments, Docket Nos. MC2013-57 and CP2013-75 (September 23, 2013); United States Postal Service Reply to Comments, Docket Nos. MC2013-57 and CP2013-75 (August 22, 2013).

⁶ Answers of GameFly to ChIR No. 2.

⁷ Netflix, Inc. (2013). *Form 10-K for the fiscal year ended December 31, 2013*, at 1. Retrieved from <http://www.sec.gov/edgar.shtml>. ("Netflix 10-K")

the products and services provided by GameFly and Netflix. In its 10-K for fiscal year 2013 filed after its response to ChIR No. 3, Netflix noted:

The market for entertainment video is intensely competitive and subject to rapid change. Many consumers maintain simultaneous relationships with multiple entertainment video providers and can easily shift spending from one provider to another. [Netflix's] principal competitors vary by geographic region and include multichannel video programming distributors providing free on demand content through authenticated Internet applications, Internet-based movie and TV content providers, including both those that provide legal and illegal (or pirated) entertainment video content, DVD rental outlets and kiosk services and entertainment video retail stores.⁸

In its 10-K for fiscal year 2013, Outerwall Inc. ("Outerwall"), the parent company of Redbox, describes the sources of competition faced by its products and services, and identifies both Netflix and GameFly specifically.

Our Redbox business faces competition from many other providers, including those using other distribution channels, ..., including:

- mail-delivery and online retailers, like **Netflix** or Amazon;
- cable, satellite, and telecommunications providers, like Comcast or DISH Network;
- traditional movie programmers, like HBO or Showtime;
- other forms of movie content providers like Internet sites including iTunes, YouTube, Hulu or Google;
- traditional brick and mortar video retailers, and other DVD kiosk businesses;
- other retailers like Walmart and other chain stores selling DVDs and video games;
- other forms of video game rental providers, like **GameFly**;
- noncommercial sources like libraries; and
- general competition from other forms of entertainment such as movie theaters, television and sporting events.⁹ (emphasis added)

To the same effect, in its recent filing, preparatory to an Initial Public Offering ("IPO"), King Digital Entertainment ("King") explains that its products and

⁸ Netflix 10-K at 2.

⁹ Outerwall, Inc. (2013). *Form 10-K for the fiscal year ended December 31, 2013*, at 3. Retrieved from <http://www.sec.gov/edgar.shtm>. ("Outerwall 10-K")

services, which include Candy Crush Saga, a casual game available as an application for a mobile device, “face competition from a number of competitors who develop games on social networks, mobile, PC and consoles.”¹⁰ King focuses on the development of digitized entertainment content, and the channels utilized by consumers to access King’s content – the Apple App Store, the Google Play Store, the Amazon Appstore, and Facebook¹¹ – compete with GameFly and represent alternatives to the Postal Service for providing consumer access to digitized entertainment content.

Finally, GameStop Corp. (“GameStop”), which describes itself as “the world’s largest multichannel video game retailer,”¹² presents a similar portrayal of the highly competitive nature of the digitized entertainment content industry.

The electronic game industry is intensely competitive and subject to rapid changes in consumer preferences and frequent new product introductions. [GameStop] compete[s] with mass merchants and regional chains; computer product and consumer electronics stores; other video game and PC software specialty stores; toy retail chains; direct sales by software publishers; and online retailers and game rental companies. Video game products are also distributed through other methods such as digital delivery. [GameStop] also compete[s] with sellers of pre-owned video game products. Additionally, [it] compete[s] with other forms of entertainment activities, including casual and mobile games, movies, television, theater, sporting events and family entertainment centers.¹³

GameStop identifies some of its competitors by name, including Steam.¹⁴

In its responses to ChIR No. 2 and other submissions in these dockets,

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¹⁰ King Digital Entertainment PLC (2014). *Form F-1 filed on February 18, 2014*, at 14. Retrieved from <http://www.sec.gov/edgar.shtm>. (“King F-1”)

¹¹ *Id.*

¹² GameStop Corp. (2013). *Form 10-K for the fiscal year ended February 2, 2013*, at 2. Retrieved from <http://www.sec.gov/edgar.shtm>. (“GameStop 10-K”)

¹³ *Id.* at 15.

¹⁴ *Id.* at 15, 19.

[END PROPRIETARY], suggesting that firms utilizing these channels do not compete with GameFly.¹⁵ But firms like Redbox and the application stores operated by Apple, Google, Amazon, and Facebook compete effectively with GameFly by providing consumer access to digitized entertainment content through kiosks, downloading, and other methods. GameFly's focus on its own competitive experiences, rather than those of market participants collectively, is inconsistent with the fundamental principle of antitrust law, which guides market definition analysis, that antitrust law protects competition, not individual competitors. GameFly's decision to focus on a single method of providing consumer access to digitized entertainment content does not demonstrate that competing methods fall outside of the relevant market, particularly where other firms compete in the market successfully utilizing those methods.

Notwithstanding the examples of successful competition from firms providing consumer access to digitized entertainment content through kiosks and downloading, the information provided by GameFly in response to ChIR No. 2 does not demonstrate that these methods of access are infeasible for GameFly.

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¹⁵ Answers of GameFly to ChIR No. 2, Question 4; GameFly Exhibit CHIR 2, Q4; Supplemental Declaration of David Hodess, Docket Nos. MC2013-57 and CP2013-75 (December 26, 2013) at ¶¶ 18, 35.

[END PROPRIETARY] With respect to GameFly's use of kiosks, the data do not reflect separation of variable and fixed costs, and thus a comparison of marginal revenue and marginal cost cannot be performed.

In its previous submissions, GameFly suggested that kiosks are a viable option for firms like RedBox that offer both video game and video rentals, but not for firms that offered only video game rentals.¹⁶ However, according to this argument, with GameFly's recent addition of a DVD video rental service,¹⁷ it appears that the use of kiosks to provide consumer access to digitized entertainment content is now a viable option for GameFly.

II. THE DIGITAL ENTERTAINMENT MARKET IS EVOLVING RAPIDLY.

As described above, currently the market for digitized entertainment content includes a large number of participants using a variety of different distribution channels, and reflects a high degree of competition. As demonstrated by the responses to the ChIR Nos. 2 and 3, this market continues to evolve rapidly, indicating the likelihood of a future increase in competition.

As noted above, the mail subscription service pioneered by Netflix is no longer even part of its "core strategy," which it defines as "grow[ing its] streaming subscription business domestically and internationally."¹⁸ **[BEGIN PROPRIETARY]**

¹⁶ *Id.*

¹⁷ Jared Newman, *GameFly Gets Into Mail-Order Movie Rentals*, TIME.COM (March 4, 2014, 5:28 PM), <http://time.com/#12328/gamefly-gets-into-mail-order-movie-rentals/>.

¹⁸ Netflix 10-K at 1.

[END PROPRIETARY]¹⁹ As reported in its 10-K for fiscal year 2013, mail service membership fell 16 percent and revenues fell 20 percent from 2012 levels.²⁰ At the same time, paid membership in its domestic streaming service grew by 25 percent and revenues by 26 percent.²¹ Results for the international service saw a 99 percent increase in paid membership and a 148 percent increase in revenues.²² Based on the Outerwall 10-K fiscal year 2013, Redbox DVD rentals almost certainly exceed rentals through Netflix's mail subscription service.²³

GameFly's subscriber base has also experienced adverse effects from changes in consumer demand. **[BEGIN PROPRIETARY]**

[END PROPRIETARY] Although GameFly attempts to minimize the significance of Redbox's video game rental operations, a comparison of the scale of operations of the two companies indicates that Redbox is an effective competitor of GameFly. In its 10-K for fiscal year 2013, Outerwall reported that in 2013 Redbox video game rentals accounted for 2.2 percent, or approximately 17

¹⁹ USPS-LR-MC2013-57/NP7, Updated Netflix and GameFly FCM Volumes (January 17, 2014).

²⁰ Netflix 10-K at 21.

²¹ *Id.* at 19.

²² *Id.* at 20.

²³ Compare Netflix 10-K at 21 with Outerwall 10-K at 26.

million, of total Redbox rentals of approximately 776 million.²⁴ **[BEGIN**

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[END PROPRIETARY]²⁵ At an average reported net revenue per rental of \$2.54,²⁶ which does not reflect the higher rental charge for video games, Redbox generated an estimated revenue of over \$43 million²⁷ from video game rentals in 2013, **[BEGIN PROPRIETARY][END PROPRIETARY]**

Hardware manufacturers have noticed the rapid evolution of the market for digitized entertainment content. In its response to ChIR No. 1, the Postal Service cited the innovative potential of the new “Steam Machines.”²⁸ Similarly, Sony observed the continuing technological shift in the market for digitized entertainment content, and particularly the video game segment of this market, in its 6-K for February 2014.

Sales of digital downloads [of video games] are increasing rapidly as the delivery of game content transitions from disc media to sales over the network. Sony is [] working towards streaming PlayStation games by leveraging the cloud technologies of Gaikai Inc., which Sony acquired in the fiscal year ended March 31, 2013. This would enable the PlayStation experience to be enjoyed across a wide range of products, providing significant opportunities for further business expansion. Through these efforts, Sony aims to re-invigorate the game market, which has recently experienced a shift in consumer preferences to casual, free-to-play games played on mobile devices. Sony also aims to increase its share in the

²⁴ Outerwall 10-K at 26-27.

²⁵ USPS-LR-MC2013-57/NP7.

²⁶ Outerwall 10-K at 26.

²⁷ This value is the product of 17 million video game rentals multiplied by the net revenue per rental of \$2.54.

²⁸ Response of the United States Postal Service to ChIR No. 1, Question 4.

online gaming market, which has expanded at a pace faster than Sony's growth in that market.²⁹

Sony's comment concerning the exponential growth of casual gaming is particularly acute. The initial registration filing preparatory to an IPO from King shows not only where the market for digitized entertainment content is heading, but, perhaps more ominously, where the market has arrived already. The number of consumers accessing digitized entertainment content, including casual games, on mobile devices daily is measured in the millions, dwarfing the count of consumers accessing this content through more traditional methods such as DVD.³⁰ And in the near future, casual games developed for mobile devices could be accessible on the same screens and played with the same type of controllers as console games.³¹

Both Outerwall and GameStop recognize the shift in consumer demand toward downloading and streaming digitized entertainment content, and acknowledge that this shift could have a potential impact on their business. Outerwall expects that "demand for physical distribution of movies will likely decrease over the long-term."³² And to "address[] the changing needs and preferences of [its] consumers," Redbox formed a joint venture with Verizon, Redbox Instant™, that provides Redbox customers digital access to digitized entertainment content through Verizon, in addition to the access these customers

²⁹ Sony Corporation (2014). *Form 6-K for the month of February 2014*, at 8. Retrieved from <http://www.sec.gov/edgar.shtm>. ("Sony 6-K")

³⁰ King F-1 at 1.

³¹ See *Google buys up games controller firm Green Throttle Games*, BBC NEWS TECHNOLOGY (March 13, 2014, 1:19 PM), www.bbc.com/news/technology-26549264?print=true.

³² Outerwall 10-K at 4.

utilize already through Redbox kiosks.³³ Importantly, the viability of this joint venture supports the Postal Service's position that consumers who access digitized entertainment content through physical DVDs also seek access to this content through alternate, substitutable methods, including downloading and streaming, and are not limited to a single form of access.

Like Outerwall, GameStop has responded to changes in consumer preferences for access to digitized entertainment content. It anticipates that "future growth [of electronic games] will be driven by the sale of video games delivered in digital form and the expansion of other forms of gaming."³⁴ Consistent with this understanding of changing consumer preferences and the market for digitized entertainment content, GameStop "operate[s] an online video game platform called Kongregate.com and [] acquired a digital PC distribution platform, Impulse, and a streaming technology company, Spawn Labs."³⁵ GameStop's prepaid digital and online timecards for subscription-based games such as World of Warcraft enable consumers to access video game content for a limited period of time, operating like a video game rental.³⁶

As demonstrated above, the view that customers who access digitized entertainment content through physical DVDs obtained through the mail do not view digital and other forms of access to digitized entertainment content as substitutes is inconsistent with the widespread recognition of the shift in customer preferences concerning access to digitized entertainment content. GameFly's

³³ *Id.* at 20.

³⁴ GameStop 10-K at 6.

³⁵ *Id.*

³⁶ *Id.*

competitors have recognized changes in the market, and altered their business models as necessary to maintain or improve their position in the market.

GameFly's continued focus on providing consumer access to digitized entertainment content through the mail reflects its own business choice, rather than the limitations of the market; is inconsistent with the actions of its competitors; and does not negate the consistent and voluminous evidence of a consumer shift between digital, mail, and other forms of access to digitized entertainment content, and the substitutability of these forms of access.

III. THE CLASSIFICATION OF THE ROUND TRIP MAILER AS A COMPETITIVE PRODUCT IS AMPLY JUSTIFIED.

As explained by the Postal Service in its previous submissions, the key issue for the Commission in these dockets is whether digital, physical, and other methods of delivering digitized entertainment content compete sufficiently with the Postal Service's mail delivery to restrict the Postal Service's ability to charge prices for the Round-Trip Mailer that are above competitive levels. Statements from multiple participants in the digitized entertainment content industry, as well as the information provided by GameFly and Netflix in response to ChIR Nos. 2 and 3, reflect a consensus understanding that firms utilizing different methods of delivering digitized entertainment content engage in robust competition. For example, the statements of Outerwall indicate that the business decisions of Redbox, which relies primarily on kiosks to provide consumer access to digitized entertainment content, are constrained by the actions of GameFly, which relies primarily on mail delivery, and Netflix, which relies primarily on streaming.³⁷

³⁷ See Outerwall 10-K at 3.

Netflix acknowledges that consumers maintain simultaneous relationships with multiple providers of access to digitized entertainment content, and can “easily shift spending from one provider to another,”³⁸ indicating that the Postal Service faces elastic demand and price pressure from non-mail access to this content. The information provided in these dockets demonstrates overwhelmingly that digital, physical, and other methods of delivering digitized entertainment content compete sufficiently with mail delivery to restrict the Postal Service’s ability to charge supracompetitive prices for the Round-Trip Mailer product.

In essence, in order for the Postal Service to exercise market power by pricing the Round-Trip Mailer product above competitive levels, it must act as a bottleneck through which any party wishing to provide consumer access to digitized entertainment content must pass. It is doubtful that the Postal Service ever acted as a bottleneck respecting the distribution of digitized entertainment content. As demonstrated above, the information submitted in these dockets does not support a claim that currently the Postal Service possesses market power in the market for the provision of consumer access to digitized entertainment content. There exist both multiple channels to distribute this content and multiple competitors engaged in that distribution. Moreover, new channels and competitors are entering the market continuously, and introducing new innovations that render previous innovations obsolete.

GameFly’s use of a business model built around subscriptions and mail delivery of access to digitized entertainment content results not from any market power of the Postal Service but from GameFly’s choice. A package consolidator

³⁸ Netflix 10-K at 2.

cannot claim that the Postal Service has market power just because it has chosen to give its business to the Postal Service rather than United Parcel Service (UPS), FedEx, or some other competitor. The Commission should not accept what amounts to an identical claim from GameFly.

Again, the Federal Trade Commission (FTC) decision³⁹ cited in the Postal Service's earlier submission provides an instructive demonstration of market competition after growth of the Internet. Specifically, the FTC recognized that where once a relevant market was limited to physical retail locations offering the same collection of products or services in close geographic proximity, the market definition has expanded to include competition from Internet retailers and other sources that offer substitutable goods or services.⁴⁰ GameFly's definition of a market limited to a single method of providing consumer access to digitized entertainment content ignores the recognition of broader markets in the FTC decision described above, and revealed more generally through historical innovation. The FTC decision concerning the office supply market cited above offers one example of this recognition, and provides guidance to the Commission as it seeks to define the relevant market for purposes of the Postal Service's request to add the Round-Trip Mailer product to the competitive product list.

As explained above and in previous submissions, the information provided in response to ChIR Nos. 1, 2, and 3 and otherwise in these dockets supports the

³⁹ 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).

⁴⁰ *Id.*; Internet competition was cited as a factor responsible for Staples' recent decision to close physical retail locations and increase its emphasis on internet sales activities. Chris Isidore, *Staples to close 225 stores*, CNN MONEY (March 6, 2014, 1:34 PM), http://money.cnn.com/2014/03/06/news/companies/staples-store-closing/index.html?hpt=hp_t2.

Postal Service's request to add the Round-Trip Mailer product to the competitive product list.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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