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

REPLY COMMENTS OF GAMEFLY, INC., ON RESPONSES OF USPS AND NETFLIX TO CHAIRMAN'S INFORMATION REQUESTS

(April 4, 2014)

Pursuant to Order No. 2011, GameFly, Inc., ("GameFly") respectfully replies to the March 21 comments of the United States Postal Service, Netflix Inc., and the Public Representative on the parties' January 2014 responses to Chairman's Information Requests Nos. 1 and 3.[1]

INTRODUCTION AND SUMMARY

The Postal Service's March 21 filing is a parade of irrelevancies aimed at distracting the Commission from the Postal Service's failure to meet its burden of proof under 39 U.S.C. § 3642. *Cf.* Public Representative comments (March 21,

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[1] Response of Netflix Inc. to Chairman's Information Request No. 3 (filed January 16, 2014); Response of the United States Postal Service to Chairman's Information Request No. 1 (filed January 17, 2014).

2014) (describing USPS arguments as a “red herring”). There is no question about what Section 3642 requires. To justify exemption of DVD mail from maximum rate reduction, the Postal Service must show that the demand for round-trip DVD mail service has become sufficiently elastic to make a substantial postage increase for this product unprofitable. In other words, the Postal Service must show that, if it raised its rates on round-trip DVD mail by a small but significant amount, DVD rental companies like GameFly and Netflix would switch enough of their DVD-by-mail volume to alternative delivery channels to offset the gain in unit contribution from the rate increase. The Postal Service has made no such showing in its March 21 comments or at any other point in this case. The only elasticity “data” offered by the Postal Service is an anecdotal Netflix statement to shareholders on a different point. Netflix’s actual views are that, if the Postal Service raises its prices, Netflix must absorb the increase and accept smaller margins.

The Postal Service’s main argument—that DVD-by-mail has ceased to be a relevant market because all consumers now regard the content available from other distribution channels as a good substitute—is equally unfounded. The undisputed record evidence shows that millions of consumers still consider the digital content available over the Internet or from Redbox self-service kiosks as a poor substitute for the quality and broad range of console games and films available for rental via DVD-by-mail. The Postal Service’s arguments to the contrary are—even assuming *arguendo* their relevance to the market power issue at all—empty speculation at best. Moreover, as *Coal Exporters Ass'n of United States v. United States*, 745 F.2d 76, 84-85, 93, 95, 99 (D.C. Cir. 1984), and similar cases make clear, the Commission's regulatory obligations include protecting mailers from confiscation of their earnings by the Postal Service, not just protecting the mailers' downstream customers.

The Commission should also deny Netflix's request to be allowed to mail DVDs as generic First-Class Mail. Granting this request would contravene the requirement of Title 39 that all products be classified either as market-dominant or competitive—not both—and would reopen the door to the very discrimination that led to GameFly's complaint against the Postal Service five years ago.

COMMENTS

I. THE POSTAL SERVICE'S MARCH 21 COMMENTS HAVE NOT CURED THE POSTAL SERVICE'S FAILURE OF PROOF.

A. The Governing Legal Standards Are Undisputed.

The Postal Service's March 21 comments offer no real challenge to the proof requirements for exemption of a market dominant product from maximum rate regulation. To justify exemption of a product under 39 U.S.C. § 3642, the Postal Service must show that the demand for DVD mail service is so price elastic that a significant increase in postage rates would be self-defeating. 39 U.S.C. § 3642(b)(1); 39 C.F.R. § 3020.32(d); *CF Industries, Inc. v. Surface Transportation Board*, 255 F.3d 816, 821-24 (D.C. Cir. 2001). Even if the USPS could provide compelling evidence that DVD rental companies face competition in the markets for *their* products, such a showing would still be irrelevant to the statutory question as long as a significant number of consumers continue to prefer the video game and film content available via DVD-by-mail over the content available from other distribution channels—*i.e.*, so long as DVD-by-mail remains a distinct product market.

(1) The relevant product for which the USPS must prove the existence of effective competition is not "digitized entertainment content," or even DVDs, but the *mail service* provided by the USPS. See 39 U.S.C. § 3642(b) and 39 C.F.R. §§ 3020.30 to 3020.32) (defining required competitive analysis in terms of Postal Service products); USPS Request to Create Round-Trip Mailer Product (July 26, 2013) (defining "product" as "Round-Trip Mailer"). The distinction between competition for the delivered product (rental DVDs) and Postal Service's delivery service (mail) is crucial. Effective competition for the former can coincide with market power over the latter; in those circumstances, the seller or renter of the delivered product must simply absorb any increases in the price charged for the delivery service.[2]

[2] GameFly Supplemental Comments (September 12, 2013) at 5-17 (discussing *Coal Exporters Ass'n of United States v. United States*, 745 F.2d 76, 84-85, 93, 95, 99 (D.C. Cir. 1984); *General Chemical Corp. v. United States*, 817 F.2d 844, 854 (D.C. Cir. 1987)).

(2) To show that round-trip DVD mail service faces effective competition, the USPS must show that raising the postal rates charged for the mail service above current levels would be unprofitable. That requires proof that the demand for the mail service is sufficiently price elastic that the lost volume will more than offset the gain in per-piece contribution.[3] As the 2013 FTC decision cited by the Postal Service makes clear, the required analysis of demand elasticities is typically a complex and data-intensive undertaking. In the Office Max/Office Depot merger case cited by the Postal Service, for example, the FTC's decision was based on a seven-month investigation of the substitutability of the "consumable office supplies" offered by the two merger applicants and competing sellers, including an "extensive" series of econometric analyses, comparisons of prices in markets with varying numbers of office supply superstores, and "events studies" analyzing the impact of office supply superstore closings on the prices charged by remaining office supply superstores in local areas. FTC File No. 131-0104, *FTC Statement Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc.* (November 1, 2013) at 1-2 (attached to GameFly Response (January 29, 2014)); accord, Netflix Comments (May 21, 2014) at 7 nn. 19. The drastic consequences of exempting a mail product from maximum rate regulation make a comparable burden of proof appropriate under 39 U.S.C. §3642. The "evidence" of demand elasticity and

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[3] GameFly comments (Aug. 15, 2013) at 5-7; GameFly Supp. Comments (September 12, 2013; refiled December 26, 2013) at 6-10; *accord*, Pub. Rep. comments (March 21, 2014) at 2; Netflix Comments (March 21, 2014) at 5.

competition offered by the Postal Service in this docket—a hodgepodge of press releases and third party information scavenged randomly out of context—does not begin to satisfy this standard.

(3) The Postal Service's main defense is that the video game and film content available via the Internet or other non-mail channels has eliminated DVD-by-mail as a separate product market. As long as a "core group of particularly dedicated, 'distinct customers' remains, however, they may constitute a distinct market that must be analyzed separately.[4]

The Postal Service's March 21 comments offer no serious challenge to these legal standards. The Postal Service's claim that it "is doubtful" that it "has ever acted as a . . . bottleneck through which any party wishing to provide consumer access to digitized entertainment content must pass" (USPS Comments at 12) completely misses the point. The concept of a "bottleneck" is simply irrelevant in this case. As used in competition analysis, the term refers to market power possessed by a vertically integrated firm over an input that it simultaneously supplies to its customers and uses itself to compete with those customers in *their* downstream markets. A standard example was the was local network (or "last mile") of the pre-divestiture Bell System of 1980: the Bell

[4] GameFly Supplemental Comments (September 12, 2013) at 28-31 (discussing *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); *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962)); GameFly Response (Jan. 29, 2014) at 1-3.

System simultaneously offered access to its (monopoly) local phone network to competing long-distance carriers such as MCI, while using the Bell System's own long-distance services to compete with MCI's long-distance business.[5] By contrast, no one has suggested that the Postal Service competes with GameFly or Netflix in the DVD-by-mail rental business.

The Postal Service again misreads a recent FTC decision as holding that the relevant market "has expanded" as a matter of law "to include competition from Internet retailers and other sources."[6] As GameFly explained two months ago when the Postal Service first raised this claim, the FTC decision reflected merely a change in factual conditions in the office supply market, not a change in the controlling legal standards.[7] Purchasers of consumable office supplies now regard the products available at mass merchants like Wal-Mart and Target, and Internet retailers such as Amazon, as good substitutes for the products available from office supply superstores like Staples.[8] By contrast, the millions of

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[5] *See*, *e.g.*, Robert W. Crandall, "The Remedy for the 'Bottleneck Monopoly' in Telecom: Isolate It, Share It, or Ignore It?" 72 *U. Chi. L. Rev*. 1 (2005).

[6] USPS Comments at 13 (citing FTC File No. 131-0104, *FTC Statement Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc*. (November 1, 2013) at 1-2); cf. USPS Update (January 22, 2014) at 5-8 (citing same FTC decision).

[7] GameFly Response to USPS Update to Response to Comments (Jan. 29, 2014); FTC Statement at 3 ("we emphasize that our decision, including our view of the competition interaction between brick-and-mortar retailers and Internet sellers, is limited to the facts before us in this particular matter.").

[8] *Id*.

consumers who still prefer to rent a wide variety of movies on DVDs from Netflix, or rent a wide variety of console video games from GameFly, do not regard the content available from the Internet or Redbox as good substitutes.[9]

Finally, the Postal Service's analogy between GameFly and a "package consolidator" that "has chosen to give its business to the Postal Service rather than United Parcel Service (UPS), FedEx, or some other competitor" (USPS comments at 12-13) founders on the same ground, as GameFly has previously noted. UPS, FedEx and other private carriers do not offer any transportation and delivery service that competes with round-trip DVD mail, as the Postal Service admitted at the outset of this case.[10] There is also no alternative non-mail channel of distribution from which consumers can obtain the same content libraries available for rental by mail from GameFly or Netflix. *See* pp. 9-21, *infra*; GameFly Supp. Comments (refiled December 26, 2013) at 32-33 (explaining fallacy of UPS/FedEx analogy). Hence, the legal analogy between DVD rental companies and "package consolidators" that can choose between the Postal

[9] GameFly comments (August 15, 2013) at 23-30; GameFly Supplemental Comments (September 12, 2013; refiled December 26, 2013) at 37-50 and Hodess Supp. Decl.; GameFly response to CHIR 2, Question 1 (January 17, 2014); GameFly Comments (refiled March 24, 2014) at 6; Declaration of David Hodess (refiled March 24, 2014).

[10] USPS Request (July 26, 2013), Attachment A, Monteith Statement at 3 (admitting that the USPS "does not know of another shipping company that provides door-to-door delivery of optical discs such as DVDs").

Service and multiple direct competitors of the Postal Service rests on a false premise.

B. The Postal Service Has Failed To Satisfy The Governing Legal Standards.

Six substantive pleadings and eight months after the Postal Service filed its product transfer request, the Postal Service has still failed to satisfy the above standards. Simply put, it has provided no evidence that if it raised its rates for round-trip DVD mail, DVD rental companies would (or could) switch to alternative channels to distribute their content—let alone would do so enough to make the price increase unprofitable. The Postal Service instead relies on speculation and broad generalizations about the state of the digitized entertainment content industry.

The premise of the Postal Service's case is that, because an increasing share of digitized entertainment content is distributed to consumers via non-mail channels, the demand for mail distribution of DVDs must have become more price-elastic. But the Postal Service has presented no data supporting this hypothesis, and it is contradicted by the Postal Service's own demand studies underlying its case in Docket No. R2013-11. The elasticity data submitted by the Postal Service (and credited by the Commission) in R2013-11 show that, in virtually every mail product, even very great losses of volume to the Internet diversion have not made the residual demand for mail price elastic—and, indeed, have left demand elasticities essentially unchanged from 2006 or 2007.[11] A report of the Postal Service's Office of Inspector General in May 2013 reached the same conclusion.[12] These elasticity data are the best evidence of record, and therefore controlling, absent better and more specific data. As the Commission recently explained in using subclass elasticity data to evaluate the profitability of the Discover NSA, "the elasticity of individual mailers may differ from that of the subclass as a whole; however, the Commission methodology uses subclass elasticities because they are the only elasticity estimates produced by the Postal Service at this time." Annual Compliance Determination Report for FY 2013 (March 27, 2013) at 67.

Nor has the Postal Service proven the demise of DVD-by-mail as a distinct product market for the Postal Service's customers. Although alternative non-mail channels have gained volume, millions of consumers still prefer the quality of playing experience available only from console game DVDs, the broad selection of console game DVDs available for rental only from DVD-by-mail companies like GameFly, and the comprehensive catalog of film entertainment available from

[11] *See* GameFly Comments (August 15, 2013) at 11-14; GameFly Supplemental Comments (September 12, 2013; refiled December 26, 2013) at 13-17, 31 (summarizing USPS elasticity estimates); Docket No. R2013-11, Order No. 1926 (December 24, 2013) at 157 (crediting USPS elasticity estimates as "best evidence of record"); GameFly Comments (March 24, 2014) at 3 (discussing R2013-11 record).

[12] USPS OIG Report No. RARC-WP-13-008, *Analysis of Postal Price Elasticities* (May 1, 2013).

the DVD-by-mail rental services of Netflix and its smaller rivals.[13] Likewise, DVD rental companies—including GameFly, Netflix and smaller firms—still have large inventories of DVDs to rent to these consumers. The only practical way to deliver most of these rental DVDs to consumers is by mail; and the only practical way for consumers to return the DVDs to the rental companies is by mail.[14]

The Commission, by issuing Chairman's Information Request No. 1, gave the Postal Service one last chance to cure its failure of proof. In particular, Question 2 asked the Postal Service to provide information on the own-price elasticity of demand for DVD mail service (emphasis added):

> Please provide a copy of all surveys, studies, and analyses performed by or for the Postal Service from FY 2003 to FY 2013 assessing the actual or possible *impact (revenues and volumes) on the Postal Service from past or proposed changes in the rates paid by mailers for round-trip DVD mailers*.

Question 4 asked the Postal Service to provide information on cross-price elasticities of demand (emphasis added):

[13] GameFly comments (August 15, 2013) at 23-30; GameFly Supplemental Comments (September 12, 2013; refiled December 26, 2013) at 37-50 and Hodess Supp. Decl.; GameFly response to CHIR 2, Question 1 (January 17, 2014); GameFly Comments (refiled March 24, 2014) at 6; Declaration of David Hodess (refiled March 24, 2014).

[14] GameFly comments (Aug. 15, 2013) at 4; GameFly Supp. Comments (September 12, 2013; refiled December 26, 2013) at 28-31, 33, 34-50; *id*., Hodess Supp. Decl. at ¶¶ 3-5.

> Please provide a copy of all surveys, studies, and analyses prepared by or for the Postal Service from FY 2003 to FY 2013 assessing *changes in DVD customers' usage of alternative delivery media* for round-trip DVD mailers—including but not limited to other direct-delivery providers, streaming of DVD content over the Internet, downloading of DVD content from the Internet, and DVDs offered at kiosks or brick-and-mortar retail stores *in response to changes in the postal rates paid for round-trip DVD mailers*.

And question 6 asked the Postal Service to provide any evidence that alternative delivery channels were "acceptable substitutes for physical delivery for a significant portion of' the video content that companies other than GameFly or Netflix "currently or formerly" delivered via round-trip DVD mailers.

The Postal Service's January 17 Response to CHIR 1 did not answer these questions. In response to Question 2, the Postal Service directed the Commission to "see the response to Question 4." In response to Question 4, however, the Postal Service provided no information on demand elasticities at all. After admitting that it had no elasticity studies,[15] the Postal Service launched into an irrelevant discussion of new game console releases that the Public Representative has correctly characterized as a "red herring."[16] Finally, in response to question 6, which asked for information on DVD-by-mail rental companies that "now use alternative means of delivering DVDs or DVD content," the Postal Service offered only a reference to Blockbuster, a company that failed

[15] USPS response to CHIR 1, Question 4 (first paragraph of answer).

[16] Public Representative Comments (March 21, 2014) at 2.

several years ago and was liquidated earlier this year after being acquired by a satellite dish company.[17]

The Postal Service's March 21 comments are equally beside the point. The Postal Service again offers no elasticity data, let alone any evidence that the demand for DVD mail service is elastic enough to deter an increase in the price of DVD mail if the Commission were to exempt the product from maximum rate regulation. The Postal Service seizes upon a Netflix statement in the company's most recent Form 10-K about the ability of "many" consumers to "shift spending from one provider to another" as "indicating" that "the Postal Service faces elastic demand and price pressure from non-mail access to this content."[18] The quoted Netflix statement "indicates" no such thing. It implies only that the demand for Netflix's services is more elastic than zero, a proposition that no one questions. And the statement refers to competition for Netflix's services generally—not the distinct group of consumers who still prefer to rent DVDs by mail.

Netflix does discuss the elasticity of demand for its mail service nine pages later in the same Form 10-K:

> *We rely exclusively on the U.S. Postal Service to deliver DVDs from our shipping centers and to return DVDs to us from our members. Increases in postage delivery rates*, including those resulting from

[17] USPS response to CHIR 1, Question 6; *cf*. GameFly Comments (March 21, 2014) at 8.

[18] USPS Comments at 12 (citing Netflix Form 10-K for 2013 (Feb. 3, 2014) at 2).

> changes to policies on the requirements of first class mail such as size, weight or machinability, *could adversely affect our Domestic DVD segment's contribution profit*.

Id. at 11 (emphasis added). The Postal Service fails to mention this statement.

Nor does the Postal Service make any showing in its March 21 comments that DVD-by-mail has disappeared as a distinct product market, or is likely to disappear in the foreseeable future. The same Netflix Form 10-K that the Postal Service has selectively cited refutes the Postal Service on this issue as well:

> The number of memberships to our DVD-by-mail offering is declining, and we anticipate that this decline will continue. *We believe, however, that the domestic DVD business will continue to generate significant contribution profit for our business.*

Id. at 11 (emphasis added). Likewise, the January 22, 2014, letter of Netflix's CEO to the company's shareholders stated:

> *6.9 million DVD members continue to value the tremendous selection we offer on DVD*. Contribution profit was roughly stable at $110 million. We expect $98 million in contribution profit for Q1, which reflects the postal rate increase implemented this month and higher seasonal usage.

Id. at 6 (emphasis added). The Postal Service makes no mention of either statement.

The remainder of the Postal Service's competition analysis in its March 21 comments is, like the Postal Service's previous submissions, little more than a clip job of random articles and corporate statements. While these sources show that alternative channels for distributing video games and films to consumers are growing, USPS comments at 2-4, 6-8, none of the documents establish that the demand for round-trip DVD mail has become elastic enough to make a price increase unprofitable, or even that the number of consumers who still regard the DVD-by-mail as a superior source of video game or film content has become too small to treat content distributed by mail as a separate market.

Outerwall (RedBox). The Postal Service cites a statement in the 2013 Form 10-K for Outerwall, Inc., the operator of the Redbox brand of self-service DVD rental kiosks, that Redbox competes with GameFly in renting video games. USPS comments at 3 & n. 9. The quoted statement by Outerwall, however, used the term "competition" only in a very general sense, encompassing even remote substitutes such as movie theaters, television and sporting events.[19] The Outerwall statement did not address the specific question raised here: whether Redbox kiosks have eliminated DVD-by-mail as a separate product market. They clearly have not. As GameFly has noted in previous comments, Redbox kiosks offer only a tiny fraction of the range of game titles offered by GameFly, and only a tiny fraction of the film titles offered by Netflix's DVD-by-mail business. For the consumers who prefer the greater selection offered through DVD-by-mail rental, Redbox is a poor substitute. GameFly Supp. Comments (refiled December 26, 2013) at 36-37, 48-50.

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[19] The same is true of the other investor and SEC filings cited by the Postal Service.

The Postal Service's assertion that GameFly could make money through Internet downloading or self-service kiosks (USPS Comments at 4-6) is frivolous. There are fundamental structural reasons why these distribution models do not work for console video games—including the inapplicability of the First Sale doctrine to Internet content distribution, the poor quality and latency of streamed games, and the limited capacity and high capacity costs of self-service rental kiosks.[20] The Postal Service has refuted none of these factors. The notion that GameFly's limited test offer of movie DVDs through its *existing* DVD-by-mail distribution infrastructure proves the viability of *Internet distribution* or *kiosks* (USPS Comments at 6) is incoherent.

Redbox's joint streaming venture with Verizon (*cf*, USPS comments at 9-10) does not solve this problem either. The Redbox streaming catalog is "not nearly as large as Netflix's, which is already small compared with its rental catalog."[21] The Postal Service's speculation that a "shift in consumer demand

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[20] GameFly Comments (August 15, 2013) at 23-30; *id*., Hodess Decl. at A4-A13; GameFly Supp. Comments (refiled December 26, 2013) at 37-50; *id*., Hodess Supp. Decl.

[21] "Redbox Instant is perfect for subscribers, but the streaming catalog is less than stellar," in C/NET (March 24, 2014) (http://www.cnet.com/products/redbox-instant-ios/); "Redbox Instant by Verizon is no Netflix competitor (yet)," Geek (Jan. 16, 2013) (http://www.geek.com/review/redbox-instant-by-verizon-is-no-netflix-competitor-yet-1536003/) ("The digital library that comprises Redbox Instant at the moment is acceptable, so long as all you want to watch are a handful of comedies, budget horror flicks, and one or two blockbuster titles from the last year."); *accord*, "Redbox Instant by Verizon Review," http://binkiesandbriefcases.com/redbox-instant-verizon-review/ (November 27, 2013).

toward downloading and streaming digitized entertainment content . . . could have a potential impact on [existing distributors'] businesses" in the future (USPS Comments at 9) is incompetent to satisfy 39 U.S.C. § 3624. Exemption of a service from maximum rate regulation today requires proof that the regulated firm faces effective competition today. *Coal Exporters Ass'n*, 745 F.2d 76, 88 (ICC could not base finding of effective competition for railroad transportation on potential entry of coal slurry pipelines that had not yet been built).

King Digital (Candy Crush Saga). The Postal Service cites King Digital as an example of a company whose "digitized entertainment content" supposedly competes with GameFly. USPS Comments at 3-4. In fact, King Digital is a company with a single hit game, Candy Crush Saga. Candy Crush Saga is a casual game. Casual games offer much less complexity and realistic action than do console games, and appeal mainly to a different group of consumers. Most GameFly subscribers do not regard casual games as adequate substitutes for console games.[22]

The Postal Service's assertion that 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" (USPS Comments at 9) is particularly ironic. Largely because of

[22] GameFly Supp. Comments (refiled December 26, 2014) at 26, 42, 43-44; *id*., Hodess Supp. Decl. ¶ 22; GameStop Form 10-K for year ended February 2, 2014 (March 25, 2013).

investor "concerns about whether 'Candy Crush' was a one-hit wonder," the price of King Digital stock has fallen since the company's IPO began trading last week.[23]

Valve (Steam Machines), Sony (GaiKai), and GameStop (Kongregate and Spawn Labs). The Postal Service's claims that Valve (Steam Machines), Sony (GaiKai), and GameStop (Kongregate and Spawn Labs) have eliminated DVD-by-mail console games as a separate product market (USPS Comments at 8-10) are further examples of litigation by vaporware.

- Valve is a game publisher that also operates the Steam PC game download service. Steam does not offer downloading to video game consoles. Although Valve has announced that it will be licensing a proprietary "Steam" operating system to third-party PC manufacturers, the project is still in the early stages of limited beta testing. Hodess Decl. (refiled March 24, 2014) at 10 ¶ 20.

- Sony's GaiKai technology is still only in beta testing, and questions about "latency" (i.e., delays in responses to player commands) and costs remain unresolved. In addition, it appears unlikely that the

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[23] Telis Demos and Matt Jarzemsky, "King Digital's Crushing IPO Saga," Wall Street Journal (Mar. 28, 2014) (http://online.wsj.com/news/articles/SB10001424052702304688104579467703736701242?mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB10001424052702304688104579467703736701242.html).

Sony project will attract many third-party games that are less than two years old. Hodess Decl. (refiled March 24, 2014) at 10-12.[24]

- Although GameStop, the largest *seller* of DVD console games in the United States, offers some casual games through its Kongregate division, the company believes that the "digital transition" is "overhyped," and the "vast majority of content will remain on discs." GameFly Supp. Comments (refiled December 26, 2013) at 42-43.

- On March 27, 2014, GameStop announced that it was shutting down its Spawn Labs cloud gaming division, which GameStop had acquired with much fanfare in 2011. "Cloud gaming isn't a good fit for today's consumers," the company's vice president of investor relations explained. "While cloud-based delivery of video games is

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[24] In a similar vein is Amazon's launch announcement yesterday of "Fire TV," an Android-based microconsole processor and controller. James Brightman, "Amazon Fire TV: A 'nonevent' for games?" GamesIndustry International (April 3, 2014) (downloaded from http://www.gamesindustry.biz/articles/2014-04-02-amazon-fire-tv-a-nonevent-for-games?utm_source=newsletter&utm_medium=email&utm_campaign=us-daily. Most independent observers believe that the product will have limited impact on the serious console game market. As one analyst noted, "The main focus of the box is streaming video. The issue is video is 1) a much bigger application than games and 2) much easier to do. It is clear games are at best currently a distant after thought for Amazon in terms of the Amazon box. The type of games they are looking at are more in the realm of tablet/mobile/casual products, which are really no substitute for what the dedicated consoles provide." *Id*. Another analyst added, "Hardcore games enthusiasts won't be satisfied by this or any other inexpensive television-connected device." *Id*.

> innovative and potentially revolutionary, the gaming customer has not yet demonstrated that it is ready to adopt this type of service to the level that a sustainable business can be created around it."[25]

Finally, another obstacle to Internet distribution of both video game and film content has emerged in recent months with the decline in average broadband speeds as the Internet has buckled under the volume generated by Internet streaming. A recent article in a trade publication confirmed that throughput speeds have been on a "downward [trend] for months on Verizon, Comcast, and AT&T."[26] Moreover, Netflix's high profile contract with Comcast for preferred access to its network is unlikely to be the solution for the rest of the industry. Observers believe that the factors that led to the Comcast-Netflix contract are unlikely to recur, and the charges likely to be demanded by other ISPs for preferred access to their networks could wipe out more than two-thirds of Netflix's 2014 consensus operating profit.[27]

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[25] Brendan Sinclair, "GameStop shutters Spawn Labs cloud streaming outfit," Games Industry International (March 27, 2014) (http://www.gamesindustry.biz/articles/2014-03-27-gamestop-shutters-spawn-labs-cloud-streaming-outfit?utm_source=newsletter&utm_medium=email&utm_campaign=us-daily).

[26] Jon Brodkin, "Netflix users on Verizon and AT&T get raw deal, have little reason for hope," Ars Technica (March 29, 2014) (http://arstechnica.com/business/2014/03/netflix-users-on-verizon-and-att-get-raw-deal-have-little-reason-for-hope/).

[27] *Id*.

In sum, the Postal Service, to justify exempting the Round-Trip DVD Mailer from maximum rate regulation, must show that (1) DVD rental companies *can* use alternative means to deliver their content, (2) *would* use those alternatives to a greater degree if the Postal Service raised its rates, and (3) *would* do so enough to offset the increase in unit contribution from the rate increase. The Postal Service has failed on all three counts.

II. ROUND-TRIP DVD MAIL SHOULD BE INELIGIBLE FOR ENTRY AS GENERIC FIRST-CLASS MAIL.

In response to CHIR 1, Question 5, the Postal Service stated that DVD customers eligible for the new Round-Trip Mailer product "would not be able to send DVDs round-trip (using Business Reply Mail or Permit Reply Mail services)." Netflix, in its March 21 comments, argues that, regardless of whether round-trip DVD mail is reclassified as a competitive product, DVD rental companies should be allowed to mail round-trip DVD mail as generic First-Class letters. Netflix Comments at 2-4. The Commission should deny this request.

First, the statutory classification scheme is binary: products are either market-dominant or competitive, with a distinct regulatory scheme for each. Cf. 39 U.S.C. §§ 3621-3629, 3631-3634, 3642. Nothing in the statute suggests that a product could simultaneously be classified as both competitive and market dominant. To the contrary, the Postal Service has consistently eliminated market dominant products when creating corresponding competitive products. The Commission's proposed rule 3010.23(d)(4) does likewise, requiring the Postal

Service, when calculating market-dominant rate adjustments, to set volumes for transferred rate cells to zero. Order No. 1879 at 12-13.

Second, whether or not the Commission reclassifies Round-Trip DVD Mail as a competitive product, allowing Netflix to use generic First-Class mail to mail DVDs would readmit through the back door the very discrimination that the Court of Appeals prohibited in *GameFly, Inc. v. PRC*, 704 F.3d 145 (D.C. Cir. 2013). First-Class Mail has a valuable attribute, sealing against public inspection, that the proposed round-trip mailer product does not.[28] Moreover, the availability of parallel products for mailing DVDs would enable the Postal Service to discrimination further against other DVD rental companies by offering special manual processing to DVD mailers entered by Netflix, but no other customer, as generic First-Class letters, while raising the price of the round-trip DVD mail product significantly above the generic First-Class Mail letter rate. That would make the benefits of mailing DVDs as generic First-Class Mail letters available to no one other than Netflix—precisely the situation that prevailed when GameFly filed its complaint five years ago in Docket No. C2009-1.[29]

[28] Netflix is correct that, if DVDs were mailable as generic First-Class Mail, GameFly could enter DVDs as the flat-shaped categories of First-Class Mail. But that would require GameFly to pay the letter-flat differential—the same price discrimination that forced GameFly to file its complaint in C2009-1.

[29] GameFly Response to USPS Motion for Reconsideration (August 2, 2013) at 14; GameFly Comments (August 15, 2013) at 32-34; Response of GameFly to Reply Comments of Netflix (August 29, 2013).

Netflix tries to brush off this problem by asserting that the Postal Service would never continue to provide high levels of manual processing to Netflix DVD mail "sent as generic FCM letters." Netflix Comments (March 21, 2014) at 3-4. With all respect, one would have had to be sleeping for the past decade to believe that. Five years after GameFly filed its complaint in Docket No. C2009-1, the Postal Service continues to fight a rear-guard action in that docket to regain the right to discriminate between Netflix and other DVD rental companies in the degree of manual processing provided. Given the impracticality of enforcing an operational constraint on the amount of manual processing provided by the Postal Service to Netflix,[30] allowing the Postal Service to handle DVD mail simultaneously as a round-trip mail product and as First-Class Mail would create a perfect environment for undue discrimination to resurface.

Contrary to Netflix's contention, neither the Filed Rate Doctrine nor general principles of discrimination bar the Postal Service or the Commission from excluding round-trip DVD mailers from generic First-Class Mail. The Filed Doctrine, a basic doctrine of common carrier and public utility law, merely requires that regulated carriers confirm their rates and services to those set forth in their published tariffs (here, the MCS and the DMM). The filed rate doctrine forbids regulated carries from offering favored ratepayers off-tariff preferences—i.e., the kinds of preferences that Netflix enjoyed until the Commission's remedial

[30] Order No. 1763 (June 26, 2013) at 15-16, 21-24, *aff'd* on reconsideration, Order No. 1807 (August 13, 2013) at 4-5

orders in Docket No. C2009-1 took effect—but does not prescribe the terms of the tariffs themselves.[31] Hence, a rule excluding round-trip DVD mail from generic First-Class mail would comply with the Filed Rate Doctrine as long as the restriction was stated in the MCS or the DMM. Likewise, such exclusion would not constitute undue discrimination under 39 U.S.C. § 403(c), for it would have a rational basis. *Cf.* DMM 601 (mailability restrictions).

[31] Order No. 718 at ¶¶ 4022-4023 (April 20, 2011); *see generally AT&T v. Central Office Telephone, Inc*., 524 U.S. 214, 221-224 (1998) (citing precedent for "filed rate doctrine"); *American Trucking Associations v. Atchison, T. & S.F. Ry. Co*., 387 U.S. 367, 406 (1967) ("secret rebates, special rates to favored shippers, and discriminations . . . led to enactment of the Interstate Commerce Act in 1887"); *Louisville & Nashville R. Co. v. Maxwell*, 237 U.S. 94, 97 (1915) ("Under the Interstate Commerce Act, the rate of the carrier duly filed is the only lawful charge. Deviation from it is not permitted upon any pretext."); *American Warehousemen's Ass'n v. Ill. Cent. R. Co*., 7 I.C.C. 556, 590, 591 (1898); David Boies and Paul R. Verkuil, *Public Control of Business* 15-24, 254-56 (1977); Solon J. Buck, *The Granger Movement* 11-14, 34 (1913).

CONCLUSION

The Postal Service has received repeated opportunities to meet its burden of proof under 39 U.S.C. § 3642, and has failed to do so. The proposed reclassification of round-trip DVD mail as a competitive product should denied without further proceedings. The Commission should also deny the request for DVD rental companies to be allowed to mail round-trip DVD mail as generic First-Class letters.

Respectfully submitted,

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