

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Acting Chairman;  
Mark Acton, Vice Chairman;  
Ruth Y. Goldway;  
Tony Hammond; and  
Nanci E. Langley

Competitive Product List  
Adding Round-Trip Mailer

Docket No. MC2013-57

Competitive Product List  
Adding Round-Trip Mailer (MC2013-57)

Docket No. CP2013-75

ORDER DENYING REQUEST



Washington, DC 20268-0001

December 23, 2014

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Appendix A—Submissions Addressing the Competitive Product Proposal

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(Issued December 23, 2014)

I. INTRODUCTION

On July 26, 2013, the Postal Service filed a request to create a new competitive product, tentatively called the “Round-Trip Mailer.”<sup>1</sup> This proposal is an outgrowth of a complaint proceeding initiated at the Commission during 2009 by GameFly, Inc. (GameFly), a mailer of round-trip DVD mail. According to the Postal Service, if approved, the proposed Round-Trip Mailer would replace existing market dominant

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<sup>1</sup> Docket No. C2009-1R, Request of the United States Postal Service Under Section 3642 to Create Round-Trip Mailer Product, July 26, 2013, at 3 (Request).

mailer options for round-trip DVD mail. For the reasons given below, the Commission denies the Postal Service's Request.

## II. EXECUTIVE SUMMARY

The Postal Service's Request is subject to the requirements of 39 U.S.C. § 3642. A central issue in this proceeding is whether the Postal Service's proposal satisfies the requirements of section 3642(b)(1) for inclusion on the competitive product list. Section 3642(b)(1) provides that each product over which the Postal Service exercises "sufficient market power" (as described in that section) must be included on the market dominant list of products, and therefore cannot be included on the list of competitive products.

The Postal Service seeks to establish that it lacks such market power, notwithstanding its admission that it is not aware of any other shipping company that provides door-to-door delivery of DVDs like the service to be provided by means of the proposed Round-Trip Mailer. Referring to principles of antitrust law, the Postal Service seeks to overcome the absence of competition from another DVD delivery service by arguing that DVDs-by-mail are part of a more broadly defined market for digitized entertainment ("the market for access to digitized entertainment content") in which DVDs-by-mail are subject to competition from digitized entertainment content delivered by other means. According to the Postal Service, these other sources of digitized entertainment content will place competitive pressure on Netflix's and GameFly's services that effectively check the derived demand for Round-Trip Mailers, and thereby constrain the Postal Service's exercise of market power.

On the basis of the record before it, the Commission concludes that the Postal Service has failed to demonstrate that the alleged forms of competition upon which it relies prevent it from exercising sufficient market power to "effectively set the price of [the Round-Trip Mailer] substantially above costs, raise prices significantly, decrease

quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products.” See 39 U.S.C. § 3642(b)(1).

The Commission’s denial of the instant Request is without prejudice to the Postal Service filing a new request for creation of the same (or a similar) Round-Trip Mailer based upon an adequate showing that it does not exercise market power as described in section 3642(b)(1). Legal, commercial, and technological developments might at some point permit the Postal Service to establish the adequacy of competition in the digitized entertainment content market to prevent it from exercising market power described in section 3642(b)(1).

The remainder of this Order is organized into eight main parts:

Section III describes the background to the present proceeding.

Section IV summarizes the history of this proceeding. An attached appendix lists the principal submissions by the participants.

Section V identifies applicable statutory and regulatory requirements.

Section VI discusses the requirements of section 3642(a) and concludes that the Postal Service has the authority to present its Request to the Commission.

Section VII discusses the requirements of section 3642(b)(1) and concludes that the Postal Service exercises sufficient market power to preclude the addition of the Round-Trip Mailer to the competitive product list.

Section VIII addresses the requirements of sections 3642(b)(2) and 3642(b)(3), and concludes, among other things, that in light of the Commission’s market power finding, it is unnecessary at this time to rule on whether the Round-Trip Mailer is covered by the postal monopoly.

Section IX explains why the Commission finds it unnecessary to address a number of related issues, such as the adequacy of the Round-Trip Mailers cost coverage, that are rendered moot by the denial of the Postal Service’s Request.

Section X presents the Commission’s conclusion denying the Request.

### III. BACKGROUND

#### A. The Initial GameFly Complaint Proceeding

At the time GameFly filed its complaint, it was in the business of renting and selling video games to consumers.<sup>2</sup> GameFly's business was similar to the business of Netflix, Inc. (Netflix), which rented movies and other similar content. Both companies used DVDs delivered and returned by mail as the medium for providing digitized entertainment content to their customers. DVDs containing rented video games, movies, or similar content were mailed by GameFly and Netflix to their customers who returned the DVDs-by-mail.

In its complaint filed in Docket No. C2009-1, GameFly alleged that the Postal Service offered preferential rates and terms of service to Netflix in violation of 39 U.S.C. 403(c). After extensive discovery and administrative hearings, the Commission ruled that the Postal Service had unlawfully discriminated against GameFly with respect to both rates and terms of service.<sup>3</sup> The Commission rejected GameFly's proposed rate and operational remedies and, instead, fashioned its own rate remedy that gave GameFly some, but not all, of the rate relief it had sought. Order No. 718 at 109-116.

#### B. The GameFly Appeal

GameFly challenged the lawfulness of Order No. 718 in the United States Court of Appeals for the District of Columbia Circuit. On January 11, 2013, the Court issued its opinion rejecting the Commission-devised rate remedy, vacating Order No. 718, and remanding the case to the Commission for consideration of an appropriate remedy

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<sup>2</sup> While this proceeding was pending, GameFly announced that it planned to begin a small test offering of a selection of movie DVDs. Notice of GameFly, Inc., Concerning Status of David Hodess as Reviewing Representative, March 10, 2014, at 1-2.

<sup>3</sup> Docket No. C2009-1, Order on Complaint, April 20, 2011 (Order No. 718).

consistent with the Court's decision. *GameFly, Inc. v. Postal Regulatory Commission*, 704 F.3d 145 (D.C. Cir. 2013) (*GameFly Opinion*).

### C. The Complaint Proceeding on Remand

In the remand proceeding in Docket No. C2009-1R, the Commission considered a range of potential operational and rate remedies. At the conclusion of the proceeding, the Commission directed the Postal Service to equalize the rates for letter-shaped round-trip DVD mailers (of the type used by Netflix), and flat-shaped round-trip DVD mailers (of the type used by GameFly).<sup>4</sup> The Commission offered the Postal Service two alternatives for equalizing the letter-shaped and flat-shaped round-trip DVD rates.<sup>5</sup> Regardless of the alternative selected, the Postal Service was to file a notice of price adjustment within 30 days of the Commission's Order on Remand and to implement the change within 45-65 days thereafter. *Id.* Ordering ¶ 3.

### D. The Postal Service's Response to the Order on Remand

On July 19, 2013, the Postal Service moved to extend the deadline for complying with the Order on Remand.<sup>6</sup> Following the denial of its motion,<sup>7</sup> the Postal Service initiated a two-track response to the Order on Remand. First, on July 25, 2013, it

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<sup>4</sup> Docket No. C2009-1R, Order on Remand, June 26, 2013 (Order No. 1763 or Order on Remand). Flat-shaped envelopes, or "flats," are larger than letter-shaped envelopes and are subject to higher postage rates as well. See Domestic Mail Manual Part 101, §§ 1.1, 2.1 available at <http://pe.usps.com/text/dmm300/101.htm>. See also Notice 123 – Price List available at <http://pe.usps.com/text/dmm300/Notice123.htm#1011092>.

<sup>5</sup> Under the first alternative, the Postal Service could have established new equalized rates for letter-shaped and flat-shaped DVD mail. Under the second alternative, the Postal Service could have reduced the price for two-ounce First-Class flat-shaped round-trip DVD mailers to the price for a one-ounce First-Class letter-shaped round-trip DVD mailer. Order No. 1763 at 39 (Ordering ¶ 1).

<sup>6</sup> Docket No. C2009-1R, United States Postal Service Motion for Extension of Time in Which to Comply with Order No. 1763, July 19, 2013.

<sup>7</sup> Docket No. C2009-1R, Order No. 1787, Order Denying Motion for Extension of Time, July 23, 2013.



sought reconsideration and clarification of the Order on Remand.<sup>8</sup> Second, on July 26, 2013, it filed the Request that is the subject of this Order. See n.1, *supra*.

1. The Postal Service's Reconsideration/Clarification Request.

The Postal Service's request for reconsideration was based upon two grounds: (1) that the rate-based remedy selected in the Order on Remand was inconsistent with the Court's decision in the *GameFly Opinion*; and (2) that the rate-based remedy prescribed in the Order on Remand did not comply with the provisions of the Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3198 (2006). Reconsideration/Clarification Request at 2-7.

The Postal Service's request for clarification sought guidance regarding the price cap implications of the equalized rate remedy ordered by the Commission, as well as clarification regarding the scope of the remedy. *Id.* at 7-11.

2. The Postal Service's Competitive Product Request.

In the Request that is the subject of this proceeding, the Postal Service seeks to create a new competitive product intended "to ensure compliance with [the Order on Remand]" pending action on the Postal Service's Request for Reconsideration and Clarification. Request at 2. The Postal Service states that its proposed Round-Trip Mailer would "replace the existing First-Class Mail Round-Trip Mailer options on the Market-Dominant side." *Id.* at 3. If approved, "there would exist one set of equalized round-trip DVD rates, regardless of shape...[and]...[a]ll service standards and

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<sup>8</sup> Docket No. C2009-1R, United States Postal Service Motion for Reconsideration and Clarification of Order No. 1763, July 25, 2013 (Reconsideration/Clarification Request). Responses were filed by GameFly and the Public Representative. Docket No. C2009-1R, Response of GameFly, Inc., to USPS Motion for Reconsideration and Clarification of Order No. 1763, August 1, 2013; Docket No. C2009-1R, Response of the Public Representative to USPS Motion for Reconsideration and Clarification of Order No. 1763, August 9, 2013.

processing elements would remain identical to the service currently received by First-Class Mail letters and flats.”<sup>9</sup>

The Postal Service states further that if the Commission were to deny its Request, it would “consider creating a new product with equalized rates on the Market-Dominant list, if the Commission clarifies that the creation of such a product would not have price cap implications.” Request at 4 (footnote omitted).

### 3. Commission Orders Addressing the Postal Service’s Requests.

*The Reconsideration/Clarification Request.* On August 13, 2013, the Commission denied the Postal Service’s request in Docket No. C2009-1R for reconsideration of the Order on Remand, but granted the request for clarification regarding the price cap implications and scope of the equalized rate remedy.<sup>10</sup> As explained by the Commission, “[t]he price cap implications of the Commission’s remedial order depend upon how the Postal Service elects to respond to the alternatives made available to the Postal Service in [the Order on Remand].” Order No. 1807 at 9. Had the rate proposed in the Request for establishment of the Round-Trip Mailer been filed as “an equalized rate for market dominant round-trip First-Class letter-shaped and flat-shaped DVD mail,... an immediate recalculation of available CPI [Consumer Price Index] pricing authority [would not have been required].” *Id.* at 10.

*The competitive product request.* In response to the Postal Service’s request at issue in the proceeding, the Commission issued a notice and order on July 30, 2013 establishing Docket Nos. MC2013-57 and CP2013-75 to consider the Postal Service’s

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<sup>9</sup> *Id.* The equalized round-trip DVD rates proposed in the Request were the same as the rates prescribed by the Commission to resolve the GameFly Complaint proceeding. See Docket No. C2009-1R, Order Prescribing Remedy, September 4, 2013 at 6 (Order No. 1828 or Order Prescribing Remedy).

<sup>10</sup> Docket No. C2009-1R, Order on Reconsideration and Clarification, August 13, 2013 (Order No. 1807 or Order on Reconsideration and Clarification).

Request.<sup>11</sup> In that same notice and order, the Commission directed the Postal Service to file a notice of the Board of Governors' determination regarding the proposal, as well as certified revenue and cost data supporting the proposal. *Id.* at 4. The Commission also established deadlines for initial and reply comments, and appointed a Public Representative to participate in the proceeding. *Id.* at 5.

Initial and reply comments were received from several parties.<sup>12</sup> In addition, GameFly filed a motion requesting that the Commission: (a) dismiss the Request for failing to establish a prima facie case; or (b) strike the Postal Service's August 22, 2013 reply to comments, or, in the alternative, permit GameFly to file a response to the Postal Service's comments.<sup>13</sup>

On September 4, 2013, the Commission issued an order in Docket Nos. MC2013-57 and CP2013-75 denying GameFly's motion to dismiss the Postal Service's Request, but authorizing participants to file additional comments.<sup>14</sup>

*Implementation of complaint case remedy.* In a companion order issued September 4, 2013, in the remand proceeding in Docket No. C2009-1R, the Commission concluded that the complexity of the legal and factual issues raised by opponents of the Postal Service's Request prevented a decision within the timeframe established by the Order on Remand. Order No. 1828 at 4-5. The Commission therefore "prescribe[d] the rate levels proposed by the Postal Service in its Competitive

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<sup>11</sup> Notice and Order on Request to Add Round-Trip Mailer Product to Competitive Product List, July 30, 2013 (Order No. 1794).

<sup>12</sup> Those comments, as well as other filings made in response to Order No. 1794, are discussed in Sections IV, and VI-IX, *infra*.

<sup>13</sup> Motion of GameFly, Inc., for Relief with Respect to the August 22 "Reply" Comments of the Postal Service, August 26, 2013. The Postal Service filed an answer to that motion on August 30, 2013. United States Postal Service Answer to Motion of GameFly, Inc. for Relief with Respect to the August 22 "Reply" Comments of the Postal Service, August 30, 2013.

<sup>14</sup> Order Granting Motion for Leave to File Additional Comments, September 4, 2013 (Order No. 1827).

Product Request as market dominant rates applicable to the existing First-Class round-trip DVD letter and flats mail categories to be effective September 30, 2013.” *Id.* at 6. In a footnote, the Commission reiterated that consideration of the Postal Service’s Request was to proceed in Docket Nos. MC2013-57 and CP2013-75. *Id.* n.11.

The Postal Service subsequently petitioned the United States Court of Appeals for the District of Columbia Circuit for review of the Order on Remand, the Order on Reconsideration and Clarification, and the Order Prescribing Remedy. On April 8, 2014, the Court upheld the Commission’s Orders and denied the Postal Service’s petition for review. *United States Postal Service v. Postal Regulatory Commission*, 747 F.3d 906 (D.C. Cir. 2014).

#### IV. THE COMPETITIVE PRODUCT REQUEST PROCEEDINGS IN DOCKET NOS. MC2013-57 AND CP2013-75

The participants in Docket Nos. MC2013-57 and CP2013-75 have filed several rounds of comments and other pleadings. Attached to this Order is an Appendix that lists the participants’ principal comments and submissions. Appendix A—Submissions Addressing the Competitive Product Proposal (Appendix A).<sup>15</sup> These filings are organized into four groups. The first group includes the Postal Service’s Request and related filings that, together, constitute the Postal Service’s proposal. *Id.* (I. The Competitive Product Request). The second group of filings includes the initial and reply comments filed in response to the Commission’s Order No. 1794<sup>16</sup> establishing the proceedings in Docket Nos. MC2013-57 and CP2013-75. *Id.* (II. Initial and Reply Comments). The third group is comprised of additional comments and filings authorized

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<sup>15</sup> A number of these submissions were accompanied by motions for leave to file out-of-time. See, e.g., Motion of GameFly, Inc., for Leave to File Documents One Day Out of Time, September 12, 2013. All such motions are granted.

<sup>16</sup> See n.10, *supra*, and accompanying text.

by Commission Order No. 1827.<sup>17</sup> *Id.* (III. Additional and Supplemental Comments Authorized by Order No. 1827). The fourth group of submissions includes responses to Chairman Information Requests, and comments of the participants on those responses. *Id.* (IV. Chairman's Information Requests, Responses, and Comments on Responses).

## V. STATUTORY AND REGULATORY REQUIREMENTS

Section 3642 authorizes the addition of new postal products to the market dominant and competitive product lists, the removal of products from those lists, and the transfer of products between the two lists. Of relevance to this proceeding are sections 3642(a) and 3642(b).

Section 3642(a) authorizes the Postal Service and users of the mail to request changes to the market dominant and competitive product lists "by adding new products to the lists, removing products from the lists, or transferring products between the lists."<sup>18</sup>

Section 3642(b), which establishes criteria for evaluating requests to change the product lists, has three sections. Section 3642(b)(1) provides for inclusion on the market dominant product list those products "in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products."<sup>19</sup> All other products are to be listed on the competitive product list. *Id.* Section 3642(b)(2) prohibits the transfer of products covered by the postal monopoly from the market dominant product list to the competitive product list. Section 3642(b)(3)

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<sup>17</sup> See n.14, *supra* and accompanying text.

<sup>18</sup> The Commission may also make such changes on its own initiative. *Id.*

<sup>19</sup> For convenience, the Commission will refer to the issue presented by section 3642 (b)(1) as the "market power issue," and will use short-hand phrases like "exercises market power" or "the exercise of market power," in reference to the statutory standard in section 3642 (b)(1).

requires that any decision under section 3642 give “due regard” to: (1) the availability and nature of private sector enterprises engaged in the delivery of the product involved; (2) the views of those who use the product involved on the appropriateness of the proposed action; and (3) the likely impact of the proposed action on small business concerns.

Requests by the Postal Service to modify the product lists are covered by part 3020, subpart B, of the Commission’s regulations. 39 C.F.R. §§ 3020.30, *et seq.* Of particular relevance to this proceeding is section 3020.32, which specifies the supporting justification required for a proposed product list modification.

## VI. AUTHORITY OF THE POSTAL SERVICE TO PRESENT ITS REQUEST

### A. Need for the New Round-Trip Mailer

Netflix, GameFly, and the Public Representative all assert that the proposed establishment of the Round-Trip Mailer on the competitive product list is unnecessary in light of the Commission’s clarification in its Order on Reconsideration and Clarification. Netflix Comments at 3; GameFly Comments at 30-31; PR Reply Comments at 1; Netflix Reply Comments at 7-10. The Postal Service responds by asserting that Order No. 1807 does not require withdrawal of the Postal Service’s Request and that there is no legal basis for requiring such withdrawal. Postal Service Reply Comments-Revised at 27.

The Commission agrees with the Postal Service’s interpretation of Order No. 1807, and its assertion that no legal basis has been shown for requiring withdrawal of its proposal. Section 3642(a) expressly allows the Postal Service to request modifications of the product lists. The Order on Remand as clarifying Order No. 1807 does not prevent the Postal Service from pursuing the proposed addition of the Round-Trip Mailer to the competitive product list. Thus, the Commission finds neither

the statute nor the Commission's previous orders bar the Postal Service's request in this proceeding.

B. Alleged Failure to Meet the Definition of "Product"

Netflix challenges the appropriateness of the Postal Service's Request under section 3642(a) by arguing that the proposed Round-Trip Mailer fails to qualify as a "product" with "a distinct cost or market characteristic" as defined in section 102(6). Netflix Comments at 4-5. In Netflix's view, the proposed Round-Trip Mailer is "an amalgamation of four products, each with its own distinct cost and market characteristic." *Id.* at 4. Netflix also asserts that the "market" for the proposed competitive product is atypical (consisting "essentially of one very large mailer and one very small mailer") and that mailers in this market therefore have "widely varying costs and characteristics." *Id.* at 5.

The Postal Service responds by asserting that the Commission has previously recognized the definition of "product" in section 102(6) to be very broad. Postal Service Reply Comments-Revised at 3-4. The Postal Service notes further that it routinely enters into Negotiated Service Agreements (NSAs) that combine different products into a single new product. *Id.* at 4. The Postal Service also argues that the Mail Classification Schedule language prescribed as part of the remedy in the complaint proceeding in Docket No. C2009-1 "created a round-trip DVD product," and that the only difference between the product proposed by the Postal Service in this proceeding and the market dominant round-trip DVD product allegedly created by the Commission as a remedy in Docket No. C2009-1 is that the proposed product would be classified as a competitive product. *Id.*

The Postal Service is correct in asserting that the proposed Round-Trip Mailer qualifies as a "product" under section 102(6). Section 102(6) defines "product" as "a postal service with a distinct cost or market characteristic for which a rate or rates are,

or may reasonably be, applied.” The Commission has previously found “product” to be broadly defined as long as it has distinct cost or market characteristics.<sup>20</sup> The Postal Service’s practice of combining products under NSAs reflects the breadth of the “product” definition.

Although it disagrees with the Postal Service’s characterization of its prior action in Docket No. C2009-1 as having “created a round-trip DVD product,”<sup>21</sup> the Commission recognizes that the complaint proceedings in Docket No. C2009-1 have created a “unique context” in which the Round-Trip Mailer proposal must be assessed.<sup>22</sup>

The Commission therefore rejects Netflix’s arguments that the proposed Round-Trip Mailer cannot qualify as a “product” under section 102(6).

## VII. THE REQUIREMENTS OF SECTION 3642(B)(1)

The central issue in this proceeding is whether the Postal Service exercises market power over round-trip DVD mailers. See Postal Service Reply Comments-Revised at 5 (“The key issue for the Commission is whether digital and physical 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.”). If the Postal Service exercises market power, its Request to include the proposed Round-Trip Mailer on the competitive product list must be denied.

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<sup>20</sup> See Docket No. RM2009-3, Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, September 14, 2010, at 22 (under the definition of “product” in section 102(6), “almost any category of mail would qualify.”).

<sup>21</sup> Both the original remedy in the complaint proceeding in Docket No. C2009-1 and the remedy prescribed in the remand proceeding in Docket No. C2009-1R directed the Postal Service to adjust the rates for flat-shaped DVD mail. Neither remedy required the creation of a new product. See Order No. 718 at 114-15 and Appendix B; Order No. 1763 at 39, Ordering ¶ 1.

<sup>22</sup> See Docket No. MC2012-26, Order No. 1657, Order on Elective Filing Regarding Post Office Box Service Enhancements, February 14, 2013, at 17 (the Commission “must consider the context” when determining whether a proposal constitutes a product).



A threshold question involves the selection of the principles to be used in assessing the exercise of market power under section 3642(b)(1). In their comments, the major participants appear to agree, either expressly or impliedly, that federal antitrust principles should be used to assess the exercise of market power. *Id.* at 6-7. See GameFly Comments at 5-11; Netflix Comments at 7-9; GameFly Supplemental Comments-Refiled at 29-34; Postal Service Reply Comments-Revised at 7; PR Additional Comments at 4.

The Commission agrees with participants that an analysis that incorporates federal antitrust principles is an appropriate and useful one in determining whether the Postal Service exercises market power under section 3642(b)(1). The use of antitrust principles is, as the Postal Service argues, consistent “with the practices of other federal agencies charged with construing and applying similar federal requirements.” Postal Service Reply Comments-Revised at 7.

The Commission’s decision to use antitrust principles in this proceeding is also consistent with its action in *Valassis NSA*, Docket Nos. MC2012-14, *et al.* In *Valassis NSA*, it was necessary for the Commission to determine the relevant “marketplace” under 39 U.S.C. § 3662(c)(10)(B).<sup>23</sup> The Commission concluded that it was appropriate to employ the merger guidelines used by the Department of Justice and Federal Trade Commission in determining the relevant marketplace.<sup>24</sup> Order No. 1448 at 24-25.

In the present case, the parties rely heavily upon antitrust case law for the principles they use to support their respective positions. The Commission concludes that reliance in this proceeding upon antitrust principles reflected in the DOJ/FTC

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<sup>23</sup> Docket Nos. MC2012-14 and R2012-8, Order Approving Addition of Valassis Direct Mail, Inc. Negotiated Service Agreement to the Market Dominant Product List, August 23, 2012, at 23 (Order No. 1448).

<sup>24</sup> See Horizontal Merger Guidelines, Department of Justice and the Federal Trade Commission, August 19, 2010 available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.html> (DOJ/FTC Guidelines).

Guidelines and articulated in relevant case law is consistent with the Commission's action in *Valassis NSA*. The case law cited by the parties in this proceeding, and the DOJ/FTC Guidelines relied upon by the Commission in *Valassis NSA*, draw upon a common body of broadly accepted federal antitrust principles.

A. The Relevant Market for Assessing Market Power

Under federal antitrust principles, a market power determination begins with the identification of a relevant market. See ABA Section of Antitrust Law, *Antitrust Law Developments* (7<sup>th</sup> ed., 2012) at 227 (ABA Antitrust Law Developments). The objective in determining the relevant market is to distinguish between products that compete to a substantial degree, and those that do not. See *id.* at 567. Competition in the relevant market affects the ability of an entity to exercise market power.

A relevant market typically has two components: (1) a relevant product market; and (2) a relevant geographic market. *Id.* The product market identifies the competing products that constitute the market. *Id.* The geographic market determines the geographic area within which competition in the relevant product market takes place. *Id.* In this proceeding, the participants have focused exclusively on the relevant product market, and, by omitting a discussion of the relevant geographic market, leave the impression that they view that latter market to be the U.S. domestic market.

A seminal case cited by both the Postal Service and GameFly in arguing their respective positions is *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962). See, e.g., Postal Service Reply Comments-Revised at 8; GameFly Supplemental Comments-Refiled at 29. In *Brown Shoe*, the Court held that “[t]he 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.” 370 U.S. 294 at 325 (footnote omitted).

The concept of reasonable interchangeability of use involves consideration of “the purposes for which they [the products] are produced- price, use and qualities considered.” *United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377 at 404 (1956). The functional similarity of products can support their inclusion in the same relevant product market. *See id.* at 399-400. On the other hand, products that may appear to be similar can sometimes be excluded from a product’s relevant market depending upon the consideration of other factors found to be relevant. *Nobody in Particular Presents, Inc. v. Clear Channel Communications*, 311 F. Supp. 2d 1048 (D. Colo. 2004) (rock concerts found to have qualities distinct from non-rock concerts).

The assessment of product interchangeability can also involve consideration of customer views, as well as industry or public perceptions of markets or a firm’s perception of who its competitors are. *See, e.g., PepsiCo, Inc. v. Coca Cola Co.*, 315 F.3d 101, 105 (2d Cir. 2002) (“Products will be considered to be reasonably interchangeable if consumers treat them as ‘acceptable substitutes.’”); *Fineman v. Armstrong World Indus.*, 980 F.2d 171, 200 (3d Cir. 1992) (industry recognition of the differences in hard surface flooring found to support jury’s finding of a resilient-only product market); *FTC v. PPG, Indus., Inc.*, 798 F.2d 1500, 1504 (D.C. Cir. 1986) (market definition based on both buyers’ and sellers’ perceptions); *United States v. Cont’l Can Co.*, 378 U.S. 441, 453-57 (1964) (evidence that can and bottle manufacturers consider each other’s prices in formulating their own pricing considered in determining relevant product market). *See, e.g., International Boxing Club v. United States*, 358 U.S. 242 (1959) (consumer perceptions of nonchampionship boxing matches as not reasonably interchangeable with championship matches).

Additional factors found to be relevant in determining whether products are reasonably interchangeable include price differences between customers and price trends over time. *United States v. Aluminum Co. of America*, 377 U.S. 271 (1964).

The availability of a product may also be a relevant consideration in determining whether a product is included in a relevant market. In *United States v. Microsoft*, 253 F.3d 34, 53-54 (D.C. Cir. 2001), the Court rejected “middleware products” from the relevant market of operating systems because they were not yet available as a substitute. The consideration of whether products are interchangeable is a fact-intensive inquiry. *Todd v. Exxon Corp.*, 275 F.3d 191, 200 (2d Cir. 2001).

Such considerations also may be relied upon to establish narrower submarkets. *Brown Shoe*, 370 U.S. 294 at 325 (footnote omitted) (“The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand....However, within this broad market, well-defined submarkets may exist which in themselves, constitute product markets for antitrust purposes....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”).

Consistent with the case law, the Commission applies the standard methodology for market definition and competitive analysis as set forth in the DOJ/FTC Guidelines. They set forth a useful and now standard and widely accepted method for analyzing whether a proposed action—in this case, a classification of round-trip DVD mailers as competitive—would likely result in a significant increase in the product’s price above current levels. This methodology utilizes the so-called “hypothetical monopolist test” to define relevant antitrust markets. Specifically, the test can be used to assess whether a profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products (“hypothetical monopolist”) likely would impose at least a small but significant and non-transitory increase in price (“SSNIP”) on at least one

product.<sup>25</sup> One begins by defining a provisional relevant market. In this case, that provisional market is the Postal Service's round-trip DVD mail service.

One evaluates the evidence regarding substitutes to determine whether a price increase would be profitable. If customers are unable to switch to potential substitutes in sufficient volumes to make the increase unprofitable, those potential substitutes should be excluded from the relevant market. *Id.*

The question of interest for market definition is whether the demand for round-trip DVD mailer service in response to a prior increase is sufficiently inelastic (*i.e.*, the change in demand is low because customers lack reasonable interchangeable substitutes) such that a firm ("hypothetical monopolist") would be able to profitably increase price. Market definition, therefore, focuses on demand substitution, *i.e.*, on the extent to which customers would substitute away from a product in response to a price increase. The analysis undertaken by the Commission is consistent with that approach.

#### 1. Positions of the Parties.

In its Request, the Postal Service points to "the precipitous decline in DVD-by-mail volumes in recent years" and alleges that "[n]ews reports suggest that this trend is largely due to the availability of other technological methods for delivering access to digital movie and game content." Request, Attachment A at 3-4 (footnote omitted). In subsequent filings, the Postal Service provides additional information to support its Request, including additional information regarding DVD mail volume declines; the availability of alternative technologies for delivering digitized entertainment content; consumer perceptions of the market; industry perceptions of the market; and other related data and information. See, *e.g.*, Postal Service Reply Comments-Revised at 14, 20; *id.* Attachment A-Declaration of Mark Schoeman at 6-7; *id.* Attachment

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<sup>25</sup> See DOJ/FTC Guidelines § 4.1.1. ("The Hypothetical Monopolist").

D-Declarations of Steven W. Monteith at ¶ 2; Postal Service Response to Additional/Supplemental Comments at 15-18; Postal Service CHIR Comments at 4.

In the Postal Service's view, DVDs-by-mail have a number of reasonably available alternatives that, together, constitute a product market that the Postal Service characterizes as the "market for access to digitized entertainment content." Postal Service Reply Comments-Revised at 10-20. The Postal Service asserts that the Round-Trip Mailer is simply one method used by Netflix and GameFly to provide consumers digitized entertainment content; that other firms use alternative delivery methods (e.g., streaming or downloading) to provide consumers access to digitized entertainment content; and that all of these firms (including Netflix and GameFly) compete in the same market. *Id.* at 11 ("The 'relevant market' is thus comprised not simply of services that provide access to digitized entertainment content to consumers through the mail, but also services that provide that content to consumers for sale or rental by other means, including Internet streams, cable-based video on demand, downloaded content, and physical kiosks.").

The significance of the broader "downstream market" advocated by the Postal Service lies in its potential to demonstrate a constraint on the Postal Service's ability to raise prices above competitive levels. *Id.* at 9. In other words, the delivery services provided by the Postal Service for Round-Trip Mailers are an input to the Netflix and GameFly rentals, which offer consumers access to digitized entertainment content. The price of the Postal Service's delivery input will be constrained by the downstream demand for Netflix and GameFly services, which will, in turn, be subject to competition from the providers of digitized entertainment content who use non-mail delivery

methods. This is essentially an argument that the exercise of market power over an input is effectively checked by the derived demand effects of a downstream market.<sup>26</sup>

Netflix, GameFly, and the Public Representative argue that the Postal Service has failed to provide adequate support for the product market it advocates and that competitive pressures in the downstream market will not prevent the Postal Service from charging excessive prices for its delivery input. They challenge: (1) the significance attached by the Postal Service to DVD mail volume declines; (2) the Postal Service's claims regarding the interchangeability of alternatives to DVD mail; (3) the Postal Service's allegations regarding consumer perceptions of the market; (4) the Postal Service's characterization of industry perceptions of the market; and (5) the suggestion that technological developments will make alternatives to DVDs-by-mail available within the foreseeable future.

## 2. Discussion.

### a. Decline in DVD Mail Volumes.

GameFly seeks to rebut the Postal Service's claims by arguing that the decline in Netflix DVDs-by-mail subscribers "proves nothing about the substitutability of Internet streaming for the remaining seven million households that still rent DVDs by mail..." GameFly Comments at 14. For example, it asserts that none of the data submitted by the parties in response to the Chairman's Information Requests "suggest that DVD-by-mail rental of video games, movies and TV shows will disappear as distinct product markets for the foreseeable future." GameFly CHIR Comments-Refiled at 6. Rather, "the volume data indicate that, despite the growth of the Internet and Redbox

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<sup>26</sup> ABA Section of Antitrust Law, *Market Definition in Antitrust: Theory and Case Studies* (2012) at 51 (footnote omitted). ("The demand for an input is what economists call a 'derived' demand because it is derived from the demand for the final product. Absent demand for a final product, there would be no demand for the input." For an example of a case in which it was argued that the derived demand effects of a downstream market prevented the exercise of monopoly power, see *Coal Exporters Association of the United States, Inc. v. United States*, 745 F.2d 76 (D.C. Cir. 1984) (*Coal Exporters Case*).

self-service kiosks, large numbers of consumers will continue to demand DVD-by-mail rental of video games for the foreseeable future...[and that]...Netflix's DVD-by-mail rental business, while certainly mature, is highly profitable and likely to remain a significant part of Netflix's business for many years to come." *Id.* (footnote omitted).

GameFly, Netflix, and the Public Representative claim that there are important limits on alleged alternatives to DVDs-by-mail that will restrict further declines in DVDs-by-mail volumes. Those limits include legal principles (such as the "first-sale doctrine" of federal copyright law, *infra* at 25) and practical considerations (such as industry practices, *infra* at 25-26; the unavailability of broadband in certain geographic areas, *infra* at 26; other technical considerations, *infra* at 26-30; and restrictions on the range and availability of content from DVD kiosks, *infra* at 31-33). Each of the alleged limiting factors is considered in the following section which explores the availability of specific alternatives to DVDs-by-mail identified by the Postal Service.

The decline in mail volume does not, by itself, establish the interchangeability that will support a finding that the relevant product market for purposes of assessing market power under section 3642(b)(1) is "the market for access to digitized entertainment content." Among other problems, the Postal Service's argument is based on the important assumption that all consumers of digital content face the same substitution possibilities. The fact that some do begs the question here—namely, what economic substitutes do current customers have for DVDs-by-mail services?

Under the DOJ/FTC Guidelines, the starting point of the analysis is the products of the merging firms. In this proceeding, the analogous starting point is round-trip delivery of rented video and game DVDs. The Postal Service asserts that the consumers of this product could and would readily switch to online streaming if it significantly increased the rate for the proposed competitive Round-Trip Mailer above the initial level. The primary consumers of this service, however, dispute this claim and are opposed to the reclassification of round-trip DVD mailers as a competitive product.



According to GameFly and Netflix, there are no close substitutes for round-trip DVD mailers to serve their customers now using that service. As discussed in greater detail below, they claim that, for a variety of reasons, certain customers either prefer or require DVDs-by-mail service to consume certain video content. As a result, they would have no means to avoid a significant increase in the rate for this service. Indeed, GameFly can point to direct evidence of this lack of alternatives. Approximately four years ago, circumstances required GameFly to begin using flat-shaped DVD mailers, even though this resulted in its mailing costs being double what its costs would have been had it used letter-shaped DVD mailers.

As noted above, antitrust case law and the DOJ/FTC Guidelines place significant weight on the views and experience of customers of the relevant product and direct evidence of past price increases.<sup>27</sup> Relying on such evidence is particularly appropriate in this instance because Netflix and GameFly are sophisticated companies for which round-trip mailers represent a significant cost of doing business. Each has an incentive to search out the lowest cost delivery method available and is in a better position than the Postal Service to explore available alternatives. It is not credible that GameFly would have chosen to use flat-shaped mailers in 2009 and continue to use flat-shaped mailers until September 30, 2013 at twice the cost if, as the Postal Service claims, it could have easily switched to online streaming or other alternatives at a lower cost.

Thus, based on an application of the generally-accepted antitrust principles as set forth in the DOJ/FTC Guidelines, the Commission concludes that the relevant market for this proceeding is round-trip delivery of rented video and game DVDs. The remainder of this section consists of a detailed evaluation of the evidence concerning

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<sup>27</sup> See, e.g., DOJ/FTC Guidelines § 2.1.2 (customer information regarding historical events, or “natural experiments,” that provide insights into competitive effects of a proposal); § 2.2.2 (customer information regarding purchasing behavior and choices, the impact of historical events such as the entry of a new supplier, likely responses to price increases, and the relative attractiveness of different products and services); § 4.1.3 (customer information regarding the shifts in purchases that respond to relative changes in price and other terms and conditions).

the alternatives to DVDs-by-mail that the Postal Service relies on to support its argument, including limitations on their availability, and the experience and perceptions of direct buyers (e.g., Netflix and GameFly), industry participants, and the public.

b. The Availability of Substitutes for DVDs-by-Mail.

In the relevant product market advocated by the Postal Service (*i.e.*, the market for access to digitized entertainment), the Round-Trip Mailer could be subject to competition by intramodal delivery systems that provide round-trip physical delivery service of DVDs. In addition, the Postal Service identifies other potential forms of competition (e.g., video that is streamed or downloaded) that are not really substitutes for the Postal Service's Round-Trip Mailer product, but rather substitutes for the digitized entertainment provided on the discs delivered by means of the Round-Trip Mailer, but allegedly affect the derived demand for the Round-Trip Mailer effectively placing a limit on the Postal Service's exercise of market power.

Netflix, GameFly, and the Public Representative all oppose using the market for access to digitized entertainment content as the relevant market for assessing market power. Their opposition is based upon both legal and practical limitations on potential substitutes for DVDs-by-mail. These limitations on interchangeable substitutes, they assert, significantly narrow the boundaries of the relevant product market by excluding digitized entertainment alternatives as effective limits on the Postal Service's exercise of market power.

For convenience, the Commission organizes its discussion of alternatives to DVDs-by-mail according to the potential methods identified by the Postal Service for providing access to digitized entertainment content. Those potential alternative delivery methods are: (1) intramodal delivery; (2) electronic delivery; and (3) other physical delivery systems. Request, Attachment A at 3-4; see *also* Postal Service Reply Comments-Revised at 10-11.

*Substitutes for DVDs-by-mail that rely upon intramodal delivery systems.*

Intramodal delivery systems are delivery systems that rely upon identical technologies to provide the same service- in this case, the physical delivery of digitized entertainment content by DVD.<sup>28</sup> In its Request, the Postal Service defines the Round-Trip Mailer product as “a convenient way for mailers to send optical discs (primarily DVDs and game discs) to subscribers, with the intent that the subscriber will return the discs...” Request, Attachment A at 3. Alternative intramodal delivery systems would include delivery systems of shipping companies, such as Federal Express (FedEx) and United Parcel Service (UPS), that deliver DVDs in a manner comparable to the Postal Service’s delivery of DVDs-by-mail. However, the Postal Service states that it “does not know of another shipping company that provides door-to-door delivery of optical discs such as DVDs (DVD-by-mail)...”<sup>29</sup>

*Substitutes for DVDs-by-mail that rely upon electronic delivery systems.* The Postal Service contends that the relevant market is not limited to the actual postal product (Round-Trip Mailer), but includes other ways the contents of the postal product can be delivered. In its Request, it identifies “online streaming and/or download services” as “other technological methods for delivering access to digital movie and game content.” Request, Attachment A at 3-4 (footnote omitted). Attachment A to the Postal Service’s reply comments adds references to a variety of additional “competing distribution channels,” such as digital cable and satellite TV, general digital broadcast TV, and mobile devices which can serve as alternative delivery systems for digital entertainment content. Postal Service Reply Comments-Revised, Attachment

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<sup>28</sup> For example, in the *Coal Exporters Case*, the Court refers to competition between railroads as “intramodal competition.” 745 F.2d 76 at 83.

<sup>29</sup> *Id.* The Postal Service subsequently modified its position when it argued that DVDs sold by Amazon and physically delivered by UPS are interchangeable substitutes for DVDs that are rented (by Netflix, GameFly, or others) and delivered by means of the Round-Trip Mailer. Postal Service Reply Comments-Revised at 17. On pages 33-35, *infra*, the Commission considers the issue of whether access to digitized entertainment content *sold* to consumers is in the same product market as access to digitized entertainment content that is *rented* to consumers.

A-Declaration of Mark Schoeman at 6, 7. A common characteristic of these technologies is their reliance upon some form of electronic means of communication providing delivery of digital content to customers. For convenience, the Commission shall refer to these alternative technologies as “electronic delivery systems.”

Netflix, GameFly, and the Public Representative claim that limitations on these electronic delivery systems render them outside the relevant product market. The Postal Service argues that the limitations on delivery by electronic means are the result of business decisions by Netflix and GameFly. Postal Service Response to Additional/Supplemental Comments at 14-15. Netflix and GameFly argue that legal, commercial, and technical limitations over which they have little, if any, control preclude reliance upon these systems as reasonably interchangeable substitutes for DVDs-by-mail.

Both Netflix and GameFly assert that under copyright law, a principle known as the “first sale doctrine” creates important differences between digital content available to consumers on DVDs, and digital content made available by Internet-delivered video services. See Netflix Comments at 8-9; GameFly Comments at 15-17. Thus, “[i]f a copyright owner sells copyrighted material in a physical form, such as a book or a DVD, the owner retains no further licensing, royalty, or distribution rights over how the individual book or DVD is used after the sale.” Netflix Additional Comments at 18 (footnote omitted). This allows companies like Netflix and GameFly to distribute the DVD by sale or rental to its customers. However, the first sale principle “does not give that DVD distributor the right to provide that same content to its customers via electronic means.” *Id.* (“Non-physical delivery rights to content constitute distinct rights that are licensed separately from DVD distribution and are the subject of complex licensing provisions.”). *Id.*

Access to substitutes for DVDs-by-mail is also restricted by commercial limitations, such as “industry-wide practices known as ‘windowing’ ....” Netflix

Comments at 8. Netflix describes “windowing” as “the content industry practice of reserving time periods or ‘windows’ of exclusivity for different types of video delivery, such as theatrical distribution, home video, and cable and broadcast distribution.”

*Id.* n.14. As an example, Netflix states that “movie content is generally available via DVD within six months of theatrical release, but it can take much longer to reach other media platforms such as streaming video or premium cable services.” *Id.*

Windowing is not the only commercial practice that can affect the availability of content. Additional practices include: (1) the imposition by Internet service providers of data caps, the prioritization of Internet traffic, and the imposition of metered pricing; (2) first-day-of-release limitations designed to protect relationships between publishers and retailers of video games; (3) pricing by publishers that makes DVD versions of games more attractive to consumers; and (4) the implementation of digital rights management measures that place limits on access to downloaded and streamed games. GameFly CHIR Comments-Refiled, Declaration of David Hodess, ¶¶ 10-13, 15.

In addition to legal and commercial limitations, Netflix, GameFly, and the Public Representative identify certain technical limitations on the availability of digitized entertainment content by electronic means. Technical limitations include: (1) limitations on the availability to consumers of broadband service, *id.* Declaration of David Hodess, ¶ 5; PR CHIR Comments at 3-5, GameFly Comments at 15-16; (2) Internet outages, GameFly CHIR Comments-Refiled, Declaration of David Hodess, ¶ 7; (3) Internet security issues, *id.* Declaration of David Hodess ¶ 16; and (4) Internet broadband speeds, GameFly CHIR Reply Comments at 20. These limitations adversely affect the availability of both movies and games. Some of these limitations including Internet speed, restricted data plans, and connection reliability, are particularly problematic for streaming of video games. GameFly CHIR Comments-Refiled, Declaration of David Hodess, ¶ 9. Another limitation, file size, increases downloading times. *Id.* ¶ 6.

GameFly and the Postal Service present extensive arguments regarding the technical ability to stream or download video games. GameFly Comments at 23-28; *id.* Attachment A-Declaration of David Hodess at A-8 through A-13. Postal Service Reply Comments-Revised, Attachment A-Declaration of Mark Schoeman at 10-12. GameFly Supplemental Comments-Refiled at 39-41; Supplemental Declaration of David Hodess-Refiled, ¶¶ 7-15. Postal Service Response to Additional/Supplemental Comments at 23-30.

GameFly alleges that these technical limitations result in a distinction between more complex games that operate on large databases (console games) and simpler games based on smaller databases (casual games). According to GameFly, the selection of console games available by streaming or downloading is much more limited than the selection of casual games by such means. See GameFly Supplemental Comments-Refiled at 43-44; GameFly CHIR Reply Comments at 17.

To support its position, the Postal Service identifies a number of enterprises that it claims offer reasonably available substitutes to DVDs-by-mail: CiiNow, Gaikai, G-Cluster, Direct2Drive, GameStop, Impulse, Kongregate, Spawn Labs, MS Xbox, MS Live Compute, OnLive, Panasonic VIERA, Sony PlayStation, Steam, Valve, King Digital, Redbox Instant, and Apple, Google, Amazon, and Facebook. Request, Attachment A at 4; Postal Service Reply Comments-Revised, Attachment A-Declaration of Mark Schoeman, *passim*; IBISWorld *Industry Report*, *passim*; Postal Service Response to Additional/Supplemental Comments at 24-26; Postal Service Response to CHIR No. 1, question 4; Postal Service CHIR Comments at 5, 8-10.

GameFly critiques the examples offered by the Postal Service. GameFly Supplemental Comments-Refiled at 41-47; Supplemental Declaration of David

Hodess-Refiled, ¶¶ 6-11; GameFly CHIR Comments-Refiled, Declaration of David Hodess, ¶¶ 20-25; GameFly CHIR Reply Comments at 15-21.<sup>30</sup>

First, GameFly points to technical problems encountered by firms seeking to expand the availability to stream or download console games. GameFly CHIR Comments-Refiled, Declaration of David Hodess, ¶¶ 23-24 (system slowdown and crash with the March 11, 2014 launch of *Titanfall*, a multi-player online game). It also cites the ongoing testing of games that have not yet been made available to gamers. Supplemental Declaration of David Hodess-Refiled ¶ 16 (CiiNow); ¶ 20 (G-Cluster); GameFly CHIR Comments-Refiled, Declaration of David Hodess, ¶ 20 (Steam/Valve); GameFly CHIR Reply Comments at 18 (Steam Machine).

Second, GameFly also alleges that online games have also encountered security issues with their servers and customer account information. GameFly CHIR Comments-Refiled, Declaration of David Hodess, ¶ 16 (MS Xbox Live Compute and Sony Playstation).

Third, GameFly points to a number of online gaming firms that have ceased operations. GameFly CHIR Reply Comments at 19-20 (Spawn Labs); Supplemental Declaration of David Hodess-Refiled, ¶ 25. (On Live).

GameFly argues further that together these legal, commercial, and technical restrictions place practical limitations on the availability of movie and video gaming content by electronic delivery systems. According to GameFly, companies with limited

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<sup>30</sup> Before reviewing the principal arguments presented by the parties, it is necessary to address a threshold issue regarding the professional qualifications of the declarants who have presented statements on behalf of the parties, as well as the credentials of individuals whose reports and analyses have been cited by the parties. Both GameFly and the Postal Service have challenged the capabilities of the other party's declarants and information sources. GameFly Supplemental Comments-Refiled at 19-28; Postal Service Response to Additional/Supplemental Comments at 23-30. The Commission will not exclude from consideration any of the information presented by the parties. Arguments regarding professional qualifications or experience of the declarants and other information sources can fairly be made by both sides. In evaluating the record, the Commission will be guided by the content and persuasiveness of the information presented in light of the arguments advanced by the opposing party or parties.

selections of console video games are CiiNow, G-cluster, GameFly's own Direct2Drive, GameStop's Impulse and Kongregate divisions, MS Xbox, Sony PlayStation and Sony-owned Gaikai, Valve's Steam Machine, Panasonic's VIERA, Redbox Instant, King Digital, and Apple, *et al.* Supplemental Declaration of David Hodess-Refiled ¶¶ 16-18, 20-26, 28 and 33-36; GameFly CHIR Comments-Refiled, Declaration of David Hodess ¶¶ 20-25.

The Postal Service argues that there currently exists, or will exist in the foreseeable future, the technical ability to deliver all forms of digitized entertainment content, including digital games, by electronic means. It, therefore, asserts that digitized entertainment made accessible by electronic means is properly part of the relevant product market for determining whether it exercises market power over the Round-Trip Mailer product. Postal Service Reply Comments-Revised at 20-21, 22-23; Postal Service CHIR Comments at 6-11. GameFly alleges it is attempting to protect an out-of-date business model, and, in doing so, is denying current reality, and the inevitability of further technological advances. Postal Service Response to Additional/Supplemental Comments at 14-15.

GameFly counters by arguing that the practical ability to deliver digital content, particularly more sophisticated digital games that operate on the basis of large databases, by electronic means suffers from numerous unresolved technical problems and limitations. GameFly CHIR Comments-Refiled, Declaration of David Hodess, ¶¶ 4-9. It asserts that although technical advances continue to be made, critical technical deficiencies continue to exist. *Id.* It expressly disclaims any argument that delivery of digital games by electronic means will not grow, or that the DVDs-by-mail business model will last forever. *Id.* ¶ 26. GameFly does, however, assert "that a significant number of consumers will continue to want to rent video games on DVDs by mail for the foreseeable future." *Id.*



Notwithstanding ongoing attempts to expand the availability of digital games by means of electronic delivery systems, the Commission finds that the record developed in this proceeding clearly shows that significant technological problems remain to be resolved. Moreover, none of the information presented to the Commission suggests a near date by which it would appear likely that the identified problems will be resolved. Indeed, a report cited by the Postal Service suggests that it might not be until 2017 that significant progress is made in resolving these problems—a point at which the report predicts that digital distribution of all games could increase to 66 percent of the market. Postal Service Response to Additional/Supplemental Comments at 29. However, significant progress in resolving technical problems is not necessarily synonymous with effective competition. Even if significant progress were to be made over the next three years, it is too uncertain, and too far in the future, to find these forms of access to digital games to be “reasonable substitutes” for DVDs-by-mail within the immediate future. See *U.S. v. Microsoft*, 253 F.3d 34, 53-54 (D.C. Cir. 2001).

The record demonstrates that legal principles, industry practices, and other practical limitations restrict the availability of both movies and games by means of electronic delivery systems. Based upon the record before it, the Commission concludes that the legal, commercial, technical, and practical limitations discussed above raise serious questions as to whether digitized entertainment content made available by means of electronic delivery systems is a reasonably interchangeable substitute at this time for content made available by means of DVDs-by-mail. Currently, however, limitations affecting both movies and games appear to make the availability of both only partial substitutes for DVDs-by-mail. Future developments in industry practices and broadband availability could improve the availability of digital content by means of electronic delivery systems. It remains to be seen whether, and when, that will occur.

*Substitutes for DVDs-by-mail that rely upon other forms of physical delivery.* A third alternative method identified by the Postal Service for providing access to digital movie or game content uses other forms of physical delivery such as kiosks and retail outlets (*i.e.*, physical delivery by means other than Round-Trip Mailers or delivery services of private shipping companies). Request, Attachment A at 4.

*Kiosks.* The most common example is physical delivery by means of a kiosk, like those operated by Redbox. *Id.* Kiosks are, in effect, DVD vending machines located in commercial establishments, such as grocery stores, and other settings, such as military bases. GameFly Comments at 20.

GameFly argues that access to digital content by means of kiosks is not a good substitute for Netflix DVDs delivered by the Postal Service. GameFly Comments at 19-21. It bases its argument principally on the limited physical capacity of kiosks (approximately 600 DVDs, or 200 different titles, at any given time) as compared to the “enormous catalogue of titles” available from Netflix by means of DVDs-by-mail. GameFly Comments at 20-21.

Similarly, GameFly argues that because of limited capacity, kiosk-based rentals of video games are not economically viable. *Id.* at 28; *id.* Attachment A-Declaration of David Hodess at A-5 through A-7. In that connection, GameFly recounts its own attempt to test the feasibility of kiosks to distribute the DVDs that it rents. GameFly Comments at 28-29. That test was unsuccessful and was cancelled after 16 months. *Id.* at 28. Finally, GameFly suggests that Redbox shares its view that the demand for video games is too small to support the use of kiosks as a means of giving consumers access to video games on DVDs. *Id.* at 29. It bases this latter claim on the assertion that only 10-15 percent of each Redbox kiosk contains video games as opposed to movies, see GameFly Comments, Attachment A-Declaration of David Hodess at A-7, and the fact that video games represent only about 2 percent of Redbox’s rental volume. GameFly Comments at 29.

The Postal Service responds by pointing to Redbox's increased revenues and the expansion of the number of kiosks it has deployed to meet growing demand. Postal Service Reply Comments-Revised at 14-18 (citing Declaration of Mark Schoeman at 3).<sup>31</sup>

GameFly replies by providing the results of a "spot check" of Redbox locations in the Los Angeles and Washington, D.C. areas showing even less than 10-15 percent of kiosk capacity being used for video game DVDs. GameFly Supplemental Comments-Refiled at 48-50; Supplemental Declaration of David Hodess-Refiled ¶¶ 33-36. The average number of video game DVDs at these kiosks was 17, or 6.2 percent, of the average total number of 278 DVDs available at each kiosk. *Id.* at 49 (table). GameFly contrasts these video game DVD totals with the 8,000 game titles in GameFly's video game catalogue. *Id.* at 50. Based upon these numbers, GameFly asserts that Redbox's profitability and growth is irrelevant to the issue of whether DVDs available from kiosks are a reasonably interchangeable substitute for DVDs-by-mail.

In subsequent comments, the Postal Service seeks to establish Redbox kiosks as a substitute for DVDs sent through the mail by presenting data showing that even though only 2 percent of Redbox's rentals were video games, the absolute number of Redbox video game rentals exceeded the total number of GameFly rentals. Postal Service CHIR Comments at 6-8. The Postal Service presents similar data to show that in 2013, Redbox also rented more video DVDs than Netflix. Postal Service CHIR Reply Comments at 15. Finally, the Postal Service argues that GameFly's earlier unsuccessful attempt to use kiosks in its video game rental operations does not preclude GameFly's use of kiosks in light of "GameFly's recent addition of a DVD video rental service....[footnote omitted]" Postal Service CHIR Comments at 6.

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<sup>31</sup> The Schoeman Declaration is, in turn, based at least in part on information contained in the IBISWorld *Industry Report*, *supra*.

The information presented by the Postal Service regarding Redbox demonstrates that the physical delivery of DVDs by kiosk is a potential alternative to delivery of DVDs-by-mail. As GameFly concedes: “Redbox has succeeded where Blockbuster failed by adopting a radically stripped down store design.” GameFly Comments at 20. However, the Commission finds that the Postal Service failed to address the inherent physical limitations of a kiosk that denies consumers access to the broad range of DVD titles offered by Netflix and GameFly through the mail. Even with a generous assumption that a kiosk’s entire inventory of 200 to 600 DVDs (as estimated by GameFly) were to overlap with DVD offerings of Netflix and GameFly, that still would not demonstrate that kiosks are a reasonably interchangeable substitute for the much larger DVD inventories of Netflix and GameFly that are available by mail. Finally, there are at least two reasons why the Postal Service’s suggestion that “GameFly’s recent addition of a DVD video rental service” makes it possible for GameFly to operate kiosks successfully is not persuasive. First, GameFly did not announce that it is adding a DVD video rental service, only that it had planned a small test offering of a selection of movie DVDs. See n.2, *supra*. Second, the Postal Service’s suggestion is irrelevant, since there is no evidence that GameFly kiosks would be any more capable than Redbox kiosks of providing access to the broad range of DVD titles available by mail from both Netflix and GameFly.

*Retail sales.* In its reply comments, the Postal Service points to the sale of movie and game DVDs by Amazon, Best Buy, and other retailers as additional examples of access to digitized entertainment content by physical means other than the Round-Trip Mailer. Postal Service Response to Additional/Supplemental Comments at 12. It also interprets GameFly’s own customer survey information regarding subscription cancellations to support its assertion that sales and rentals of video game DVDs are substitutable alternatives. *Id.* at 17-18.

GameFly responds by asserting that DVD rentals and sales are largely distinct markets. GameFly Supplemental Comments-Refiled at 50. GameFly believes that the distinction between the two markets is due largely to the fact that the cost of purchasing a new video game at retail can be as much as \$60, and that it is cheaper to rent such games than to purchase them. *Id.* GameFly bases its opinion on the fact that it both rents and sells video games, and that its experience has been that customers purchase 3-5 games per year, and rent 15-20 games per year. *Id.* GameFly characterizes its rentals and sales as “complements” and states that “the vast majority of the company’s subscribers do both.” *Id.*

The Postal Service asserts that “GameFly’s attempted exclusion from the relevant market of the sale, rather than the rental, of access to digitized entertainment content is inconsistent with...and appears to ignore GameFly’s own business model.” Postal Service Response to Additional/Supplemental Comments at 31. The Postal Service is referring to the fact that GameFly rents and sells video games. In the Postal Service’s view, GameFly’s business model “demonstrates the substitutability of the sale and rental of access to digitized entertainment content.” *Id.* at 32. In this connection, the Postal Service cites non-public information provided in GameFly’s supplemental comments showing the results of surveys GameFly periodically takes of subscribers who cancel. *Id.* at 33.

The record is inconclusive as to whether retail sales of DVDs should be considered a viable alternative to rentals of DVDs. The Postal Service makes broad claims that sales of DVDs are available from a variety of sources. GameFly provides a convincing rebuttal to some, but not all, of the Postal Service’s assertions. It identifies the relatively high cost of new video game DVDs as a cause that distinguishes the markets for DVD sale and DVD rentals. This rationale may apply to new video game DVDs, but does not necessarily apply to the sale of used DVDs, the price of which would appear likely to be lower, perhaps considerably lower. Neither party addresses

the cost of used games and the implications of such costs for the distinction between sales and rental markets. Similarly, none of the parties addressed whether the cost of new or used non-game DVDs serves to distinguish DVD sales and DVD rentals.

Nor does the Commission find the fact that GameFly both sells and rents video game DVDs to be dispositive. The GameFly customer survey information cited by the Postal Service is subject to different interpretations. Nonetheless, GameFly clearly states that its business model uses rentals as a means of making sales. GameFly Comments at 39. Unlike movies and TV shows, video games are an interactive form of entertainment. They can be played multiple times with a different outcome. Thus, customers may decide to purchase a game to play multiple times. Similarly, video games are expensive, and customers prefer to try them out before deciding to make a purchase. Thus, GameFly must mail DVDs in Round-Trip Mailers in case the customer decides not to make a purchase.

Finally, the Commission notes that the Postal Service's claims about the current and future strength of competition from brick and mortar retail outlets is at odds with the historic decline in rental outlets such as Blockbuster. It is generally conceded that the advent of Netflix's DVDs-by-mail service resulted in the decline and eventual exit of Blockbuster and other large brick and mortar suppliers of DVD rental services. See, e.g., GameFly CHIR Comments-Refiled at 8.

The Commission, therefore, concludes that the evidence regarding whether DVD sales are properly considered to be viable alternatives to DVD rentals for purposes of determining the relevant product market for DVDs-by-mail to be inconclusive.

c. Consumer Perceptions of the Market.

The Postal Service and GameFly agree that consumer perceptions can provide important support for the establishment of relevant product market boundaries. Postal Service Reply Comments-Revised at 13-14 (citing *PepsiCo, Inc. v. Coca-Cola Co.*,

315 F.3d 101, 105 (2d Cir. 2002), and *Fineman v. Armstrong World Indus., Inc.*, 980 F.2d 171, 199 (3d Cir. 1992)); GameFly Supplemental Comments-Refiled at 18 n.5 and accompanying text. As noted above, however, one must distinguish between direct consumers of round-trip DVD mailers such as GameFly and Netflix and indirect customers who consume the digital entertainment. The two are related. The demand of direct buyers will be derived from the demand of indirect customers. As noted above, however, it is not appropriate to focus on the demand of all consumers of digital entertainment, but rather only those consumers now (indirectly) consuming round-trip DVD mailers.

The Postal Service asserts that consumers view access to digitized entertainment content delivered by mail or by other means as interchangeable. See Postal Service Reply Comments-Revised at 14; see *also* Postal Service Response to Additional/Supplemental Comments at 15-18 (“consumers view digitized entertainment content delivered through the mail, streaming, kiosks, and other delivery methods as interchangeable and substitutable.”).

To support its claim, the Postal Service cites: (1) the growth in the number of Netflix’s streaming customers and revenues; (2) the decline in the number of Netflix’s DVD customers and revenues; (3) statements from industry analysts that the revenues of streaming media are expected to grow at the expense of DVD-based media; (4) the growth of kiosk-based video rentals; and (5) the purchase by “many customers” of content “from multiple providers that use different technologies.” Postal Service Reply Comments-Revised at 14; see *also* Postal Service Response to Additional/Supplemental Comments at 32-33 (suggesting that GameFly customers who elect to purchase DVDs they have rented from GameFly view the sale and rental of access to digitized entertainment content as substitutable).

GameFly argues that the Postal Service focuses on the wrong group of consumers, namely, consumers who have abandoned DVDs-by-mail for digital content

available through the Internet or by means of alternate physical delivery systems, or who have never relied upon DVDs-by-mail. GameFly Supplemental Comments-Refiled at 18. It is GameFly's position that the legally relevant consumers in this proceeding are those who continue to rent DVDs-by-mail. *Id.* at 19. It bases this position on a line of decisions beginning with *Brown Shoe, supra*, that have recognized that "well-defined submarkets" may exist within broader product markets. *Id.* at 29 (citing *Brown Shoe*, 370 U.S. 294 at 325; *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1038 (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)).

GameFly places particular emphasis on the *Whole Foods* and *Staples* cases. In *Whole Foods*, the Court held that "a 'core group' of particularly dedicated 'distinct customers,' paying 'distinct prices,' may constitute a recognizable submarket...." *Whole Foods*, 548 F.3d at 1039. The dedication of such core groups can be due to a number of possible factors, including the fact that "they find a particular product 'uniquely attractive'...." *Id.* In *Staples*, the Court found that a "unique combination of size, selection, depth and breadth of inventory offered by the superstores distinguishes them from other retailers." *Staples*, 970 F. Supp. at 1079. GameFly also argues that a report co-authored by one of the Postal Service's declarants (and cited by the Postal Service in its reply comments) supports GameFly's claim that remaining Postal Service customers, not customers who elect to use the Internet, should be used to "define the relevant product market in which DVD rental companies operate." GameFly Supplemental Comments-Refiled at 31.

Relying upon the concept of a "core group of consumers" to define the relevant product market, GameFly argues that there is a core group of consumers who rent entertainment and video game DVDs-by-mail, and do not regard such content available by Internet streaming, downloading, kiosks, or retail purchases to be adequate substitutes based upon legal, commercial, and practical limitations, such as limits on



available titles. *Id.* at 34-50. The limitations (legal, commercial, technical, economic, and practical) on Internet streaming, Internet downloading, DVD kiosks, and DVD sales that are the bases for the core consumer group perceptions of the market relied upon by GameFly are discussed under the section heading “The Availability of Substitutes for DVDs-by-Mail,” *supra* at 23-35.

The claim that a core group of consumers do not consider Internet streaming, Internet downloading, DVD kiosks, or DVD sales as reasonably interchangeable substitutes for DVDs-by-mail is confirmed by the fact that consumers continue to pay Netflix, GameFly, and other companies for the right to receive rented DVDs-by-mail. See, e.g., GameFly Supplemental Comments-Refiled at 35 (“...two-thirds of the households that subscribe to DVD-by-mail from Netflix do so despite paying separately for streaming from Netflix as well.”).

The Postal Service attempts to overcome GameFly’s reliance upon the market perceptions of a “core group of consumers” by distinguishing the *Whole Foods* decision. It claims that *Whole Foods* “considered the existence of a submarket involving competition among multiple competitors,” whereas “GameFly seeks to define a market as limited to a single firm, itself, where interbrand competition is limited or nonexistent.” Postal Service Response to Additional/Supplemental Comments at 17. In fact, what GameFly has sought to do is rebut the Postal Service’s attempt to demonstrate the availability and substitutability of digitized entertainment content from other sources, both electronic (e.g., Internet streaming or downloading) and physical (e.g., DVD kiosks or DVD sales). In *Whole Foods*, the Court recognized that “market definition focuses on what products are *reasonably* substitutable; [and] what is reasonable must ultimately be determined by ‘settled consumer preference.’” *Whole Foods*, 548 F.3d at 1039 (citing *United States v. Phila. Nat’l Bank*, 374 U.S. 321, 357 (1963)). On that basis, the Court concluded that “in some situations core customers, demanding exclusively a particular product or package of products, distinguish a submarket.” *Id.* at 1041. Consistent with

the decision in *Whole Foods*, GameFly seeks to narrow the scope of the product to the market perceived by a core group of customers.

Likewise, the Postal Service relies upon judicial precedents that “rejected attempts to define markets in terms of distribution methods when those methods are employed to distribute products that consumers consider equivalent.” That reliance is misplaced. Postal Service Reply Comments-Revised at 12-13 (citing, *e.g.*, *Pepsico, Inc. v. Coca-Cola Co.*, 114 F. Supp. 2d 243 (S.D.N.Y. 2000)). In those cases, the unsuccessful litigants attempted to establish separate markets for products recognized as equivalent by consumers on the basis of the method of distribution. In this case, GameFly seeks to demonstrate that product markets are not equivalent based upon legal, commercial, technical, economic, and practical differences, which, considered together, result in consumer perceptions of a narrower market than the market advocated by the Postal Service.

Finally, the Postal Service claims that GameFly is attempting “to define its relevant market in terms of the Postal Service’s specialty,” and that this attempt is precluded by the generally recognized principle that a firm’s “own products do not themselves comprise a relevant product market....” Postal Service Reply Comments-Revised at 18-19 (citing, *e.g.*, *Green Country Food Market, Inc. v. Bottling Group*, 371 F.3d 1275, 1282 (10th Cir. 2004)). GameFly counters the Postal Service’s argument by noting that *Green Country* and the other cases cited by the Postal Service would only apply if GameFly were attempting to limit the product market to the Postal Service’s round-trip delivery of DVDs in the face of competition by other shipping companies that also provided round-trip delivery of DVDs. GameFly Supplemental Comments-Refiled at 32-33. In this case, however, the Postal Service has conceded that there is no competition for round-trip delivery of DVDs by other shipping companies. Instead, GameFly is arguing that digitized entertainment content available by means of DVDs-by-mail has distinctive product characteristics different from the

product characteristics of digitized entertainment available from other sources. *Id.* at 33.

Clearly, it is appropriate to define a relevant market that has a single supplier--namely, a monopolist. The Postal Service's position might be persuasive if it faced competition from other suppliers of round-trip delivery service, but that is not the case in this proceeding. The Commission concludes that the Postal Service's argument and the cases cited to support it are not pertinent.

Consumer perceptions are a decisive consideration in the determination of a relevant product market. *See, e.g., Whole Foods*, 548 F.3d at 1039. In this proceeding, there is considerable evidence that a core group of consumers view DVDs-by-mail as a separate product market. Notwithstanding the increase in the number of subscriptions for movie content by means of streaming cited by the Postal Service, a substantial portion of Netflix's customer base continues to pay extra for the right to receive DVDs-by-mail. A similar situation exists for GameFly's customer base. For the reasons discussed above, the Commission concludes that consumer perceptions support a finding that DVDs-by-mail constitute a separate and distinct product market for purposes of determining whether the Postal Service exercises market power over round-trip DVD mail. This conclusion could, of course, change depending upon future developments in industry practices and broadband availability.

d. Industry Perceptions of the Market.

The Postal Service and GameFly agree that industry perceptions also should be considered in identifying the relevant product market. Postal Service Reply Comments-Revised at 15-17 (citing *FTC v. PPG Indus., Inc.*, 798 F.2d 1500 (D.C. Cir. 1986); *FTC v. Warner Communications Inc.*, 742 F.2d 1156 (9th Cir. 1984) (*per curiam*)); GameFly Supplemental Comments-Refiled at 9 (citing *Rothery Storage & Van Lines*, 792 F.2d 210, 219 (D.C. Cir. 1986)).

While they agree on the need to assess industry perceptions of the market, the Postal Service and GameFly have opposing views on those industry perceptions. The Postal Service cites statements by Netflix in its 2012 Securities and Exchange Commission (SEC) Form 10-K, which the Postal Service states “repeatedly emphasize...[Netflix’s] exposure to competitors offering access to digitized entertainment content through a variety of delivery methods.” Postal Service Reply Comments-Revised at 15-16. In subsequent comments, the Postal Service cites additional statements by Netflix in its 2013 Annual Report to the Securities and Exchange Commission (SEC Form 10-K), which the Postal Service asserts are acknowledgement of “a highly competitive market with a large number of competitors that offer...substitutes for the products and services provided by GameFly and Netflix.” Postal Service CHIR Comments at 2-3. The Postal Service characterizes “Netflix’s understanding of its involvement in a broader market for digitized entertainment content” as “highly probative” particularly in view of GameFly’s reliance on Netflix to support its view of the relevant product market. Postal Service Reply Comments-Revised at 15.

Netflix’s view of its business and the industry in which it operates differs from that of the Postal Service. Netflix sees itself operating two lines of business: “a streaming Internet TV network and a DVD distribution business, and each line of business requires separate operations and expertise with little overlap between them.” Netflix Additional Comments at 19. As Netflix explains, these different lines of business (which operate out of separate corporate divisions using personnel with different types of expertise) reflect underlying legal, commercial, and practical considerations that differentiate its DVDs-by-mail and streaming operations. *Id.* at 17-19.

In public filings with the SEC, Netflix also states its expectation that its DVD distribution business will continue to operate for the foreseeable future. For example, in its 2013 SEC Form 10-K, Netflix states its belief that notwithstanding anticipated declines in DVDs-by-mail subscriptions, “the domestic DVD business will continue to

generate significant contribution profit for our business.” See GameFly CHIR Comments-Refiled at 6.

Netflix also challenges the Postal Service’s interpretation of its investment activity as evidence of a “purported strategy to slight the DVD-by-Mail service.” Netflix CHIR Comments at 7-8 n.20; see *also* GameFly CHIR Comments-Refiled at 7 (“That capital is allocated in this manner [between Netflix’s DVD business and its streaming business] does not prove that the alternative investment projects are in the “same market.” (footnote omitted)).

The Postal Service cites a number of statements by GameStop, which describes itself as “the world’s largest multichannel video game retailer,” to the effect that the digitized entertainment industry is highly competitive, and includes, among its competitors, game rental companies. Postal Service CHIR Comments at 4. GameStop also asserts that video game products are distributed by means of electronic delivery systems. *Id.* In addition, GameStop has stated in its SEC Form 10-K at 6 that its anticipated “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.” *Id.* at 10. Balanced against these statements, however, are GameStop statements, such as its assertion “that the ‘digital transition’ is ‘overhyped’ and the ‘vast majority of content will remain on discs.’” GameFly Supplemental Comments-Refiled at 42. Other considerations cited by GameStop’s CEO as supporting the continued use of discs are: the value that gamers place on trade-in opportunities not available digitally; slow bandwidth speeds; and the lack of content on gaming networks. *Id.*

GameFly also cites statements by the CEO of Valve, the operator of the Steam Machine system, expressing skepticism that streaming will ever become a mainstream delivery channel for console gaming. *Id.* at 46 (CEO of Valve “expressed skepticism at a trade conference that streaming would ever become a mainstream delivery channel for console gaming.”). The CEO of Valve has also expressed the view that services

such as Gaikai (now owned by Sony) are heavily reliant upon fast Internet connections, but that such connections are a luxury that not everyone can afford or are often unavailable. *Id.* In addition, he points to two other limitations on game streaming. The first, is his expectation that the increase in network costs that would accompany a growth in cloud gaming would be unsustainable. *Id.* The second limitation would be increased latency sensitivity that will result from bigger games with larger databases. *Id.* at 46-47.

The record includes varying industry perceptions of the relevant product market. Those perceptions vary, in part, upon the product or products at issue and the timeframe being considered. For example, collectively, digital movies and games can be viewed as available from a broad spectrum of sources (DVDs, Internet streaming, Internet downloading, kiosks, cable TV, satellite TV, retail sales, etc.) as they are in the IBISWorld *Industry Report*. As a generalized statement, this can be accepted as true. But when attention is focused on movies with different characteristics (*e.g.*, movies subject to the “First-Sale Doctrine” as opposed to movies that are not), the generalized statement regarding the availability of movies from the full array of alternative sources is no longer true.

From the record before the Commission, the same holds true for games. From a broad perspective, it is true that games can be delivered by multiple sources and technologies. However, companies that provide games and industry analysts recognize distinctions between so-called casual games and console games as those terms have been used in the comments and information filed in this proceeding. Similarly, industry perceptions vary depending upon whether attention is focused on the present, the near-term, or the longer-term. What may be viewed as impossible today may be possible in the future.

For the reasons discussed above, the Commission is persuaded by the representations and information presented by Netflix and GameFly that industry

participants currently perceive DVDs-by-mail to constitute a separate and distinct product market. The continuing evolution of technology and markets may very well change these representations. At some point in the future, the prevailing industry view may be that digital content available by DVDs-by-mail can be provided by the entire spectrum of delivery technologies. However, the record before the Commission at this time does not support the conclusion that day is here, or imminent.

### 3. Findings and Conclusions Regarding the Relevant Market.

Based on an application of case law and generally accepted antitrust principles, as set forth in the DOJ/FTC Guidelines, the Commission finds that the relevant market for assessing whether the Postal Service exercises market power over the round-trip DVD mail at issue in this proceeding is the market for round-trip delivery of rented video and game DVDs. It bases that finding on the analysis and conclusions set forth above. The Commission's conclusions can be briefly summarized as follows.

First, the decline in DVD mail volume and the simultaneous increase in the availability of digitized entertainment content by other means (such as Internet streaming, Internet downloading, cable TV, satellite TV, kiosks, retail sales, and other delivery systems) does not by itself demonstrate that DVDs-by-mail is part of a broader product market that uses these other technologies to deliver movie and game content. For DVDs-by-mail to be part of a broader product market, there must be a demonstration that other products are reasonable substitutes for DVDs-by-mail. The Postal Service has not made such a demonstration here.

Second, alternatives to the delivery of digitized entertainment content by means other than DVDs-by-mail are subject to significant limitations. Those limitations include the unavailability of intramodal delivery alternatives (such as UPS or FedEx delivery service); legal limitations on the manner in which digitized entertainment content can be delivered; practical limitations; and technical limitations. While electronic delivery

systems and alternative physical delivery systems may offer reasonable substitutes for some content made available by means of DVDs-by-mail, the Postal Service has not shown that these alternative delivery systems offer consumers reasonable substitutes to DVDs-by-mail for all content at this time.

Third, a core group of consumers of digital content perceive DVDs-by-mail as a separate product market for which there are no reasonably available economic substitutes. That perception is clearly demonstrated by the willingness of those consumers to pay a premium for access to certain digital content available by DVDs-by-mail. To satisfy those consumers, GameFly determined that its next-best alternative was to use flats at twice the per-unit cost when it was precluded from using letter-shaped mailers.

Fourth, industry participants perceive DVDs-by-mail to be a separate product market. While some of those industry participants anticipate technological and market developments that will one day make all, or most, digital content available by delivery systems other than DVDs-by-mail, is currently not the case, nor does it appear likely in the near term.

Together, these reasons establish that the relevant product market for assessing market power in this proceeding under section 3642(b)(1) is the market for round-trip physical delivery of rented videos and games via a DVD mailer.

## B. Market Power

Section 3642(b)(1) requires that products over which the Postal Service “exercises sufficient market power that it can effectively set the price...substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products” must be placed on the market dominant product list. In order to add a product to the competitive product list, section 3020.32(d) of the Commission’s regulations requires the Postal



Service to “verify that the change does not classify as competitive a product over which the Postal Service exercises sufficient market power [as that term is defined in the section 3642(b)(1) of the statute].”<sup>32</sup>

1. Positions of the Parties.

The Postal Service takes the position that it does not exercise market power over its proposed Round-Trip Mailer product because of numerous substitutes for DVDs-by-mail that are available in a broad “market for access to digitized entertainment content,” and that the number of available substitutes is increasing rapidly as the technology for delivering entertainment content develops. These substitutes, it argues, can be relied upon to constrain its ability to exercise market power. Request, Attachment A at 3-4; Postal Service Reply Comments-Revised at 9-10, 22-24; Postal Service Response to Additional/Supplemental Comments at 10-11, 15-16, 18-22, 30-31; Postal Service CHIR Comments at 7-9; Postal Service CHIR Reply Comments at 8-12. Alternatively, the Postal Service argues that it would lack market power even if the Commission were to find the relevant product market to be limited to entertainment content made available on DVDs from companies such as Redbox. Postal CHIR Reply Comments at 14-15.

Opponents Netflix, GameFly, and the Public Representative argue that the relevant product market is the market for DVDs-by-mail, which the Postal Service has conceded lacks any intramodal competitors (such as FedEx or UPS). GameFly CHIR Reply Comments at 4; Netflix CHIR Reply Comments at 1-4; PR CHIR Comments at 3-5. Alternatively, they assert that even assuming the existence of competition in the

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<sup>32</sup> 39 C.F.R. § 3020.32(d). The word “verify” in section 3020.32(d) has never been interpreted by the Commission to require conclusive proof from the Postal Service that it will lose substantial business as a result of price increases or service degradation. See Docket No. MC2010-36, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, March 2, 2011, at 14-15 (Order No. 689). (Section 3642(b)(1) “does not require a certainty that business will be lost if prices are raised either significantly or significantly above costs. Rather, section 3642(b) provides that when there is a risk of losing a significant level of business to other firms offering similar products, a product (or subordinate unit) will not be classified as market-dominant.”).

consumer market for digitized entertainment content, the Postal Service has not demonstrated that this competition would effectively constrain the prices of the Round-Trip Mailer. *See, e.g.,* GameFly Supplemental Comments-Refiled at 5-13; GameFly CHIR Comments-Refiled at 1-4.

Opponents argue further that there is significant evidence of the exercise of market power which the Postal Service has failed to rebut. That evidence consists of: the Postal Service's own price elasticity data (GameFly Supplemental Comments-Refiled at 13-17); unusually high cost coverages (Netflix Comments at 5-6); and the demonstrated pricing power that the Postal Service has exercised over GameFly for the past four years (PR Additional Comments at 5). In addition to this evidence, opponents point to the Postal Service's alleged failure to provide a credible analysis of the price elasticity of the Round-Trip Mailer. *See, e.g., id.* at 1, 5.

## 2. Discussion.

The principal basis for the Postal Service's claim that it lacks market power over the Round-Trip Mailer product is that competition in the broadly defined market for access to digitized entertainment will constrain its ability to exercise market power. For the reasons discussed in Section VII. A., *supra*, the Commission has determined that the Postal Service has failed to demonstrate that alternatives to the Round-Trip Mailer product (other than potential intramodal alternatives) are reasonably interchangeable substitutes. The Commission's rejection of the market for access to digitized entertainment advocated by the Postal Service as the relevant product market implicitly precludes the Postal Service from relying upon alternatives (other than potential intramodal alternatives)

to demonstrate that it does not exercise market power over the Round-Trip Mailer.<sup>33</sup>

Rejection of the relevant market advocated by the Postal Service does not, however, prevent the Postal Service from attempting to demonstrate by alternative means that it does not exercise market power over the Round-Trip Mailer product. Such a demonstration does not require the Postal Service to present “conclusive proof” that it will lose substantial business as a result of price increases or service degradation. As the Postal Service notes, the Commission has previously stated that “[section 3642(b)(1)] does not require a certainty that business will be lost if prices are raised either significantly or significantly above costs. Rather, section 3642(b) provides that when there is a risk of losing a significant level of business to other firms offering similar products, a product (or subordinate unit) will not be classified as market dominant.” Order No. 689 at 14-15.

In responding to the arguments that its own price elasticity estimates are evidence of market power, the Postal Service asserts that the evidence regarding First-Class Mail elasticities relied upon by opponents does not demonstrate whether the price elasticity of demand for the Round-Trip Mailer, itself, is elastic or inelastic. Postal Service Response to Additional/Supplemental Comments at 30-31 (“As recognized in an article co-authored by A. Thomas Bozzo, an economist of the firm Christensen Associates, some subclasses within First-Class Mail face elastic demand.” (footnote

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<sup>33</sup> Opponents argue that even if the market for digitized entertainment content (as opposed to the market for access to digitized entertainment content) were found to be competitive, it would not justify approval of the Postal Service’s Request because of the Postal Service’s failure to demonstrate that downstream competition in the market for digitized entertainment constrains prices of the Round-Trip Mailer. See, e.g., GameFly Supplemental Comments-Refiled at 5-13; GameFly CHIR Comments-Refiled at 1-4. In light of the determination that the relevant market is the market for round-trip delivery of rented video and game DVDs, the Commission need not address this argument.

omitted)). It also asserts that competitive product status has never been conditioned on the development of elasticity data.<sup>34</sup> Postal Service CHIR Reply Comments at 8-9.

The Postal Service arguments, at most, seek to rebut arguments that have been made against classification of the Round-Trip Mailer as a competitive product, but do not provide affirmative support for the Round-Trip Mailer by addressing the requirement that the Postal Service verify that it does not exercise market power. 39 C.F.R. § 3020.32 (d).

Instead, the Postal Service attempts to confirm its lack of market power by asserting that prior rate increases applicable to DVDs-by-mail reduced DVDs-by-mail volumes. Postal Service CHIR Reply Comments at 10-11. This observed decrease in volume in response to a rate increase is neither surprising nor dispositive with respect to the issue of market power, given that most increases in price for a good or service will cause the quantity demanded to decrease. Rather, the central issue is whether the decrease in quantity demanded is sufficient to cause overall Postal Service revenues to decline, despite an increase in unit price thereby precluding the Postal Service's exercise of market power by rendering the price increase unprofitable to the Postal Service.<sup>35</sup>

A key determinant of a firm's market power is the elasticity of its own demand. *Id.* at 36. Assuming the Postal Service's asserted decrease in DVDs-by-mail volumes was caused by the prior rate increases, this observed decrease only demonstrates that demand is not perfectly inelastic, (*i.e.*, unresponsive to price changes). Such a decrease does not indicate whether demand is *sufficiently* elastic with respect to price

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<sup>34</sup> While the Commission has never required the Postal Service to support competitive product proposals with elasticity data, neither has it prevented the Postal Service from submitting elasticity data in support of a proposal. In this case, the Postal Service has decided to rely entirely upon the claim that the relevant market is the market for access to digitized entertainment content as the basis for verifying that it lacks market power.

<sup>35</sup> Church, J., and Ware, R., *Industrial Organization: A Strategic Approach*, Irwin McGraw-Hill, at 607.

to render the rate increase unprofitable which would constitute evidence of the lack of market power.

This type of analysis only concerns the effect of price increases on the grounds of quantity demanded, and holds other possible factors constant.<sup>36</sup> Of course, other non-price factors may also cause a decrease in demand (*i.e.*, a shift in demand). Such non-price factors are referred to in economic literature as “exogenous” factors, and include a general reduction in economic income (income effect), legal or regulatory changes, increased advertising for alternatives, etc.<sup>37</sup>

Netflix and GameFly cite several such exogenous factors they consider responsible for the decrease in DVDs-by-mail volumes. The time period over which the cited rate increases occurred was coincident with the time period during which Netflix was promoting its streaming services. Netflix customers who elected to terminate DVD subscription services or reduce their use of DVDs may have done so because of their preference for particular forms of streamed entertainment content. Similarly, the decline in GameFly DVDs-by-mail volumes may have occurred because of the preference of customers for so-called casual games on the Internet.

In this record, the Postal Service does not provide an estimate of price elasticity of demand for DVDs-by-mail, and disclaims that any known First-Class Mail price elasticities are relevant to Round-Trip Mailers. Absent an estimate of price elasticity of demand for DVDs-by-mail, the Postal Service cannot distinguish the effect of prior rate increases from the effect of non-price factors in DVDs-by-Mail volume. Without this information, the Postal Service’s argument that prior rate increases produced the decrease in volume is *post hoc ergo propter hoc* fallacy that fails to demonstrate “a risk of losing a significant level of business” from increases in price or decreases in quality

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<sup>36</sup> Ferguson, C.E., and Gould, J.P., *Microeconomic Theory*, 4th Ed., 1975, at. 45.

<sup>37</sup> Thompson, Arthur A., Jr., *Economics of the Firm: Theory and Practice*, 5<sup>th</sup> ed., Prentice Hall, Englewood Cliffs, N.J., 1989 at 123-134.

or output as required by 39 C.F.R. §3020.32(d). See n.32, *supra*. These assertions do not support the Postal Service's claim that the volume decrease on which it relies is evidence of an elastic demand for DVDs-by-mail that precludes the Postal Service's exercise of market power.

To the contrary, GameFly and Netflix both maintain that there are no close substitutes for round-trip DVD mailers to serve their customers now using that service. *Supra* at 22. Moreover, this lack of substitutes and the referenced rate increases prompted GameFly to continue to rely on flats to mail its DVDs—at nearly twice the price. *Id.* Such circumstances suggest a relatively inelastic demand, higher revenues and greater profitability to the Postal Service, and Postal Service exercise of market power.

Nor has the Postal Service rebutted the argument by Netflix that the Postal Service's exercise of market power can be found in the "unusually high cost coverages" for existing DVDs-by-mail service (which would be the same under the proposed Round-Trip Mailer product). Netflix Comments at 5-6. Netflix alleges that these coverages are evidence that, in the words of the statute, the Postal Service "can effectively set the price of the product substantially above costs." *Id.* at 6.

The Postal Service's exercise of market power in the relevant product market (the market for round-trip physical delivery of rented videos and games via DVD mail) is also evidenced by the demonstrated pricing power that it has exercised over GameFly for the past four years. PR Additional Comments at 5; GameFly Comments at 29. Between 2009, when GameFly filed its complaint in Docket No. C2009-1, and 2013, when rate relief was imposed by the Commission, GameFly was required to pay almost double per piece what it currently pays for sending round-trip DVDs-by-mail. GameFly Comments at 29.

Finally, the Postal Service argues that GameFly "has admitted that it would have to absorb any postal price increase by accepting smaller margins." Postal Service

Response to Additional/Supplemental Comments at 21. This alleged admission is relied upon by the Postal Service to suggest that GameFly has implicitly conceded that the “hypothetical market” of core customers is, in fact, too narrow and that the competition that forces GameFly to accept smaller margins demonstrates that the Postal Service does not exercise market power. *Id.* at 18-22.

Contrary to the Postal Service’s suggestion, GameFly does not concede the existence of a broader product market (in which the Postal Service does not exercise market power) by admitting that it, GameFly, would have to absorb any potential price increases. GameFly’s argument is that the Postal Service has failed to satisfy its obligation to prove that competition in the market for access to digitized entertainment content “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*.” GameFly Supplemental Comments-Refiled at 6 (emphasis in original). GameFly supports its argument with citations to the *Coal Exporters Case*, *supra*; and *Telecor Communications v. Southwestern Bell Telephone Co.*, 305 F.3d 1124 (10th Cir. 2002). *Id.* at 6-7.<sup>38</sup> As part of its argument, GameFly asserts that “all available evidence indicates that product competition for DVDs-by-mail, to the extent effective, will simply force DVD rental

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<sup>38</sup> The Postal Service seeks to distinguish the *Coal Exporters Case* by arguing: (1) that downstream competitors in the *Coal Exporters Case* were subject to a price cap that prevented them from passing on a rate increase to their customers; and (2) the downstream competitors in the *Coal Exporters Case* all used the same delivery methods-railroads, whereas the downstream competitors in the instant case is delivery methods other than Postal Service delivery. Postal Service Response to Additional/Supplemental Comments at 19. The first ground for distinguishing the *Coal Exporters Case* is undercut by the Postal Service’s own assertion that the broader product market it advocates in this case would, like the delivered price of export coal in the *Coal Export Case*, allegedly cap the price paid by customers of GameFly, Netflix, and other downstream competitors. With respect to the second ground for distinguishing the *Coal Exporters Case*, the Postal Service never explains why the “diversity of delivery methods” it identifies in this case render the *Coal Exporters Case* inapposite. In both cases, the relevant issue is whether, regardless of the specific method or methods of delivery of the end-product, the exercise of market power over the upstream input is effectively constrained. The Postal Service’s objection to reliance upon the *Telecor Case* rests upon the Court’s alleged failure to consider the perspective of the end user. *Id.* at 20. In the instant case, the Commission has considered the perspective of the end user as advocated by the Postal Service in presenting its theory of the case. See *supra*.

companies to absorb any postal price increases by accepting smaller margins.” *Id.* at 3 (emphasis added). This does not constitute the concession alleged by the Postal Service to have been made.

Alternatively, the Postal Service argues that “[i]f GameFly’s theory about the need to absorb any Postal Rate increase was true (and it is not), then GameFly and Netflix would have market power and they could pass on any Postal Service rate increase to their customers.” *Id.* at 18. Although acceptance of the Postal Service’s argument could potentially rebut any GameFly claims of being forced to absorb Postal Service price increases, this argument does nothing to assist the Postal Service in demonstrating that *it* does not exercise market power. Indeed, this argument suggests that GameFly and Netflix could be viewed as conduits for extending the reach of the Postal Service’s exercise of market power.

### 3. Findings and Conclusions Regarding the Postal Service’s Exercise of Market Power.

The Commission finds that the Postal Service has failed to adequately demonstrate that it lacks market power over the proposed Round-Trip Mailer product as required by 39 U.S.C. § 3642(b)(1) and 39 C.F.R. § 3020.32(d). The only reasonably interchangeable substitutes for sending DVDs-by-mail are currently, and for the immediate future, intramodal delivery services. The Postal Service has admitted that there are currently no such intramodal delivery services available from other delivery companies. The Postal Service has elected not to present any elasticity studies to show that it lacks market power. The Postal Service has not demonstrated a connection between its rate increases and the declines in DVD mail volume. Market power is further evidenced by DVD mail cost coverages and the Postal Service’s demonstrated and projected pricing power over GameFly that threatens it with the need to absorb Postal Service price increases if the Postal Service’s Request were granted. The Commission, therefore, concludes that the Postal Service has failed to demonstrate



that it does not exercise market power over the proposed Round-Trip Mailer. The product, therefore, cannot be added to the competitive product list at the present time.

#### VIII. THE REQUIREMENTS OF SECTIONS 3642(B)(2) AND 3642(B)(3)

##### A. Evaluation of the Request under Section 3642(b)(2)

##### 1. Positions of the Parties.

Section 3642(b)(2) prohibits the transfer from the market dominant product list to the competitive product list those products covered by the postal monopoly. In its Request, the Postal Service takes the position that the Round-Trip Mailer is not covered by the postal monopoly either “because it is not a letter, or because the letter content is within the scope of one of the exceptions/suspensions to the Private Express Statutes.” Request, Attachment A at 5.

According to the Postal Service, the content of the Round-Trip Mailer is not a letter, but merchandise—more specifically, an “optical disk[] containing encoded computer data to be run on compatible computer devices” and, as such, is excluded from coverage by the Private Express Statutes. *Id.* (citing 39 C.F.R. § 310.1(a)(3) which distinguishes between letters and merchandise). Alternatively, it argues that optical discs containing movies or games would be “excluded from the definition of letter under the Private Express Statutes...as a ‘computer program recorded on media suitable for direct input.’” *Id.* at 5-6 (citing 39 C.F.R. § 310.1(a)(7)(xii) and Private Express Statutes Advisory Opinion 85-3 (PES Op. 85-3) included with the Request as Attachment C). Any invoices or documents included in the Round-Trip Mailer that relate to optical discs, such as invoices, receipts, or instructional manuals would also, in the Postal Service’s view, be excluded from coverage by the Private Express Statutes. *Id.* at 6-7 (citing 39 C.F.R. § 310.3(a)) and that advertisements included in the Round-Trip Mailer that conform to the exceptions to or suspensions of the Private Express Statutes would be beyond the scope of the postal monopoly. *Id.* at 7 (citing 39 C.F.R. § 320.7).

Netflix challenges the Postal Service's characterization of the optical disc to be transmitted by the Round-Trip Mailer as merchandise. Netflix Additional Comments at 7-9. Netflix also emphasizes that the Postal Service itself "defines the market for its product as 'the provision of access to digitized entertainment content to consumers.'" *Id.* at 8 (emphasis in original). Netflix argues that content does not constitute merchandise, but a message that, in legal terms, makes the optical disc a "letter" subject to the Private Express Statutes. *Id.* at 7-9. Netflix also opposes the Postal Service's alternative suggestion that optical discs containing movies or video games are "computer programs recorded on media suitable for direct input," and therefore beyond the scope of the Private Express Statutes by virtue of 39 C.F.R. § 310.1(a)(7)(xii). *Id.* at 9-12.

Both the Postal Service and FedEx oppose Netflix's assertion that the postal monopoly covers the Round-Trip Mailer and precludes its addition to the competitive product list. Postal Service Response to Additional/Supplemental Comments at 5-9. FedEx Comments at 1-7.

Although FedEx agrees with the Postal Service that the Round-Trip Mailer is not covered by the postal monopoly, it bases its conclusion on different grounds. *Id.* at 1. FedEx argues that both Netflix and the Postal Service have mistakenly relied upon Postal Service regulations that are *ultra vires* and void, and that the scope of the postal monopoly must be determined on the basis of the postal monopoly statutes themselves. *Id.* at 1-4. As interpreted by FedEx, those statutes lead to the conclusion that the Round-Trip Mailer is not a "letter" and is therefore beyond the scope of the monopoly. *Id.* Finally, FedEx argues that Netflix's interpretation of the Postal Service's administrative exemptions of "non-letters" from the postal monopoly does not support its conclusion that the Round-Trip Mailer is subject to the postal monopoly. *Id.* at 5-7.

Although the Postal Service appreciates FedEx's support for the Postal Service's position that Round-Trip Mailers are not subject to the Private Express Statutes, it

points out that FedEx is, by its own admission, raising “new issues or facts.” Postal Service Response to FedEx Comments at 1. The Postal Service states that it “finds much to dispute about FedEx’s analysis of the Private Express Statutes” and that “[t]here are multiple other types of Commission proceedings that would be better suited to consideration of the broader legal and policy issues that the post-PAEA Private Express Statutes pose.” *Id.*

In further comments, Netflix argues that the Commission must address fundamental questions regarding the Private Express Statutes before it can conclude that the requirements of section 3642(b)(2) have been met. Netflix CHIR Comments at 9-14; *id.* Netflix Appendix A. It asserts further that “[m]any persons who are not parties in this docket may have ‘a vital interest in the scope of the postal monopoly law,’ and should be given notice that the Commission intends to rule on these fundamental questions.” *Id.* at 12.

## 2. Discussion.

For the Commission to grant the Postal Service’s Request, it would necessarily be required to conclude that section 3642(b)(2) did not preclude the addition of the Round-Trip Mailer to the competitive product list as reflected by the comments filed in this proceeding. The legal and policy issues surrounding the postal monopoly have far-reaching and important implications that go beyond the boundaries of this proceeding. *See generally*, Postal Regulatory Commission, Report on Universal Postal Service and the Postal Monopoly, 2008. In light of the parties’ arguments, this issue may be appropriate for review in a separate proceeding. However, in light of the Commission’s market power finding, *supra*, a ruling on the postal monopoly is unnecessary at this time.

B. Evaluation of the Request under Section 3642(b)(3)

In reaching its decision, the Commission is required by section 3642(b)(3) to give due regard to: (a) the availability and nature of enterprises in the private sector engaged in the delivery of the product involved; (b) the views of those who use the product on the addition of the Round-Trip Mailer to the competitive product list; and (c) the likely impact of the proposed action on small business concerns.

As part of its analysis under section 3642(b)(1), *supra*, the Commission has given consideration to each of the subjects specified by section 3642(b)(3). The Commission has considered the availability and nature of enterprises engaged in the delivery of DVDs. The Commission has considered the views of Netflix, GameFly, MMAVault, and CafeDVD, all of whom use round-trip DVD mailers. The Commission has also given due regard to the impact of its action on small business concerns through its consideration of the comments of MMAVault, CafeDVD, and the Public Representative.

IX. MISCELLANEOUS

Having concluded that the proposed Round-Trip Mailer fails the market power test of section 3642(b)(1), it is unnecessary for the Commission to resolve the issue addressed by GameFly and Netflix regarding the propriety of prohibiting round-trip DVD mail from being sent as generic First-Class or Standard Letter Mail. GameFly Comments at 32-34; Netflix Reply Comments at 2-7; GameFly Response to Reply Comments at 2-7; Netflix Additional Comments at 2-7; Netflix CHIR Comments at 2-4; GameFly CHIR Comments-Refiled at 21-24.

Similarly, it is unnecessary for the Commission to resolve the issue of whether the proposed competitive product, Round-Trip Mailer, would, if approved, cover its attributable costs and make the minimum contribution to institutional costs required by 39 U.S.C. § 3633(a). The Postal Service presents costs, revenues, and volume data

information to demonstrate compliance with section 3633(a). Postal Service Revenue and Cost Data; Postal Service Reply Comments-Revised at 25-26, Attachment B-Declaration of Virginia J. Mayes-Revised; Attachment C-Declaration of A. Thomas Bozzo-Revised; Postal Service Library References designated as USPS-LR-MC2013-57/NP3 through NP5, August 26, 2013; Postal Service Response to Additional/Supplemental Comments at 33. GameFly challenges these data and urges the Commission to give them no weight. GameFly Comments at 31-32; Declaration of Sander Glick, August 19, 2013; GameFly Supplemental Comments-Refiled at 54-55; Supplemental Declaration of Sander Glick, September 12, 2013. Given the denial of the Postal Service's Request, the issue of whether the proposed Round-Trip Mailer would satisfy the requirements of section 3633(a) is rendered moot.

Finally, the denial of the Postal Service's Request makes it unnecessary to address Netflix's argument that the equalized rate requirement imposed by the Commission's Order on Remand would be frustrated by classifying the Round-Trip Mailer as a competitive product. See Netflix Additional Comments at 12-16; GameFly Reply Supplemental Comments at 2-6.

## X. CONCLUSION

For the reasons set forth above, the Commission concludes that the Postal Service has failed to verify that it lacks market power over the proposed Round-Trip Mailer as required by 39 U.S.C. § 3642(b)(1) and 39 C.F.R. § 3020.32(d).

*It is ordered:*

The Postal Service's Request to create a Round-Trip Mailer product on the competitive product list is denied.

By the Commission.

Shoshana M. Grove  
Secretary

## APPENDIX A

### SUBMISSIONS ADDRESSING THE COMPETITIVE PRODUCT PROPOSAL

#### I. The Competitive Product Request

1. Request of the United States Postal Service Under Section 3642 to Create Round-Trip Mailer Product, July 26, 2013 (Request).
2. Notice of Board of Governors Determination, August 2, 2013.
3. Response to Order No. 1794 and Notice of Filing of Nonpublic Library Reference USPS-MC2013-57/NP1, August 5, 2013 (Postal Service Revenue and Cost Data).

#### II. Initial and Reply Comments

1. Comments of GameFly, Inc. on USPS Proposal to Reclassify DVD Mailers as Competitive Products, August 15, 2013 (GameFly Comments).
2. Declaration of Sander Glick, August 15, 2013 (Non-public); refiled August 19, 2013 (Public).
3. Comments of Netflix, Inc., August 15, 2013 (Netflix Comments).
4. Reply Comments of the Public Representative in Response to Commission Order No. 1794, August 22, 2013 (PR Reply Comments).
5. Comments of MMAVault in Response to Commission Order No. 1794, August 22, 2013 (MMAVault Comments).
6. Reply Comments of CafeDVD in Response to Commission Order No. 1794, August 22, 2013 (CafeDVD Reply Comments).
7. Reply Comments of Netflix, Inc., August 22, 2013 (Netflix Reply Comments).
8. United States Postal Service Reply to Comments, August 22, 2013 (revised September 5, 2013) (Postal Service Reply Comments-Revised), including Attachment A-Declaration of Mark Schoeman; Attachment B-Declaration of Virginia J. Mayes-Revised; Attachment C-Declaration of A. Thomas Bozzo-Revised; Attachment D-Declaration of Steven W. Monteith-Revised).

9. Notice of Filing of Nonpublic Library References, August 26, 2013.
  - a. USPS-LR-MC2013-57/NP3 (Netflix and GameFly FCM Volumes);
  - b. USPS-LR-MC2013-57/NP4 (Permit Reply Mail Cost Study);
  - c. USPS-LR-MC2013-57/NP5 (Permit Reply Mail Volumes); and
  - d. USPS-LR-MC2013-57/NP6 (IBISWorld *Industry Report*).
10. Response of GameFly, Inc., to Reply Comments of Netflix, Inc., August 29, 2013 (GameFly Response to Reply Comments).

III. Additional and Supplemental Comments Authorized by Order No. 1827

1. Additional Comments of Netflix, Inc. Submitted Pursuant to Order No. 1827, September 11, 2013 (Netflix Additional Comments).
2. Comments of the Public Representative in Response to Order No. 1827, September 11, 2013 (PR Additional Comments).
3. Supplemental Comments of GameFly, Inc. on USPS Proposal to Reclassify DVD Mailers as Competitive Products, September 12, 2013 (refiled December 26, 2013) (Public and Non-public) (GameFly Supplemental Comments-Refiled).
4. Supplemental Declaration of David Hodess, September 12, 2013 (refiled December 26, 2013) (Public and Non-public) (Supplemental Declaration of David Hodess-Refiled).
5. Federal Express Corporation Comment on the Scope of the Postal Monopoly, September 17, 2013 (FedEx Comments).
6. Reply Supplemental Comments of GameFly, Inc. on USPS Proposal to Reclassify DVD Mailers as Competitive Products, September 18, 2013 (GameFly Reply Supplemental Comments).
7. United States Postal Service Response to Comments, September 23, 2013 (Public and Non-public); United States Postal Service Notice of Errata to Response to Comments, September 26, 2013 (Postal Service Response to Additional/Supplemental Comments).
8. United States Postal Service Response to Federal Express Corporation Comments, September 23, 2013 (Postal Service Response to FedEx Comments).



9. United States Postal Service Update to Response to Comments, January 22, 2014 (Postal Service Update).
10. GameFly, Inc., Response to United States Postal Service Update to Response to Comments, January 29, 2014 (GameFly Response to Update).

IV. Chairman's Information Requests, Responses, and Comments on Responses

1. Response of Netflix Inc. to Chairman's Information Request No. 3, January 16, 2014 (Public and Non-public).
2. Response of the United States Postal Service to Chairman's Information Request No. 1, January 17, 2014 (Postal Service Response to CHIR No. 1).
3. Notice of Filing of Nonpublic Library Reference USPS-LR-MC2013-57/NP7 (Updated Netflix/GameFly FCM Volumes), January 17, 2014.
  - a. USPS-LR-MC2013-57/NP7 (Netflix and GameFly FCM Volumes).
4. Answers of GameFly, Inc., to Chairman's Information Request No. 2, January 17, 2014 (Public and Non-public).
5. Answer of GameFly, Inc., to Chairman's Information Request No. 1, Question 5(c), January 17, 2014.
6. United States Postal Service Comments Addressing Responses to Chairman's Information Request Nos. 1, 2, and 3 (Postal Service CHIR Comments), March 21, 2014 (Public and Non-public).
7. Comments of Netflix, Inc. Submitted Pursuant to Order No. 2011, March 21, 2014 (Netflix CHIR Comments).
8. Comments of the Public Representative in Response to Order No. 2011, March 21, 2014 (PR CHIR Comments).
9. Comments of GameFly, Inc., on Responses of USPS and Netflix to Chairman's Information Requests, March 21, 2014; refiled March 24, 2014 (GameFly CHIR Comments-Refiled).
10. United States Postal Service Reply Comments Submitted Pursuant to Order No. 2011, April 4, 2014 (Public and Non-public) (Postal Service CHIR Reply Comments).

11. Reply Comments of GameFly, Inc., on Responses of USPS and Netflix to Chairman's Information Requests, April 4, 2014 (GameFly CHIR Reply Comments).
12. Reply Comments of Netflix, Inc. Submitted Pursuant to Order No. 2011, April 4, 2014 (Netflix CHIR Reply Comments).
13. Response of GameFly, Inc., to April 4, 2014, USPS Reply Comments, April 11, 2014 (GameFly Response to Postal Service CHIR Reply Comments).