

ORAL ARGUMENT HAS NOT BEEN SCHEDULED

**IN THE  
UNITED STATES COURT OF APPEALS  
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

|                                |   |             |
|--------------------------------|---|-------------|
| GAMEFLY, INC.,                 | ) |             |
|                                | ) |             |
| <i>Petitioner,</i>             | ) |             |
|                                | ) |             |
| v.                             | ) |             |
|                                | ) |             |
| POSTAL REGULATORY COMMISSION   | ) |             |
| and UNITED STATES OF AMERICA,  | ) | No. 11-1179 |
|                                | ) |             |
| <i>Respondents,</i>            | ) |             |
|                                | ) |             |
| UNITED STATES POSTAL SERVICE,  | ) |             |
|                                | ) |             |
| <i>Intervening Respondent.</i> | ) |             |

**OPENING BRIEF OF PETITIONER  
GAMEFLY, INC.**

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January 18, 2012

**CERTIFICATE AS TO PARTIES  
RULINGS AND RELATED CASES**

**A. Parties, Intervenors and Amici**

The parties in the proceeding below before the Postal Regulatory Commission (“PRC” or “Commission”) were GameFly, Inc. (the complainant) and the United States Postal Service (“Postal Service” or “USPS”) (the defendant).

Five other persons intervened below as “limited participators” under 39 C.F.R. § 3001.20a, which allows “limited participation” in a case by “persons not parties”: Valpak Direct Marketing Systems, Inc., Valpak Dealers’ Association, Inc., Time Warner Inc., Douglas F. Carlson, and David B. Popkin. None of the limited participators participated further in the case.

Several other persons—Blockbuster, Inc., John A. Branda, Butler Mailing Services, Inc., MMA Vault, Inc., and Netflix, Inc.—filed informal comments under 39 C.F.R. § 3001.20b, which authorizes the filing of “information expression[s] of views by persons not parties or limited participators (commenters).” None of these persons intervened as parties.

The parties before this Court are GameFly, Inc. (the petitioner), the PRC and the United States of America (respondents), and the USPS (intervening respondent). There are no amici.

**B. Ruling Under Review**

The ruling under review is PRC Order No. 718 issued on April 20, 2011, in PRC Docket No. C2009-1, *Complaint of GameFly, Inc.* (“Order”).

**C. Related Cases**

This case has not previously been before this Court or any other court. Petitioner’s counsel are unaware of any related cases pending in this Court or any other court.

## **RULE 26.1 DISCLOSURE STATEMENT**

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure and Circuit Rule 26.1 of this Court, GameFly, Inc. (“GameFly”) hereby submits this Corporate Disclosure Statement.

GameFly is a privately held corporation with its headquarters and primary place of business in Los Angeles, California. GameFly is an online membership-based video game rental company that uses the United States USPS to ship video games to and from its customers. GameFly has no parent company. No publicly-held company has a 10 percent or greater ownership interest in GameFly.

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\* Authorities on which we chiefly rely are marked with an asterisk

## GLOSSARY OF TERMS

- A. Record appendix filed by GameFly with this brief
- BRM Business Reply Mail
- DVD Acronym for “Digital Versatile Disc” or “Digital Video Disc,” an optical disc storage media format on which videos, games or other content can be recorded.
- Flat A mailpiece contained in an envelope with a maximum size of 15" in length, 12" in height, and 0.75" in thickness. A flat must exceed at least one of these minimum dimensions: 11.5" in length, 6.125" in height, and 0.25" in thickness. USPS Quick Service Guide 301 (<http://pe.usps.com/text/qsg300/Q301.htm#1009536>).
- Letter A mailpiece contained in an envelope with a maximum size of 6" in length, 4.25" in height, and 0.016" in thickness. USPS Quick Service Guide 201 (<http://pe.usps.com/text/qsg300/Q201.htm#1009536>).
- OIG USPS Office of Inspector General
- Order PRC Order No. 718 issued on April 20, 2011, in PRC Docket No. C2009-1, *Complaint of GameFly, Inc.*
- PRC Postal Regulatory Commission (before 2007, Postal Rate Commission)
- USPS United States Postal Service

## **JURISDICTIONAL STATEMENT**

This petition challenges a final order of the Postal Regulatory Commission (“PRC”) on the ground that the PRC, despite finding that the USPS was discriminating unlawfully against GameFly under 39 U.S.C. § 403(c), failed to award legally adequate relief under 39 U.S.C. § 3662(c). This Court has jurisdiction under 39 U.S.C. § 3663. The order became final on April 20, 2011. GameFly petitioned for review on May 20, 2011, within the 30-period set by 39 U.S.C. § 3663.

## **STANDING**

GameFly has standing under 39 U.S.C. § 3663 because the company is “adversely affected or aggrieved” by the PRC’s order. The PRC, despite finding that GameFly was victim of unlawful discrimination under 39 U.S.C. § 403(c), refused to award relief adequate to “achieve compliance with” section 403(c) and “remedy the effects of any noncompliance” as 39 U.S.C. § 3662(c) requires. The PRC’s failure to provide more complete relief injures GameFly because it still must pay more in postage per piece than Netflix, the DVD rental company that has been the main beneficiary of the Postal Service’s discrimination, to obtain comparable protection from DVD breakage by the USPS. This Court can redress this injury by granting the petition for review.

## **STATUTORY AND REGULATORY PROVISIONS**

The pertinent statutes and regulations appear in the addendum in the back of this brief.

## **STATEMENT OF ISSUE PRESENTED FOR REVIEW**

Whether the Commission's refusal to require the Postal Service to remedy its discrimination against GameFly by either—

- (1) providing manual processing on nondiscriminatory terms to GameFly's DVD return mailers when mailed as letters, or
- (2) eliminating (or substantially reducing) the 44 cents per piece in extra postage charged by the USPS for each DVD mailer mailed as flats

was arbitrary, capricious, an abuse of discretion, without observance of procedure required by law, unsupported by substantial record evidence, or contrary to 39 U.S.C. §§ 403(c) and 3662(c). (Yes.)

## **STATEMENT OF THE CASE**

### **A. GameFly's Business**

GameFly is a privately held company that rents and sells video games to consumers. Most of the games are recorded on DVDs. Order ¶¶ 1001, 2001

(A. 269, 271). Like other DVD rental companies, GameFly distributes its products by mail. GameFly ships DVDs to its rental subscribers and purchasers by First-Class Mail; subscribers return the DVDs to GameFly via First-Class Mail Business Reply Mail. Order ¶ 1002 (A. 269); Joint Statement of Undisputed and Disputed Facts (July 20, 2009) (“Joint Statement”) ¶¶ 18-19 (A. 6). GameFly pays the postage both ways: the outbound postage at the time of mailing, and the return postage and Business Reply Mail fees through a Business Reply Mail account with the USPS. Joint Statement ¶¶ 15-19 (A. 6).

The same mailer (envelope) is used both ways. The outer face of the mailer is addressed to the subscriber. For the return trip, the subscriber tears off the outer face to reveal an inner face with a GameFly address. Joint Statement ¶ 20 (A. 6).

GameFly has an annual DVD mail volume of about 14 million pieces. About 57 percent of these are outbound mailings; the remainder are return mailings. Joint Statement ¶¶ 21-22 (A. 6); Letter from David Hodess to the PRC (March 23, 2011) (A. 264).<sup>1</sup>

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<sup>1</sup> Outbound volume exceeds return volume mainly because customers often decide to buy rented games after playing them.

Several other DVD rental companies also distribute their merchandise by mail. Netflix and Blockbuster are bigger than GameFly; other DVD rental companies are smaller. Order ¶¶ 2002, 3001, 4019 (A. 271, 284). Blockbuster offers video games as well as movies, and thus is a direct competitor of GameFly. Joint Statement ¶¶ 14, 93 (A. 6, 18). Netflix currently limits its rental product line to DVD movies and TV shows. See [www.netflix.com](http://www.netflix.com) (site visited January 12, 2012). Recently, however, the company revealed that it is considering offering video game rentals as well. Netflix Quarterly Letter to Shareholders for the third quarter of 2011 (October 24, 2011) at 3 (available at <http://ir.netflix.com/results.cfm>).

**B. DVD Breakage In The Mails: An Industry-Wide Problem With A Highly Selective USPS Response**

The DVD rental industry has a common problem: the Postal Service's machines for processing letter-shaped mail tend to break DVDs. Order ¶¶ 1004, 2003 (A. 270-71). A movie or game DVD is small and light enough that it can qualify as a one-ounce letter if enclosed in a lightweight mailer. Joint Statement ¶ 25 (A. 8). However, the repeated bending forces and impacts on mailpieces as they are forced at high speed around the rollers and through the gates and chutes of letter processing machines produce high rates

of disc breakage. Order ¶¶ 1004, 2003, 4084, 4102 (A. 270-71, 318, 324).<sup>2</sup> This problem primarily affects return mail, which typically receives more sorting than outbound mail, and thus is exposed more to damage from automated letter processing equipment. *See* Order ¶¶ 1004, 3001, 3004, 4077, 4136, 4148-50, 4153-55, 4161-62, 4201 (A. 270, 284-85, 315-16, 334-35, 339-41, 343, 357) (noting that the problem primarily involves the return trip).

This breakage is costly to DVD rental companies, and they have tried for years to reduce it.<sup>3</sup> In addition, DVD mailers tend to jam the Postal Service's automated letter sorting equipment. Order ¶¶ 1004, 3004, 4136, 4161-4163

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<sup>2</sup> *See also* Joint Statement ¶ 27 (“DVDs enclosed in lightweight mailers, when processed on USPS processing equipment, can experience breakage.”) (A. 8); Rebuttal Testimony of Sander Glick for GameFly, Inc. (GFL-RT-1) at 9-13 (citing USPS documents) (A. 126-30); Public (Redacted) Versions of Documents Covered by Presiding Officer's Ruling C2009-1/17, Part 1 of 2 (“Compendium 1”) (GFL216) (A. 52) (reporting disc breakage rates from tests); Tr. 4/312 (GFL 525) (A. 113); Tr. 4/437 (GFL7229) (A. 114) (ATR report); Tr. 4/452 (GFL7244) (A. 115) (ATR report).

<sup>3</sup> *See, e.g.*, Compendium 1 (GFL768) (A. 78); Public (Redacted) Versions of Documents Covered by Presiding Officer's Ruling C2009-1/17, Part 2 of 2 (“Compendium 2”) (GFL1484-1485) (A. 101-02); USPS Response to GFL/USPS-82(c) (A. 257 (responding affirmatively when asked if any DVD mailers had “requested that their inbound mailers be handled manually to reduce breakage rates”)); Compendium 1 (GFL 10) (A. 41) (noting that “damaged (broken) disks during processing and/or delivery” were “common problems” reported by Netflix); Joint Statement ¶ 102 (A. 19) (noting that Blockbuster formally asked the USPS to “immediately implement manual culling and processing of inbound mail pieces for Blockbuster Online” to mitigate the “persistent damage to mailer contents”).



(A.270, 285, 334-35, 343-44). USPS officials have acknowledged that DVD breakage and jamming are serious industry-wide problems.<sup>4</sup>

The USPS, however, has not dealt with the problems in a uniform or evenhanded way. DVDs mailed back to Netflix (and, to a lesser extent, Blockbuster) receive special handling from the USPS—including diversion from the automation letter stream, hand-culling, hand processing, and the use of special trays and containers—to keep the DVDs out of the most destructive segments of the automated letter mail processing path. Order ¶¶ 1003, 3004, 4102, 4122, 4127, 4136, 4148, 4149 n. 45, 4153-55, 4160, 4161-66, 4170, 4174-76, 4192, 4201-02, 4220, 5024 (A. 269-70, 285, 324, 330-32, 334-35, 339-48,

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<sup>4</sup> See Compendium 1 (GFL773) (A. 84) (Round-Trip Disc Mail (RDM) Work Group Minutes: 26 September 2005) (“Disc damage is now becoming the number one issue with RDM mailers as more mail is processed on equipment.”); Compendium 2 (GFL1335) (A. 87) (slide from USPS PowerPoint Presentation titled “LSS Project Re-Measure: Return DVD Handling & Damage Reduction” and dated February 24, 2009) (“Automated USPS handling procedures cause a perceived amount of damage to mailers’ DVD products causing a large return volume to be processed manually at the mailers’ request.”); Compendium 1 (GFL126) (A. 43) (document titled “Netflix and the Round-Trip Disk Mail (RDM) Project”) (“these tests suggest that if RDM disks are processed completely within letter automation in both directions, they would suffer losses due to cracking in excess of 5 percent per round trip.”); Compendium 1 (GFL 216) (A. 52) (reporting a breakage rate of 4.5 percent per trip for a test sample of DVDs); Compendium 2 (GFL7149) (A. 103) (quoted in USPS response to GFL/USPS-119) (explaining that the cause of DVD breakage appears to be repeated bending of DVDs during their travel through DBCS and AFCS letter processing equipment).

354, 357-58, 365, 382). This special handling increases the Postal Service's costs. Order ¶¶ 4192-4203 (A. 354-58). The USPS does not charge Netflix or Blockbuster extra for the special treatment, however. Order ¶¶ 1004, 4127, 4137, 4209-43, 5024 (A. 270, 331, 335-36, 360-74, 382).

By contrast, the USPS has refused to provide the same degree of manual processing to DVD mailers entered by smaller companies like GameFly. Order ¶¶ 1004, 4078-82, 4084-87, 4128, 4132-39, 4213, 5024 (A. 270, 316-19, 332-36, 362-63, 382).<sup>5</sup>

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<sup>5</sup> As the PRC found, these actions have been part of a wider pattern of discrimination. *First*, the USPS has refused to impose a rate surcharge on Netflix DVD mailers for nonmachinability (i.e., inability to be processed in automated sorting equipment) despite the initial determination of the USPS's engineering department that the mailer design was nonmachinable, the numerous complaints within the USPS from headquarters and field operating personnel that the mailpiece was nonmachinable, and the 2007 audit report of the USPS's Office of Inspector General urging that the mailpiece be charged a nonmachinable surcharge. At the same time, however, the USPS repeatedly classified "Netflix clone mailpieces" as nonmachinable. Order ¶¶ 1003, 4209-29 (A. 269-70, 360-69). *Second*, the USPS dropped internal proposals to adopt uniform national standards and classifications for DVD mailers when Netflix objected to the proposals, despite repeated warnings by USPS employees that the existing arrangements could lead to discrimination claims. *Id.* at ¶¶ 4230-4243 (A. 369-74). *Third*, a number of post offices maintained lobby mail deposit slots reserved solely for Netflix return mail. *Id.* at ¶ 4133 & n. 44 (A. 333-34).

The unavailability of the manual processing option has prevented GameFly from using First-Class machinable letter rates for its DVDs, and has forced the company to resort to costly workarounds to keep the DVDs out of the Postal Service's automated letter processing machines. Order ¶¶ 4077, 4079, 4081, 4084-87, 4128, 4137, 5024 (A. 315-19, 332, 335-36, 382).

First, GameFly mails its inbound and outbound DVD mailers as First-Class "flats"—a more expensive rate category intended for larger envelopes. Order ¶ 2008, 4077, 4084, 4128, 4137-38 (A. 272, 315-16, 318, 332, 335-36). This reduces DVD breakage because the machines used by the USPS to process flats bend and stress mailpieces less than do the machines used to process letters. Order ¶ 4079, 4085, 4102 (A. 316, 318-19, 324) ("GameFly's protection [from DVD breakage] comes in the form of automated flats processing.").

Second, GameFly places cardboard protective inserts in its DVD mailers. The inserts help cushion the DVDs against shock, and reduces the frequency with which postal employees try to process them as letters despite the extra postage. Order ¶ 5023-24 (A. 381-82).

These workarounds are reasonably effective, but their cost has been steep. The USPS charges \$0.44 for a DVD mailer entered as a one-ounce First-Class letter, but \$0.88 for the same piece entered as a one-ounce First-Class flat.<sup>6</sup> Moreover, the protective cardboard insert adds enough weight that the total weight of the mailpiece exceeds one ounce, requiring the payment of a second-ounce charge of \$0.17 per piece until last April. *See* Order ¶¶ 5023-24 (A.381-82); Joint Statement ¶¶ 48, 60-62 (setting forth applicable mailing rates) (A. 11, 13).<sup>7</sup> The result was that GameFly had to pay extra postage to avoid USPS automated letter processing (when the complaint was filed in 2009, the extra charge was \$0.61 one way, or \$1.22 per round trip), while Netflix avoided automated letter processing thanks to the Postal Service's offer of special manual processing at no extra charge. *See* pp. 6-7, *supra*. Multiplied by an annual DVD mail volume of about 14 million pieces (*see* p. 3, *supra*), the added cost of postage to GameFly was about \$8.4 million annually—more than the company's net income. Joint Statement ¶¶ 21-22 (A. 6); Letter from David Hodess to the PRC (March 23, 2011) (A. 264).

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<sup>6</sup> These figures do not reflect discounts offered by the USPS entering mail already presorted.

<sup>7</sup> The second-ounce charge has since increased to \$0.20. *See* DMM Notice 123 (“Price List”) (Effective June 6, 2011) *available at* <http://pe.usps.gov/text/dmm300/Notice123.htm>.

The preferential treatment given to Netflix vis-à-vis other DVD rental companies did not go unchallenged within the USPS. Internal USPS communications obtained in discovery revealed that the Postal Service's professional staff had been expressing concern for years about the cost, operational problems, unfairness and potential legal exposure created by the preferential treatment given to Netflix, and had tried repeatedly to resolve these issues. Order ¶¶ 4201, 4218, 4222, 4230, 4243 (A. 357, 364-65, 369, 374); GameFly PRC Br. at 46-50 (citing internal USPS documents) (A. 206-10). Further, a 2007 investigative report by the Postal Service's Office of Inspector General recommended that the USPS charge extra for the special manual processing given to Netflix. Order ¶¶ 4201, 4210, 4213-14, 4216-20, 4226, 4228-29, 4238-39 (A. 357, 360-65, 367-69, 372-73) (citing report); Compendium 1 (GFL 685-704) (USPS Office of Inspector General, Audit Report No. MS-AR-08-001, *Review of USPS First-Class Permit Reply Mail* (November 8, 2007) ("OIG Report")) (A. 55-74). Netflix, however, privately told USPS headquarters officials that the company would accept neither automated letter processing of its return mail *nor* a rate surcharge for manual processing. Order ¶¶ 4231, 4236, 4243 (A. 369-72, 374); Compendium 1 (GFL189) (A. 45) (statement by USPS employee) ("Netflix isn't [interested in NSA] because they don't want it on auto."); *Id.* (GFL523); *Id.* (GFL468)

(“Breakage can be reduced by culling – But mailer does not want to pay surcharge for manual handling”).<sup>8</sup> “In the face of this opposition,” USPS headquarters overruled the proposals of its professional staff: “the efforts to address these issues were ultimately abandoned.” Order ¶ 4243 (A. 374); *accord*, Order ¶¶ 4147-4150, 4155, 4210, 4226, 4231, 4236, 4239 (A. 338-41, 360-61, 367, 369-73).

### **C. GameFly’s Unsuccessful Efforts To Obtain Relief From The USPS**

Between 2007 and the spring of 2009, GameFly met repeatedly with employees of the USPS in its operations, engineering and mailing standards groups in an effort to find a joint solution to GameFly’s DVD breakage problem. Order ¶¶ 2006, 2022 (A. 272, 277). GameFly also conducted tests, both individually and collaboratively with USPS engineers, on a variety of alternative mailer designs. These efforts were unsuccessful. Joint Statement ¶¶ 116-119 (A. 22).

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<sup>8</sup> This is not quite accurate. In September 2005, counsel for Netflix advised the USPS that Netflix “might consider” paying “perhaps” one penny a piece extra if the USPS agreed to allow Netflix to “simply continue to receive the special handling in our opening operations for return mail.” Compendium 1 (GFL769) (A. 79).

In early 2009, GameFly sought to open discussions with the USPS law department in an attempt to obtain treatment comparable to Netflix without litigation. Order ¶ 4078 (A. 316); Joint Statement ¶¶ 126-130 (A. 24-25). These efforts were also unsuccessful. Order at ¶¶ 2007, 2009-10, 4078 (A. 272-73, 316). GameFly filed a discrimination complaint with the Commission on April 23, 2009. *Id.* at ¶ 2011 (A. 273).

## **D. The Governing Law**

### **1. The anti-discrimination provisions**

Title 39 forbids undue discrimination among postal ratepayers. 39 U.S.C. § 403(c) states that the USPS, in “providing services and in establishing classifications, rates, and fees . . . shall not, except as specifically authorized in this title, make any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preferences to any such user.” 39 U.S.C. § 3622(c)(10) likewise requires that the terms of niche classifications and rate and service contracts be “available on public and reasonable terms for similarly situated mailers.” These provisions codify the “axiom of regulatory law in the public utility/common carrier area” that a regulated entity must “offer the same rate-and-service package to all similarly situated applicants.” *Experimental Rate and Service Changes to Implement*

*Negotiated Service Agreement With Capital One*, PRC Op. & Rec. Decis. MC2002-2 (May 15, 2003) ¶¶ 7013 (citing precedent under Interstate Commerce Act and cognate regulatory statutes).<sup>9</sup>

A claim of undue discrimination by the USPS has three basic elements. First, is the complainant “similarly situated” to another customer of the USPS? Second, is the USPS discriminating against the complainant by offering the latter customer better prices or terms of service? Third, if the first two elements are present, the USPS has the burden of showing that the discrimination has a rational and legitimate basis; otherwise, the discrimination is “undue” and “unreasonable.” Order ¶¶ 4014-4021, 4070-71, 4132-39, 4140 (A. 294-96, 312-13, 333-37); *accord*, *Capital One*, *supra*, at ¶¶ 7005, 7011, 7014; *National Easter Seal Society v. USPS*, 656 F.2d 754, 760-62 (D.C. Cir. 1981); *MCI Telecoms. Corp. v. FCC*, 917 F.2d 30, 39 (D.C. Cir. 1990).

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<sup>9</sup> *Cf. American Trucking Associations v. Atchison, T. & S.F. Ry. Co.*, 387 U.S. 367, 406 (1967); *Transcontinental Bus System, Inc. v. Civil Aeronautics Board*, 383 F.2d. 466, 475 (5th Cir. 1967); David Boies and Paul R. Verkuil, *Public Control of Business* 15-24, 254-56 (1977); Solon J. Buck, *The Granger Movement* 11-14, 34 (1913).



## 2. The complaint remedy

The main vehicle for challenging an existing rate or practice under 39 U.S.C. § 403(c) is a complaint under 39 U.S.C. § 3662(a). The Commission, upon finding that the complaint raises “material issues of fact or law,” must adjudicate the case. *Id.* at § 3662(b). If the Commission ultimately finds that the complaint is justified, the Commission “shall order the Postal Service to take such action as the Commission considers appropriate to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance.” *Id.* at § 3662(c). The Commission has interpreted this statutory directive as binding, not permissive:

While the Commission is broadly empowered to fashion a remedy . . . the remedy it selects *must be responsive to “the effects of any noncompliance.”* . . . The remedy chosen by the Commission *must, therefore, address [the particular] undue discrimination* and be supported by, and consistent with, the record.

Order ¶ 5011 (emphasis added) (A. 378).

The rigor of this obligation is underscored by comparing the current language of 39 U.S.C. § 3662 with its predecessor. Until 2007, Section 3662 lacked an effective remedial provision. The Commission, when finding in a complaint case that the USPS had established unlawful rates or practices, could only recommend, not compel, corrective action:

If the Commission, in a matter covered by subchapter II of this chapter, determines the complaint to be justified, it shall, after proceedings in conformity with section 3624 of this title, issue a recommended decision which shall be acted upon in accordance with the provisions of section 3625 of this title and subject to review in accordance with the provisions of section 3628 of this title.

39 U.S.C. § 3662 (2000) (referencing 39 U.S.C. § 3625 (2000)). The USPS, if it disagreed with the recommendation, could simply reject it. 39 U.S.C. § 3625(a) (2000). Congress enacted the present language of § 3662(c) to cure this deficiency. Postal Accountability and Enhancement Act § 204, Pub. L. No. 109-435, 120 Stat. 3198, 3216 (2006) (codified at 39 U.S.C. § 3662); H.R. Rep. No. 66, 109<sup>th</sup> Cong., 1st Sess. (Apr. 28, 2005) at 52 (quoted and discussed in Order ¶¶ 5008-5009 (A. 377-78)).

#### **E. The Commission's Decision**

GameFly's complaint generated two years of litigation at the PRC, including extensive discovery, prefiled testimony, cross-examination and post-hearing briefs. Order ¶¶ 2023-40 (A. 277-283). The USPS, in its testimony and pleadings, offered a volley of arguments against the complaint. GameFly responded to each of the USPS's defenses, in large part through the use of internal studies and communications obtained from the USPS in discovery.

## 1. The Commission's findings

The PRC issued its final decision on April 20, 2011. Order (A. 265-393). In its decision, the Commission found that GameFly and Netflix were similarly situated; that the USPS was discriminating between Netflix and GameFly; and that the USPS had failed to establish any rational basis for the discrimination. Order ¶¶ 1003, 5001-05 (A. 269-70, 376). In reaching these conclusions, the Commission found for GameFly, and against the USPS, on nearly every significant factual issue in dispute.

***Similarly Situated:*** The PRC found that GameFly was “similarly situated” to Netflix and Blockbuster. Order ¶¶ 4126, 5002 (A. 331, 376). The Commission specifically considered and rejected the Postal Service’s claims that differences in the business models (Order ¶¶ 4089, 4092 (A. 320-21)), DVD designs (*id.* at ¶¶ 4096, 4102) (A. 322, 324)), mailpiece designs (*id.* at ¶¶ 4104, 4107 (A. 325-26)), volumes (*id.* at ¶¶ 4108, 4125 (A. 326, 331)), mail density (*id.*), number of mail entry and collection points (*id.*), and average transportation distance were material enough to destroy the fundamental similarity of the three DVD rental companies and their mail. *Id.* Moreover, the Commission held that GameFly’s use of the flats rate category did not negate the company’s fundamental similarity with Netflix and Blockbuster. *Id.*

at ¶ 4084 (A. 318). GameFly used the flats category, the Commission found, only because the USPS refused to provide Netflix-comparable levels of manual processing to GameFly mailers entered as letters. Order ¶¶ 4084, 4137-4138 (A. 318, 335-36).

***Discrimination:*** The Commission found that the USPS “has given GameFly less favorable rates and terms and conditions of service than other similarly situated mailers”—specifically Netflix and, to a lesser extent, Blockbuster. Order ¶¶ 1003, 4132-39, 5003, 5024 (A. 269-70, 333-36, 376, 382). The Commission also considered and rejected the Postal Service’s claims that (1) the special processing received by Netflix resulted from the independent decisions of local operating officials, and therefore could not be attributed to the USPS under section 403(c); and (2) the special handling given to Netflix DVD mailers was a permissible exercise of “operational flexibility”:

[T]he decision to allow extensive hand processing of Netflix and Blockbuster return DVD mail without a non-machinable surcharge when it was surcharging other non-machinable First-Class Mail letters makes the difference in treatment between Netflix and Blockbuster, on the one hand, and GameFly on the other, a difference in rates and terms and conditions of service for which the Postal Service is clearly responsible.

Order ¶ 4136 (A. 334-35). The Commission cited a variety of record evidence, including internal documents obtained from the USPS in discovery, indicating

that “the forms and extent of special processing were known to Headquarters personnel and were both tacitly and expressly condoned.” *Id.* at ¶ 4134 (A. 334) (citing, *inter alia*, Joint Statement ¶¶ 79, 87 and 90) (A. 16-17).

The PRC found further evidence of undue discrimination in the Postal Service’s refusal to (1) impose a surcharge on Netflix DVD mailers for nonmachinability (i.e., inability to be processed in automated sorting equipment), *id.* ¶¶ 4209-29 (A. 360-69), or (2) establish a uniform set of rates and classifications for all DVD mailers, *id.* at ¶¶ 4230-4243 (A. 369-74).

***No Rational Basis For Discrimination:*** The PRC held that the USPS had failed to demonstrate any rational basis for the discrimination. *Id.* ¶¶ 4140-4246, 5002 (A. 337-76). The PRC considered and rejected each of the supposed justifications advanced by the USPS. In particular, the PRC found that: (1) the special manual handling given to Netflix and Blockbuster DVD mailers had the approval of USPS headquarters, and could not be defended as the result of local operating decisions (*id.* at ¶¶ 4141-4155 (A. 337-41)); (2) the special manual handling given to Netflix and Blockbuster DVD mailers, rather than maximizing mail processing efficiency and minimizing the Postal Service’s costs, had the opposite effect (*id.* at ¶¶ 4156-4166, 4177-4204 (A. 341-45, 348-58)); (3) giving the same level of manual handling to additional DVD

rental companies such as GameFly would not be impractical (*id.* at ¶¶ 4167-4171 (A. 345-46)); (4) the discrimination was unjustified by differences between GameFly and Netflix in mail volume, customer address density, average distance that the USPS must carry each company's mailers between company and customer, or number of points where the company picked up its return mail from the USPS (*id.* at ¶¶ 4172-4176 (A. 347-48)); and (5) the discrimination was unnecessary to meet standards for speed of delivery. *Id.* at ¶¶ 4177-4208 (A. 348-60); *see also* USPS response to GFL/USPS-71(b) (A. 255); USPS Response to GFL/USPS-162(a) (A. 259) (admitting that claimed efficiencies of manual processing were not based on any studies or data); USPS Responses to GFL/USPS 73(b) and (d) (A. 263).<sup>10</sup>

## 2. The Commission's remedy

The Commission's remaining task was to prescribe a remedy for the discrimination. Here, the Commission seemed to lose its nerve.

GameFly asked the Commission to prescribe two remedies. The first was a Commission order requiring the USPS to offer GameFly and other DVD

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<sup>10</sup> The Commission also rejected the USPS's claims that GameFly (1) lacked standing to pursue a complaint under 39 U.S.C. § 403(c), and (2) was barred from relief by the Federal Tort Claims Act. Order ¶¶ 4005-4010 (A. 291-92).

rental companies manual culling and manual processing of DVD mailers entered at machinable letter rates to the same extent that Netflix receives. Order at ¶ 5012 (A. 378-79); GameFly PRC Br. at 87-88 (A. 247-48). The second alternative proposed by GameFly was the establishment of a reduced automation rate for flat-shaped DVD mailers; the rate could be set at a level slightly above the automation letter rate for DVD mailers to produce equal contributions per piece for the two shapes. Order at ¶ 5013 (A. 379); GameFly PRC Br. at 88 (A. 248).

As noted above, 39 U.S.C. § 3662(c) directs the Commission, upon finding that the USPS has established rates or terms of service that are unlawful, to “order the Postal Service to take such action as the Commission considers appropriate to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance,” *id.*, § 3662(c). The Commission’s remedial authority under this section is broad. Order ¶ 5009 (A. 377-78). For undue discrimination, the Commission in principle could require the USPS to: (1) offer the same degree of manual processing to GameFly mailpieces, if mailed at machinable letter rates, that Netflix receives; (2) discontinue offering manual processing for Netflix letters; (3) require the USPS to raise the rates for Netflix to the level paid by GameFly and other

disfavored DVD rental companies; (4) require the USPS to lower the rates for GameFly and other disfavored customers to the level paid by Netflix; or (5) equalize the rates at an intermediate point through a combination of (3) and (4). *Cf. ICC v. Campbell*, 289 U.S. 385, 392 (1933); *Investigation of Freight Rates for Transportation of Recyclable or Recycled Commodities*, 361 I.C.C. 641 (1979).

The PRC, however, shrank from imposing any of these remedies. It ruled that the USPS was free to continue giving Netflix—and any other customer that the USPS chose to favor—manual processing of DVD mailers entered at letter rates. Order ¶¶ 1005, 5026, 5028 and Appendix B at 1 (establishing Mail Classification Schedule 1110) (A. 270, 382-83, 392-93). Moreover, despite finding that “Netflix return mail is effectively non-machinable,” *id.* ¶ 5024 (A. 382), the Commission also authorized the USPS to continue its special handling of this mail without charging a non-machinable surcharge. *Id.*, ¶ 5025 (A. 382).

The PRC refused, however, to require the USPS to offer this preferential treatment on comparable terms to other DVD rental companies. *Id.* at ¶¶ 5012, 5014-16 (A. 378-80). This, the PRC asserted, would “requir[e] the Commission to involve itself in operational matters which have, to date, been almost extensively [sic] the prerogative of the Postal Service.” *Id.* at ¶ 5014



(A. 379). Moreover, the PRC stated, enforcing the nondiscriminatory availability of manual processing would require “a significant amount of data” and therefore “could cause the Postal Service to incur potentially significant administrative costs.” *Id.*

To make the second-best alternative of flats-rated mail more palatable for GameFly and other DVD rental companies whom the USPS denied the preferred Netflix arrangement, the Commission directed the USPS to waive the 17-cent second-ounce charge for DVD’s mailed as flats. Order ¶¶ 1005, 5025, 5027-5028, 5030 and Appendix B at 1-2 (establishing Mail Classification Schedule 1115, “Flat Round-Trip Mailer”) (A. 270, 382-83, 392-93). The Commission declined, however, to require the USPS to equalize the rates for the letter and flats rate categories by eliminating (or even reducing) the 44-cent letter-flat surcharge itself. Order ¶¶ 5017-5020, 5029-5030 (A. 380-81, 383).

The Commission gave two reasons for this. First, the costs of processing Netflix DVDs as letters and GameFly DVDs as flats may differ, and the GameFly’s estimates of those cost differences might be off. Order ¶¶ 4204, 5019, 5029 (A. 358, 380, 383). Second, setting prices is, “in the first instance, a responsibility of the Postal Service”; letters and flats traditionally have had different prices; and the “Commission prefers to allow the Postal Service

statutory flexibility in this area.” Order ¶ 5020 (A. 380-81). “A given mailer is not necessarily entitled to pay the same contribution as another mail when they enter mail with different characteristics.” *Id.*

The Commission did not explain, however, why these considerations were relevant in the context of providing relief from unlawful discrimination to a customer who—as the Commission had just found—was using flats only because of that discrimination—*i.e.*, the refusal of the USPS to provide manual processing of letter-rated DVD mailers for that customer on the same terms as for Netflix. *Cf.* Order ¶¶ 4084, 4137-4138 (A. 318, 335-36); *see also* Order ¶ 4137 (A. 335-36):

[T]he differences in mail service between Netflix and Blockbuster, on the one hand, and GameFly on the other, are not due to a knowing and voluntary decision by GameFly to mail as flats, rather than letters. The differences are due to differences in the service offered by the Postal Service.

*Accord*, Order ¶ 4138 (A. 336):

[D]ifferences in the service between Netflix and Blockbuster, on the one hand, and GameFly on the other, are not due to GameFly’s business choices, but to distinctly different treatment offered by the Postal Service only to certain favored mailers.

The effect of the Commission’s order is that (1) the USPS may continue providing custom manual processing to Netflix, at letter rates and without a

non-machinable surcharge, for mail that the Commission has found to be non-machinable; (2) the USPS is free to deny similar terms of service to GameFly or any other DVD rental company as the USPS pleases; and (3) GameFly and other disfavored ratepayers must still pay 44 cents extra each way, or 88 percent per round trip, to get the same bypass of automated letter processing that Netflix enjoys for free.

The Commission acknowledged that its Order could still require GameFly mail to “continue to generate more than double the contribution per piece than Netflix mail.” Order ¶ 5030 (A. 383). The Commission nevertheless pronounced itself satisfied with its handiwork: “By making the letter-shaped and flat-shaped round-trip DVD mailer rates available to all qualifying mailers, any potential discrimination against other similarly situated mailers is also remedied.” *Id.*

### **SUMMARY OF ARGUMENT**

The Commission, despite finding that the USPS found that the USPS was engaged in unlawful discrimination against GameFly under 39 U.S.C. § 403(c), failed to provide relief sufficient to “achieve compliance with the law” or “remedy the effects of any noncompliance” are required by 39 U.S.C.

§ 3662(c). The Commission's reasons for not providing more complete relief were arbitrary, capricious, and unsupported by the record.

The Commission's statement that the only relief provided—elimination of the 17-cent second-ounce surcharge for DVD mailers set as flats—gave GameFly relief “similar” to Netflix and remedied “any potential discrimination against other similarly situated mailers” (Order ¶¶ 5025, 5030 (A. 382-83)) is contradicted by the Commission's own findings earlier in the Order. The extra postage that the Postal Service's discrimination forced GameFly to pay to protect its DVD mailers from damage included not just the second-ounce charge but also the extra 44 cents per piece that GameFly must pay to mail its DVDs as flats, a costlier rate category necessitated by the Postal Service's refusal to provide Netflix-like levels of manual processing to GameFly DVD mailers entered as letters. Order ¶¶ 4084, 4137-4138, 5023 (A. 318, 335-36, 381-82). The PRC's refusal to eliminate (or even reduce) the letter-flat differential has left more than two-thirds of the original rate disparity in place.

This outcome might satisfy 39 U.S.C. §§ 403(c) and 3662(c) if the Commission had provided a reasoned basis for providing relief so incomplete. The Commission provided no such basis. The Commission's stated reasons

for denying both of the forms of relief proposed by GameFly—the “operational” remedy of requiring the USPS to offer GameFly Netflix-like levels of manual handling at First-Class letter rates, and the “pricing” remedy of eliminating all or most of the letter-flat rate differential for DVD mailers mailed as flats—are rife with anomalies and contradictions.

*The PRC’s Reasons for Not Providing An Operational Remedy.* The PRC gave two reasons for not prescribing the “operational remedy” of requiring the USPS to provide DVD mailers sent by GameFly and DVD rental companies at letter rates the same level of manual processing as Netflix: (1) this remedy would “requir[e] the Commission to involve itself in operational matters,” and (2) monitoring compliance could cause the Commission and the Postal Service “to incur potentially significant administrative costs.” Order ¶¶ 5014-5016 (A. 379-81). Neither claim is reasoned or well-founded.

When the USPS engages in undue discrimination among ratepayers in the operational terms of their service, the Commission is not only permitted but required to provide relief. 39 U.S.C. § 403(c) forbids undue discrimination in “providing services and . . . classifications,” not just “establishing rates.” Both the Commission and other regulators have held that that Section 403(c) and cognate antidiscrimination provisions of other statutes authorize the

regulator to override the operational decisions of the regulated firm when necessary to remedy undue discrimination in operating practices.

The PRC's speculation about the feasibility and administrative cost of enforcing an operational remedy are unsupported by the record, and contradicted by the PRC's own finding that the USPS could feasibly give Netflix-like levels of manual processing to GameFly (Order ¶¶ 4170-4171 (A. 346)), and by the Commission's existing reliance on performance data generated by scanning barcodes on mailpieces. GameFly would have elaborated on these facts if the PRC had given GameFly notice and an opportunity to be heard on the issue before the PRC found *sua sponte* that enforcement was impractical.

***The PRC's Reasons for Not Providing A Pricing Remedy.*** The Commission offered two justifications for not eliminating or even reducing the 44-cent letter-flat rate differential: (1) the difference between the Postal Service's costs of handling GameFly vs. Netflix DVD mailers is not known precisely, and (2) general ratemaking principles entitle the USPS to maintain price differentials between differing kinds of mail, at least in the "first instance." Order at ¶¶ 4204, 5017-5020, 5029-5030 (A. 358, 380-81, 383). Neither rationale has merit.

The notion that uncertainties about the precise magnitude of the cost difference between letter processing and flats processing of DVD mailers can justify leaving the 44 cent rate differential completely unchanged founders on several grounds. First, the argument is circular. As the Commission has conceded, GameFly mails its DVD mailers as flats only because the Postal Service has made the less costly letter rate category untenable. Order ¶¶ 4084, 4137, 4138 (A. 318, 335-36). Without this operational discrimination, GameFly would be using the letter rate, and the differences between the Postal Service's costs of processing letters and flats would be moot.

Second, the PRC's criticism of the available cost estimates is unsupported by the record. The only example offered by the PRC of a "questionable" modeling assumption used by GameFly's cost witness was his use of a proxy value for one input in his cost model. The PRC, however, has repeatedly approved the use of proxy cost data when they are the best available evidence. The use of proxy data was particularly appropriate here: a direct estimate of the value in question was unavailable, the Postal Service's own expert consultants had adopted the same proxy in their own study of the Postal Service's cost of processing Netflix DVD mailers, and the USPS did not submit a competing cost study of its own in this case.

Third, the arbitrariness of the Commission's reasoning is underscored by the asymmetry of its consequences. The Commission did not contend that GameFly's cost study actually understated the relevant cost differences. By contrast, the Commission's refusal to eliminate, or even reduce, the 44-cent letter-flat differential makes certain that GameFly will have to pay 44 cents more per piece than Netflix, and GameFly's mail quite possibly may "continue to generate more than double the contribution per piece than Netflix mail." Order ¶ 5030 (A. 383). This is hardly surprising: as the Commission found, "processing mail on automation equipment is vastly more efficient and less costly than processing it manually." Order ¶ 4023 (A. 297). In denying pricing relief, the Commission has allowed the perfect to become the enemy of the good.

The Commission's invocation of the general principle that regulated firms should have leeway to engage in differential pricing between different kinds of mail and customers in response to differences in demand, value of service, and other non-cost factors (Order at ¶¶ 5020, 5030 (A.380-81, 383)) is equally wide of the mark. GameFly has not asked the PRC to equalize the rates of all First-Class letter mail and all First-Class flats mail, regardless of the contents and nature of the mail. GameFly has asked the Commission to



eliminate or reduce the letter-flat rate differential only for the narrow subset of mail used to send a single commodity: rental DVDs. Within this niche, the Commission has found no material non-cost differences between the two shapes of mail. To the contrary, as noted above, the Commission found that GameFly uses flats only because the Postal Service's discriminatory processing practices have precluded the use of letter mail. Nor has the Commission identified any material non-cost difference between letter- and flat-shaped mail used by other DVD rental companies.

At bottom, the Commission's position reduces to the proposition that the theoretical possibility of non-cost differences between letter- and flat-shaped DVD mail is sufficient to give the USPS license to discriminate, even if those differences (if any) have never been identified or their effect quantified. Once again, the Commission has contradicted its own findings. As the Commission noted earlier in the Order, allowing the Postal Service to justify price discrimination "without a demonstration of" how the "inherent differences between mailers impact . . . the mailer's service choices" would effectively write the antidiscrimination prohibition out of the statute: such differences could justify discrimination between any pair of customers. Order ¶ 4092 (A. 320-21).

## STANDARD OF REVIEW

Review of the Order is governed by the Administrative Procedure Act, 5 U.S.C. § 706. *See* 39 U.S.C. § 3663 (incorporating APA provision). Section 706 requires that an agency order be set aside, *inter alia*, if it is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law,” “short of statutory right,” “without observance of procedure required by law,” or “unsupported by substantial evidence” in a proceeding on the record. 5 U.S.C. § 706(2)(A), (C) through (E).

In applying this standard, the Court considers whether the agency “has offered a rational explanation for its decision [and] whether its decision is based on consideration of the relevant factors . . .” *American Federation of Govt. Employees v. FLRA*, 470 F.3d 375, 380 (D.C. Cir. 2006) (citations omitted). The Court will uphold the agency’s decision ‘if, but only if, we can discern a reasoned path from the facts and considerations before the [agency] to the decision it reached.’” *Id.* (citations omitted). The decision “must come with [such] relevant evidence as a reasonable mind might accept as adequate to support a conclusion.” *Id.* (citations omitted). “Certainly, if the result reached is ‘illogical on its own terms,’ the Authority's order is arbitrary and capricious.” *Id.* (citation omitted).

Finally, the Commission's order must be overturned if the agency failed to give a party adequate notice and opportunity to be heard before deciding a disputed issue of fact or law. 5 U.S.C. § 554(b)(3) (right to be "timely informed of . . . the matters of fact and law asserted"); *id.*, § 556(d) ("A party is entitled to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts."); *Mail Order Ass'n of America v. USPS*, 2 F.3d 408, 429-30 (D.C. Cir. 1993); *American Louisiana Pipe Line Co. v. FPC*, 344 F.2d 525, 528-29 (D.C. Cir. 1965).

## ARGUMENT

### **I. THE COMMISSION'S REFUSAL TO AWARD RELIEF THAT "ACHIEVES COMPLIANCE WITH" 39 U.S.C. § 403(c) AND REMEDIES THE EFFECT OF THE POSTAL SERVICE'S DISCRIMINATION WAS ARBITRARY, CAPRICIOUS, AND CONTRARY TO LAW.**

Between the findings and the remedy of the Order lies a void. The first 108 pages of the Order were a model of care and thoroughness. With extensive citations to the record evidence, including Postal Service documents produced in discovery, the Commission exhaustively showed that GameFly had proven all three elements of a discrimination claim under 39 U.S.C. § 403(c)—i.e., that GameFly was similarly situated with Netflix and Blockbuster; the Postal Service had discriminated in the rates and terms of

service offered to these and other DVD rental companies; and the discrimination was unlawful because the Postal Service had established no rational basis for the discrimination. The USPS declined to seek judicial review of any of these findings, and they are now controlling.

Beginning on page 109, however—the start of the section dealing with remedies—the Commission went wobbly. As noted above, 39 U.S.C. § 3662(c) provides that the PRC, upon finding that a complaint is justified,

*shall order* the Postal Service to take such action as the Commission considers *appropriate to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance* (such as ordering unlawful rates to be adjusted to lawful levels, ordering the cancellation of market tests, ordering the Postal Service to discontinue providing loss-making products, or requiring the Postal Service to make up for revenue shortfalls in competitive products).

39 U.S.C. § 3662(c) (emphasis added).<sup>11</sup> Moreover, as noted above, the qualifying language “as the Commission considers appropriate” does not give the Commission discretion to settle for a remedy that is inadequate:

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<sup>11</sup> As the Commission notes, this “broad remedial power is consistent with, and reinforced by, 39 U.S.C. § 503,” which “authorizes the Commission to ‘take any other action they [the Commissioners] deem necessary and proper to carry out their functions and obligations to the Government of the United States and the people as prescribed under this title.’” Order ¶ 5009 (A. 377-78) (quoting 39 U.S.C. § 503).

[T]he remedy [the Commission] selects must be responsive to “the effects of any noncompliance.” In this case, the noncompliance consisted of undue discrimination against GameFly with respect to its DVD return mailers. *The remedy chosen by the Commission must, therefore, address this undue discrimination and be supported by, and consistent with, the record.*

Order ¶ 5011 (emphasis added) (A. 378).

The Commission’s remedy did not come close to satisfying this standard. The Commission asserted that the separate letter and flats rate categories it established in the Order give GameFly relief “similar” to Netflix and remedy “any potential discrimination against other similarly situated mailers” (Order ¶¶ 5025, 5030 (A. 382-83)). The Commission’s own findings refute this self-congratulatory claim. The “increased postage” that GameFly must pay to “ensure that it avoids automation letter equipment” includes not just the “additional ounce charge” (then 17 cents, now 20 cents) *but also the letter-flat differential of 44 cents.* Order ¶¶ 4084, 4137-4138, 5023 (A. 318, 335-36, 381-82). The Commission’s order eliminated the first but not the second: hence, more than two-thirds of the total price disparity remains. A rate of 44 cents for a DVD mailer sent as a letter, and a rate of 88 cents for a DVD mailer sent as a flat, are not “similar.”

This outcome could satisfy 39 U.S.C. §§ 403(c) and 3662(c) only if the Commission provided a reasoned basis for leaving so much of the discrimination in place. The Commission did not do so. We discuss in turn the Commission's for rejecting (1) the "operational" remedy of requiring the USPS to offer GameFly Netflix-like levels of manual handling at First-Class letter rates; and (2) the "pricing" remedy of eliminating the letter-flat rate differential for DVD mailers mailed as flats.

**A. The Commission's Grounds For Not Prescribing An Operational Remedy Are Arbitrary And Capricious.**

The PRC defended its decision not to impose the "operational remedy" of requiring the USPS to offer all DVD rental companies the same level of manual handling for DVDs mailed at machinable letter rates on the grounds that (1) this remedy would "requir[e] the Commission to involve itself in operational matters," and (2) monitoring compliance "could cause the Postal Service to incur potentially significant administrative costs." Order ¶¶ 5012, 5014-5016 (A. 378-80). We discuss each objection in turn.

**1. The Commission's supposed lack of authority to prescribe operational relief**

The notion that the Commission has no authority to order operational relief in a complaint involving “operational matters” is at odds with statute and precedent. While the USPS, like other regulated monopolies, certainly has discretion in the first instance to decide how to operate, the USPS must exercise that discretion within the constraints of 39 U.S.C. § 403(c). If the USPS exceeds these bounds and a complainant seeks relief by filing a complaint under 39 U.S.C. § 3662, the PRC is not only permitted but required to provide relief. Order ¶¶ 5008-5011 (A. 377-78) (discussed *supra*).<sup>12</sup> Moreover, nothing in sections 403(c) and 3662 limits the scope of these provisions to discrimination in pricing. To the contrary, section 403(c) forbids

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<sup>12</sup> The Commission has recognized the same distinction in the context of pricing. A USPS witness contended that requiring the USPS to create a separate rate category for First-Class DVD mail would improperly impinge on “important choices of pricing policy that lie squarely within the USPS’s management prerogatives, and its pricing discretion and flexibility under the current statutory scheme.” Order ¶ 4237 (A. 372). The Commission rejected this argument, reasoning that the USPS’s general pricing discretion cannot “justify the USPS’s failure to pursue classification or rate changes that could eliminate the disparity in treatment of DVD mailers when such disparities are identified in an OIG audit and are the subject of a formal complaint alleging discrimination.” *Id.* at ¶ 4238 (A. 372). The same logic applies to the USPS’s “management prerogatives” and “discretion” over operational matters.

undue discrimination in “providing services and . . . classifications,” not just in “establishing rates.” 39 U.S.C. § 403(c).

Consistent with these provisions and the cognate antidiscrimination provisions of other common carrier and public utility statutes, the PRC and other federal agencies repeatedly have overridden the discretion of regulated firms when necessary to remedy undue discrimination in operating practices. *See, e.g., Red Tag Proceeding*, Docket No. MC79-3, PRC Op. & Rec. Decision (May 18, 1980) at 11-12, 19 (high priority handling should be available to all periodicals entered at Second-Class rates, not just daily and weekly publications; prohibition against undue discrimination forbids charging one group of users of a class of mail “the same rate” as another group of users but providing “a lesser quality service”); *Suncor Energy Marketing Co., Inc. v. Platte Pipe Line Co.*, 132 FERC ¶ 61,242 at P 137 (2010); *Baltimore & Ohio R.R. v. U.S. ex rel. Pitcairn Coal Co.*, 215 U.S. 481 (1910) (finding that cognate discrimination provision of Interstate Commerce Act gave the ICC primary jurisdiction to impose prospective relief from discriminatory operating practices); *Rex Jellico Coal Co. v. Louisville & N. R. Co.*, 237 I.C.C. 67, 71 (1940) (whether to “furnish” service over private tracks “or withhold it is within the discretion of the [railroad] carrier, except that in either event the statutory



inhibition against undue discrimination or undue prejudice must be observed.”). Refusing to enjoin discriminatory operating practices merely because relief would “require the Commission to involve itself in operational matters” is an arbitrary and unexplained departure from this precedent, and an abdication of the Commission’s responsibility under 39 U.S.C. § 3662(c).

## **2. Enforcement and compliance costs**

The PRC’s denial of operational relief also cannot be upheld by speculating that enforcement of an operational remedy could be difficult or “could” cause the USPS or the PRC to incur “potentially significant” administrative costs. *Cf.* Order ¶ 5015 (A. 379). The Commission cited nothing in the record to indicate that compliance would be unduly difficult for the USPS, and the PRC’s speculation to this effect was contradicted by the PRC’s finding to the contrary earlier in the same decision:

The Commission is not persuaded by the Postal Service’s arguments that it would be infeasible to provide GameFly similar, if not the exact same, treatment as Netflix and Blockbuster. While the level of normal processing can be expected to fluctuate among facilities and over periods of time, no insuperable obstacle has been shown on the record to prevent comparable levels of manual processing. This conclusion assumes, of course that GameFly would make changes to the shape and type of its return mail, and would adopt a more distinctive and visible mailpiece.

Order ¶¶ 4170-4171 (A. 346). In any event, any administrative or other compliance costs incurred by the USPS would be self-inflicted—the result of the Postal Service’s insistence on continuing to process Netflix’s mailpieces manually at machinable letter rates, despite the repeated warnings of its own employees and a formal investigative report of the Postal Service’s own Office of Inspector General urging management to end this practice. Order ¶¶ 2004, 4136, 4147, 4201, 4210, 4219-22, 4226, 4228-29, 4238-39, 4243 (A. 271-72, 334-35, 338-39, 360-71, 365-69, 372-74).

The PRC’s claim that monitoring and enforcement of compliance with an operational remedy would be difficult or overly costly for the PRC itself was equally unfounded. The PRC cited no evidence to support this *ipse dixit*, and its truth is certainly not self-evident. Advances in mailpiece barcoding technology now allow the tracking of individual mailpieces through the USPS network, and barcode scan data can reveal how often a customer’s pieces have passed through automated processing equipment.<sup>13</sup> The scan data would

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<sup>13</sup> For example, the amount of automated letter processing could be identified by putting identifying barcodes on the mailpieces. Scanning the barcodes allows the USPS to track the barcodes through the postal network. The USPS has gained a great deal of experience tracking its performance using data generated by scanning barcodes. Indeed, the USPS’s performance measurement system, which the Commission approved last year, relies for the

reveal the rate at which each company's mailpieces were reported passing through automated equipment. Hence, the Commission's finding that enforcement of an operational remedy would nonetheless be impractical or overly costly for either the USPS or the PRC must be set aside as unsupported by record evidence. 5 U.S.C. § 706(2)(E); accord, *Newsweek, Inc. v. USPS*, 663 F.2d 1186, 1205 (2d Cir. 1981), reviewed on other grounds, *Nat'l Ass'n of Greeting Card Publishers v. USPS*, 462 U.S. 810 (1983) (setting aside \$143 million PRC adjustment USPS revenue requirement based on "two methodologies not introduced during the hearings").

Finally, the Commission's rejection of the proposed operational remedy as infeasible denied GameFly adequate notice and opportunity to be heard. The Commission gave GameFly no warning before deciding *sua sponte* that operational relief would be impractical to enforce. This lack of notice violated GameFly's due process rights under the Administrative Procedure Act. See 5 U.S.C. § 554(b)(3) (right to be "timely informed of . . . the matters of fact and law asserted"); *id.*, § 556(d) ("A party is entitled to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the majority of mail on barcode scan data. PRC, *Fiscal Year 2010 Annual Compliance Determination* (March 29, 2011) at 58.

facts.”). *Accord, Mail Order Ass’n of America v. USPS*, 2 F.3d 408, 429-30 (D.C. Cir. 1993) (PRC’s adoption of a costing methodology not disclosed before the close of the record violated 5 U.S.C. § 556(d)); *American Louisiana Pipe Line Co. v. FPC*, 344 F.2d 525, 528-29 (D.C. Cir. 1965) (overturning FPC decision rejecting rate tariff on grounds not raised by the FPC before the close of the record); PRC Docket No. R94-1, *Postal Rate and Fee Changes, 1994*, PRC Op. & Rec. Decis. (Nov. 30, 1994) at III-40, n. 41 (explaining that PRC struck econometric model and calculations from the record because they were “filed too late to allow adequate review of these econometric calculations,” and thus “raised due process concerns”).

**B. The Commission’s Reasons For Maintaining The Letter-Flat Rate Differential For DVD Mailers Were Also Arbitrary And Capricious.**

The Commission’s arguments for preserving the letter-flat price differential for DVD mailers were also arbitrary and capricious. As noted above, the Commission offered two purported justifications for its action: (1) the difference between the Postal Service’s costs of handling GameFly vs. Netflix DVD mailers is not known precisely; and (2) “pricing products to fairly balance the multiple policies, objectives, and factors of title 39 is, in the first instance, a responsibility of the Postal Service.” Order ¶¶ 4204, 5017-20, 5029-

5030 (A. 358, 380-81, 383). Neither claim is supported by reasoned findings or substantial evidence.

**1. Uncertainty about the precise cost differences between letter-rated and flat-rated DVD mailers**

The Commission's claim that the magnitude of the cost differences between letter vs. flat-shaped DVD mailers is too uncertain to justify eliminating the 44-cent rate surcharge for flat-shaped DVD mailers founders on several grounds. First, the premise of the argument is hopelessly circular. As the Commission has conceded, GameFly mails its DVDs mailers as flats only because the Postal Service's discriminatory processing policies have forced GameFly to avoid the less costly rate category for letters. Order ¶¶ 4084, 4137-4138 (A. 318, 335-336) (quoted on p. 23, *supra*). This obstacle remains only because the Commission has refused to remove it. *See* pp. 21-22, *supra*. Absent the operational discrimination, GameFly would be using the letter rate category, and any differences in the costs to the USPS of processing letters and flats would be moot: the only potentially relevant cost differences would be between Netflix *letter*-rated mailers and GameFly *letter*-rated mailers. And the Commission has already resolved the latter issue: the cost differences, if any, are too small to matter. Order ¶¶ 4175 (A. 348) (finding cost differences

related to transportation distances and number of mail pickup points “do not justify less favorable treatment being given to GameFly”); *id.*, ¶ 4176 (A. 348).

Second, uncertainty about the cost differences between letters and flats would not justify denial of pricing relief even if the cost differences between letters and flats were determinative. The focus of the Commission’s criticism was a cost study by Sander Glick, a costing witness for GameFly, who estimated the cost differences between processing GameFly DVD mailers as automated flats and Netflix DVD mailers as letters with significant manual processing. To estimate the cost of processing GameFly DVD letters as automated flats, Mr. Glick took an earlier USPS-sponsored study of the cost of handling Netflix and Blockbuster DVD mailers as letters (the “Christensen study”), and then adjusted the Christensen results to reflect how the USPS processes GameFly mailers as flats. Glick Direct at 7-12 (A. 34-39). The Order criticized “some” of these adjustments as “questionable, and . . . likely only [to] provide a second best point of departure for separate ratemaking purposes.” Order ¶¶ 4204, 5019 (A. 358, 380). The only “questionable” assumption actually identified by the Commission, however, was the use of a “CRA adjustment factor for Standard Mail Regular Flats, whereas GameFly

uses First-Class Mail.” *Id.* at ¶ 4204 n. 51 (A. 358). This criticism does not withstand scrutiny.

The assumption in question was that a CRA adjustment factor derived from data on Standard Mail Regular flats, would be a reasonable proxy for a CRA adjustment factor derived from data on First-Class Mail flats.<sup>14</sup> The use of this proxy originated not with Mr. Glick, but from a model of flats processing costs for outgoing DVD mailers developed by *the Postal Service’s own cost consultant, Christensen Associates*.<sup>15</sup> Christensen used this proxy factor because the USPS had never derived a CRA adjustment factor directly from data on First-Class Mail flats. Mr. Glick adopted the Christensen approach in his own model for consistency—to ensure that Glick’s estimate of differences between the costs of handling Netflix and GameFly DVD mailers would not

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<sup>14</sup> A “CRA adjustment factor” is an adjustment factor used to reconcile (1) the costs attributed by cost models to individual categories of service with (2) the total costs actually recorded by the Postal Service in its account books and periodically reported in the Postal Service’s Cost and Revenue Analysis (“CRA”) reports. *See, e.g.*, Docket No. R2000-1, *Postal Rate and Fee Changes, 2000*, Direct Testimony of USPS witness David Yacobucci (USPS-T-25) at 14 (available at [www.prc.gov/prc-pages/library/detail.aspx?docketId=R2000-1&docid=20200&docketpart=Documents&doctype=Testimony](http://www.prc.gov/prc-pages/library/detail.aspx?docketId=R2000-1&docid=20200&docketpart=Documents&doctype=Testimony)).

<sup>15</sup> Christensen Associates is a highly respected economic consulting firm, and performed its study for the USPS of the costs of processing DVD mailers with input from knowledgeable subject matter experts from Postal Service headquarters. Tr. 12/2075-2076 (Glick) (A. 154-55).

be tainted by differences between Glick's and Christensen's modeling methodologies. *See* Glick Direct at 3-4 (A. 30-31).

There was nothing inappropriate about the use of a proxy CRA adjustment for this purpose by Mr. Glick and Christensen Associates. The USPS had never developed or published a direct measure of the CRA cost adjustment for First-Class flats, and did not submit a competing cost study in this case. *See* Order ¶¶ 4174, 4191-92, 4203 (A. 347-48, 353-54, 358).<sup>16</sup> In circumstances of this kind, the use of proxy adjustment factors is a well-accepted practice. "It is not unusual to apply proxy CRA adjustment factors to modeled costs when there is not a corresponding CRA unit cost available." Order ¶ 4197 (A. 355-56). Indeed, the PRC itself noted approvingly the practice of using proxy adjustment factors in rejecting the Postal Service's criticism of another proxy value in this very case. *Id.* ("To wit, the CRA

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<sup>16</sup> GameFly served the USPS with multiple interrogatories relating to the applicability of the Christensen Associates study to the costs of processing GameFly's DVD mailers as flats, and Mr. Glick adjusted his models as warranted by the USPS responses. Glick Direct at 8-12 (A. 35-39).



adjustment factor ‘borrowed’ from the QBRM model is itself ‘borrowed’ from the model of bulk metered mail costs”).<sup>17</sup>

The Commission’s unexplained departure from its own precedent on the use of proxy CRA adjustment factors is arbitrary and capricious. “At the least, the Commission must explain this differential treatment of seemingly like cases.” *LePage’s 2000, Inc. v. PRC*, 642 F.3d 225, 232 (D.C. Cir. 2011) (citing *Westar Energy, Inc. v. FERC*, 473 F.2d 1239, 1241 (D.C. Cir. 2007)). The Court “cannot uphold a decision ‘where an agency departs from established precedent without a reasoned explanation.’” *LePage’s 2000*, 642 F.3d at 233 (quoting *ANR Pipeline Co. v. FERC*, 71 F.3d 897, 901 (D.C. Cir. 1995)); accord, *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 57 (1983).

Third, the arbitrariness of the Commission’s refusal to credit Mr. Glick’s cost study is underscored by the asymmetrical results of the Commission’s

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<sup>17</sup> The use of proxy data and other simplifying assumptions reflects the reality that no statistical or cost model offers perfect certainty or precision. “[A] model is meant to simplify reality in order to make it tractable. . . . To invalidate a model simply because it does not perfectly fit every data point “would be to defeat the purpose of using a model.” *Appalachian Power Co. v. EPA*, 135 F.3d 791, 805-06 (D.C. Cir. 1998) (citing *Chemical Mfrs. Ass’n v. EPA*, 28 F.3d 1259 (D.C. Cir. 1994)).

choice. The Commission did not contend that the proxy value in fact caused Mr. Glick's study to understate the actual differences in the Postal Service's costs of handling Netflix and GameFly DVD mailers, or even that any resulting error was likely to be an understatement, not an overstatement, of the cost differences. By contrast, the direction and magnitude of the effect of leaving the letter-flat rate differential in place are certain: GameFly will have to pay the full 44-cent letter-flat differential per piece to get the same degree of protection from automated letter processing that Netflix enjoys at letter rates of postage. *See supra* at p. 34.

The record contained no evidence, and the Commission made no finding, that the cost of handling GameFly mailers exceeds the cost of handling Netflix mailers (if at all) by anything approaching 44 cents. To the contrary, the Commission admitted that keeping the letter-flat rate differential in place may force GameFly mail to "continue to generate more than *double the contribution per piece than Netflix mail.*" Order ¶ 5030 (emphasis added) (A. 383). This is hardly surprising: as the Commission also admitted, "all recent understanding of the behavior of USPS costs [is that] in virtually every instance, processing mail on automation equipment is vastly more efficient and less costly than processing it manually." Order ¶ 4203 (A. 358).

In this context, the Commission's fastidiousness about using Mr. Glick's cost estimate deprived GameFly of adequate relief under 39 U.S.C. § 3662(c) by making the perfect the enemy of the good. *Cf. Commonwealth of Pennsylvania v. ICC*, 535 F.2d 91, 96 (D.C. Cir. 1976) (“[i]t is reasonable to assume that Congress did not intend the infeasible perfect to oust the feasible good.”); *Edison Electric Inst. v. ICC*, 969 F.2d 1221, 1227 (D.C. Cir. 1992) (the ICC did not act arbitrarily by “using the data that are available now and undertaking to incorporate more data into its analysis as they become available in the future” in developing a productivity factor to apply to railroad rate ceilings); 1 Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions* 199 n. 39 (1970) (“An approximation, even one subject to a wide margin of error, to the correct answer is better than the wrong answer worked out to seven decimal places.”).

## **2. Unidentified non-cost differences between letter-rated and flat-rated DVD mailers**

The PRC also gained nothing by invoking the supposed “statutory” right of the USPS to exercise “flexibility,” at least “in the first instance,” to set rates within broad rate categories, including letters and flats, at varying markups above cost based on differences in demand, value of service, or the non-cost ratemaking factors of Title 39, including 39 U.S.C. § 3622(c). Order ¶ 5020 (A. 380-81) (“A given mailer is not necessarily entitled to pay the same

contribution as another mail when they enter mail with different characteristics”; the “Commission prefers to allow the Postal Service statutory flexibility in this area.”); *id.* at ¶ 5030 (A. 383) (claiming that “the remaining price disparity is reasonable in light of the differences between letter-shaped and flat-shaped round-trip DVD mailers”).

These statements appear to combine two different principles: the *procedural* right of a regulated carrier to set rates “in the first instance” (“carrier ratemaking initiative”), and the *substantive* standard that allows a regulated firm to maintain prices at varying markups in response to variations in demand, value of service and the non-cost factors of 39 U.S.C. § 3622(c) (“differential pricing”). Neither principle can justify the Commission’s refusal to cut the 44-cent letter-flat differential.

First, the Commission’s position is hopelessly self-contradictory. Deference to the Postal Service’s supposed primacy in ratemaking did not stop the PRC from overriding the pricing judgment of the USPS by ordering it to waive the 17 cent second-ounce charge for DVDs mailed as flats. By what theory does the Commission have the power to reduce the rate for a two-ounce flats-rated DVD mailer by 17 cents but not by 17 plus 44 cents?

In fact, *both* rate adjustments are within the Commission's authority. The ratemaking initiative possessed by a regulated firm means only the right to propose and implement rate changes, subject to the possibility of after-the-fact review by the regulator if someone challenges the rates. *See Arizona Grocery Co. v. Atchison, T. & S.F. Ry.*, 284 U.S. 370, 389-390 (1932) (under a regulatory regime that allows carrier initiative in pricing, "the great mass of rates will be carrier-made rates"). After-the-fact review does not mean nonexistent review, and "in the first instance" does not mean forever. The necessary corollary of "limited . . . pre-implementation review" is that "complicated or subjective compliance issues" must be dealt with "through the complaint procedures of section 3662" or other post-implementation proceedings. Order No. 43, PRC Docket No. RM2007-1, *Regulations Establishing A System of Ratemaking* (Oct. 29, 2007); *accord*, *Arizona Grocery, supra* (describing authority of the ICC to prescribe lower rates upon complaint after the rates took effect). That is precisely what GameFly asked the PRC to do.

The Commission's hands-off treatment of the 44 cent letter-flat differential also finds no support in differential pricing principles. The PRC has confused the universe of First-Class mail with the narrow subset at issue here. Americans use First-Class letters and First-Class flats to mail an

enormous variety of matter, and for widely varying purposes; hence, charging different markups over cost for First-Class letters as a whole, and First-Class flats as a whole, perhaps might be justified by differences in the value of service or the other non-cost factors enumerated in Title 39. But *this* case concerns only a narrow subset of letter- and flat-rated First-Class Mail: DVD mailers. Within this niche, the Commission has found no material non-cost differences between letter and flat-shaped mail. To the contrary, the Commission specifically found that GameFly uses flats *only* because the Postal Service's discriminatory processing practices have foreclosed the use of letters: absent the discrimination, GameFly would be mailing its flats as letters. Order ¶¶ 4084, 4137-4138 (A. 318, 335-36); *see also id.* at ¶¶ 4087, 4092-4094, 4102-4103, 4107, 4115 (A. 319-33, 324-26, 328) (finding that GameFly would be willing and able to mail its DVDs as letters with a distinctive mailpiece design and forego the use of Confirm tracking and tracing service if offered Netflix-like manual handling at letter rates).

Nor does the record indicate that the DVD mailers of *other* DVD rental companies differ in any significant characteristic by the shape of mailpiece used. All of the major DVD rental companies that mail DVDs use the mail in essentially the same way. Compare Joint Statement ¶¶ 15-20 (A. 6)

(GameFly); *id.* at ¶¶ 64-71 (A. 14) (Netflix); *id.* at ¶¶ 93-101 (A. 18-19) (Blockbuster). All DVDs, whether mailed as letters or flats, are small and light enough to be mailed as one-ounce letters if sent in lightweight mailers. *See* pp. 4, *supra.* All DVDs suffer unacceptable breakage rates if subjected to automated letter processing when mailed back from subscribers. *See* pp. 4-6, *supra.* And the USPS offered no evidence in the record that GameFly's elasticity of demand for mail service differs materially from the demand elasticities of Netflix or Blockbuster. The Commission's finding that GameFly and Netflix were "similarly situated" under 39 U.S.C. § 403(c), Order ¶ 4126 (A. 331), was clearly consistent with these facts.

In essence, the Commission's argument against further pricing relief reduces to the proposition that the mere *possibility* that the letter-shaped DVD mail and flat-shaped DVD mail *might* differ in some non-cost characteristic is sufficient to foreclose any reduction in the letter-flat price differential, even though no difference in the non-cost characteristics of the two mailpiece shapes has been proven, or even identified. But this proposition, if accepted, would swallow up 39 U.S.C. § 403(c), as the Commission itself acknowledged in a related context:

Without a demonstration of how those inherent differences between mailers impact the Postal Service or the mailer's service

choices, such differences could be used to distinguish virtually every mailer from every other mailer. For example, different prices could then be justified for the same Standard Mail product used by two competing banks *solely on the ground that each bank markets a slightly different financial product, has different costs of doing business, or serves different customers.*

Order ¶ 4092 (A. 320-21) (emphasis added). The non-cost justification that the Commission offered in ¶¶ 5020 and 5030 was the same *reducto ad absurdum* that the Commission explicitly rejected in ¶ 4092—and implicitly rejected by ordering the USPS to waive the second-ounce charge for flats with DVDs.

### CONCLUSION

For these reasons, the petition for review should be granted.

Respectfully submitted,

/s/

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January 18, 2012



# **STATUTORY ADDENDUM**

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## **5 U.S.C. § 554. Adjudications**

**(a)** This section applies, according to the provisions thereof, in every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing, except to the extent that there is involved—

**(1)** a matter subject to a subsequent trial of the law and the facts de novo in a court;

**(2)** the selection or tenure of an employee, except a administrative law judge appointed under section 3105 of this title;

**(3)** proceedings in which decisions rest solely on inspections, tests, or elections;

**(4)** the conduct of military or foreign affairs functions;

**(5)** cases in which an agency is acting as an agent for a court; or

**(6)** the certification of worker representatives.

**(b)** Persons entitled to notice of an agency hearing shall be timely informed of—

**(1)** the time, place, and nature of the hearing;

**(2)** the legal authority and jurisdiction under which the hearing is to be held; and

**(3)** the matters of fact and law asserted.

When private persons are the moving parties, other parties to the proceeding shall give prompt notice of issues controverted in fact or law; and in other instances agencies may by rule require responsive pleading. In fixing the time and place for hearings, due regard shall be had for the convenience and necessity of the parties or their representatives.

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**5 U.S.C. § 556. Hearings; presiding employees; powers and duties; burden of proof; evidence; record as basis of decision**

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(d) Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof. Any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence. A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence. The agency may, to the extent consistent with the interests of justice and the policy of the underlying statutes administered by the agency, consider a violation of section 557(d) of this title sufficient grounds for a decision adverse to a party who has knowingly committed such violation or knowingly caused such violation to occur. A party is entitled to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts. In rule making or determining claims for money or benefits or applications for initial licenses an agency may, when a party will not be prejudiced thereby, adopt procedures for the submission of all or part of the evidence in written form.

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**5 U.S.C. § 706. Scope of review**

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

### **39 U.S.C. § 403**

**(a)** The Postal Service shall plan, develop, promote, and provide adequate and efficient postal services at fair and reasonable rates and fees. The Postal Service shall receive, transmit, and deliver throughout the United States, its territories and possessions, and, pursuant to arrangements entered into under sections 406 and 411 of this title, throughout the world, written and printed matter, parcels, and like materials and provide such other services incidental thereto as it finds appropriate to its functions and in the public interest. The Postal Service shall serve as nearly as practicable the entire population of the United States.

**(b)** It shall be the responsibility of the Postal Service—

**(1)** to maintain an efficient system of collection, sorting, and delivery of the mail nationwide;

**(2)** to provide types of mail service to meet the needs of different categories of mail and mail users; and

**(3)** to establish and maintain postal facilities of such character and in such locations, that postal patrons throughout the Nation will, consistent with reasonable economies of postal operations, have ready access to essential postal services.

**(c)** In providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not, except as specifically authorized in this title, make any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preferences to any such user.

**39 U.S.C. § 503. Rules; regulations; procedures**

The Postal Regulatory Commission shall promulgate rules and regulations and establish procedures, subject to chapters 5 and 7 of title 5, and take any other action they deem necessary and proper to carry out their functions and obligations to the Government of the United States and the people as prescribed under this title. Such rules, regulations, procedures, and actions shall not be subject to any change or supervision by the Postal Service.

### **39 U.S.C. § 3622. Modern rate regulation**

**(a) Authority Generally.**— The Postal Regulatory Commission shall, within 18 months after the date of enactment of this section, by regulation establish (and may from time to time thereafter by regulation revise) a modern system for regulating rates and classes for market-dominant products.

**(b) Objectives.**— Such system shall be designed to achieve the following objectives, each of which shall be applied in conjunction with the others:

**(1)** To maximize incentives to reduce costs and increase efficiency.

**(2)** To create predictability and stability in rates.

**(3)** To maintain high quality service standards established under section 3691.

**(4)** To allow the Postal Service pricing flexibility.

**(5)** To assure adequate revenues, including retained earnings, to maintain financial stability.

**(6)** To reduce the administrative burden and increase the transparency of the ratemaking process.

**(7)** To enhance mail security and deter terrorism.

**(8)** To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.

**(9)** To allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products.

**(c) Factors.**— In establishing or revising such system, the Postal Regulatory Commission shall take into account—



(1) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;

(2) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;

(3) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;

(4) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;

(5) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;

(6) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;

(7) the importance of pricing flexibility to encourage increased mail volume and operational efficiency;

(8) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;

(9) the importance of providing classifications with extremely high degrees of reliability and speed of delivery and of providing those that do not require high degrees of reliability and speed of delivery;

(10) the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including

agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that—

**(A)** either—

**(i)** improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or

**(ii)** enhance the performance of mail preparation, processing, transportation, or other functions; and

**(B)** do not cause unreasonable harm to the marketplace.

**(11)** the educational, cultural, scientific, and informational value to the recipient of mail matter;

**(12)** the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services;

**(13)** the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail; and

**(14)** the policies of this title as well as such other factors as the Commission determines appropriate.

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**39 U.S.C. § 3625 (2000) (repealed by Postal Accountability and Enhancement Act, Pub. L. No. 109-435, Title II, § 201(b), Dec. 20, 2006, 120 Stat. 3205). Action of the Governors**

(a) Upon receiving a recommended decision from the Postal Rate Commission, the Governors may approve, allow under protest, reject, or modify that decision in accordance with the provisions of this section.

(b) The Governors may approve the recommended decision and order the decision placed in effect.

(c) The Governors may, under protest, allow a recommended decision of the Commission to take effect and (1) seek judicial review thereof under section 3628 of this title, or (2) return the recommended decision to the Commission for reconsideration and a further recommended decision, which shall be acted upon under this section and subject to review in accordance with section 3628 of this title.

(d) The Governors may reject the recommended decision of the Commission and the Postal Service may resubmit its request to the Commission for reconsideration. Upon resubmission, the request shall be reconsidered, and a further recommended decision of the Commission shall be acted upon under this section and subject to review in accordance with section 3628 of this title. However, with the unanimous written concurrence of all of the Governors then holding office, the Governors may modify any such further recommended decision of the Commission under this subsection if the Governors expressly find that (1) such modification is in accord with the record and the policies of this chapter, and (2) the rates recommended by the Commission are not adequate to provide sufficient total revenues so that total estimated income and appropriations will equal as nearly as practicable estimated total costs.

(e) The decision of the Governors to approve, allow under protest, reject, or modify a recommended decision of the Commission shall be in writing and shall include an estimate of anticipated revenue and a statement of explanation and justification. The decision, the record of the Commission's hearings, and the Commission's recommended decision shall be made generally available at

the time the decision is issued and shall be printed and made available for sale by the Public Printer within 10 days following the day the decision is issued.

**(f)** The Board shall determine the date on which the new rates, fees, the mail classification schedule, and changes in such schedule under this subchapter shall become effective.

### **39 U.S.C. § 3662. Rate and service complaints**

**(a) In General.**— Any interested person (including an officer of the Postal Regulatory Commission representing the interests of the general public) who believes the Postal Service is not operating in conformance with the requirements of the provisions of sections 101 (d), 401 (2), 403 (c), 404a, or 601, or this chapter (or regulations promulgated under any of those provisions) may lodge a complaint with the Postal Regulatory Commission in such form and manner as the Commission may prescribe.

#### **(b) Prompt Response Required.**—

**(1) In general.**— The Postal Regulatory Commission shall, within 90 days after receiving a complaint under subsection (a)—

**(A)** either—

**(i)** upon a finding that such complaint raises material issues of fact or law, begin proceedings on such complaint; or

**(ii)** issue an order dismissing the complaint; and

**(B)** with respect to any action taken under subparagraph (A)(i) or (ii), issue a written statement setting forth the bases of its determination.

**(2) Treatment of complaints not timely acted on.**— For purposes of section 3663, any complaint under subsection (a) on which the Commission fails to act in the time and manner required by paragraph (1) shall be treated in the same way as if it had been dismissed pursuant to an order issued by the Commission on the last day allowable for the issuance of such order under paragraph (1).

**(c) Action Required if Complaint Found To Be Justified.**— If the Postal Regulatory Commission finds the complaint to be justified, it shall order that the Postal Service take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance (such as ordering unlawful rates to be adjusted to lawful levels, ordering the cancellation of market tests, ordering the

Postal Service to discontinue providing loss-making products, or requiring the Postal Service to make up for revenue shortfalls in competitive products).

**(d) Authority To Order Fines in Cases of Deliberate Noncompliance.—** In addition, in cases of deliberate noncompliance by the Postal Service with the requirements of this title, the Postal Regulatory Commission may order, based on the nature, circumstances, extent, and seriousness of the noncompliance, a fine (in the amount specified by the Commission in its order) for each incidence of noncompliance. Fines resulting from the provision of competitive products shall be paid from the Competitive Products Fund established in section 2011. All receipts from fines imposed under this subsection shall be deposited in the general fund of the Treasury of the United States.

**39 U.S.C. § 3662 (2000) (repealed by Postal Accountability and Enhancement Act, Pub. L. No. 109-435, Title II, § 205, Dec. 20, 2006, 120 Stat. 3216). Rate and Service Complaints**

Interested parties who believe the Postal Service is charging rates which do not conform to the policies set out in this title or who believe that they are not receiving postal service in accordance with the policies of this title may lodge a complaint with the Postal Rate Commission in such form and in such manner as it may prescribe. The Commission may in its discretion hold hearings on such complaint. If the Commission, in a matter covered by subchapter II of this chapter, determines the complaint to be justified, it shall, after proceedings in conformity with section 3624 of this title, issue a recommended decision which shall be acted upon in accordance with the provisions of section 3625 of this title and subject to review in accordance with the provisions of section 3628 of this title. If a matter not covered by subchapter II of this chapter is involved, and the Commission after hearing finds the complaint to be justified, it shall render a public report thereon to the Postal Service which shall take such action as it deems appropriate

**39 U.S.C. § 3663. Appellate review**

A person, including the Postal Service, adversely affected or aggrieved by a final order or decision of the Postal Regulatory Commission may, within 30 days after such order or decision becomes final, institute proceedings for review thereof by filing a petition in the United States Court of Appeals for the District of Columbia. The court shall review the order or decision in accordance with section 706 of title 5, and chapter 158 and section 2112 of title 28, on the basis of the record before the Commission.



**CERTIFICATE OF COMPLIANCE  
WITH FED. R. APP. P. RULE 32(a)**

This brief complies with the type-volume limitations set forth in Fed. R. App. P. 32(a)(7)(B) and Circuit Rule 32(a)(2) because the brief contains 11,564 words, as counted by Microsoft Word, excluding the parts of the brief that are exempted by Fed. R. App. P. Rule 32(a)(7)(B)(iii) and Circuit Rule 32(a)(1).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Word 2010 in 14 point Calisto.

*/s/ David M. Levy*

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January 18, 2012

## CERTIFICATE OF SERVICE

I certify that I electronically filed this pleading with the Clerk of this Court today via the appellate CM/ECF system. Counsel for all parties are represented by registered CM/ECF users, and will be served by the appellate CM/ECF system. I caused the supplemental appendix of documents filed under seal by GameFly, Inc., to be served today by Express Mail upon:

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January 18, 2012