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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
OAKLAND DIVISION

IN RE ONLINE DVD RENTAL ANTITRUST LITIGATION	**Master File No. 4:09-md-2029 PJH** **MDL No. 2029** **Hon. Phyllis J. Hamilton**
This document relates to: **ALL ACTIONS**	**PLAINTIFFS' OPPOSITION TO DEFENDANT NETFLIX'S MOTION FOR SUMMARY JUDGMENT**

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> "*In terms of profitability over the coming years, the key issue is the number of major competitors. If there are only two major players, Blockbuster and Netflix, the profitability may be substantial like other two-firm entertainment markets. If on the other hand Amazon, Wal-mart, Blockbuster and Netflix are all major competitors in online rental, then the profits would likely be small.*"
>
> —Netflix CEO Reed Hastings, Apr. 21, 2005 (Ex. 1 at *69.)

I. INTRODUCTION

Since taking over as CEO of Netflix in 1998, it has been Reed Hastings' ("Hastings") mission to acquire and maintain a monopoly in the DVDR Market. And, thanks to a well-choreographed series of anticompetitive agreements (thinly-veiled as "promotion agreements"), Netflix and Hastings have accomplished that mission by unlawfully stifling all meaningful competition.

Plaintiffs have direct and circumstantial evidence establishing that Defendants entered into an agreement to restrain trade in the DVDR Market, with Wal-Mart exiting the market and Netflix taking over Wal-Mart's subscribers and agreeing not to sell new DVDs. This market allocation, in addition to being *per se* unlawful and unlawful under the rule of reason, was part of a long-term, sustained effort by Netflix to willfully acquire and maintain a monopoly. Netflix, which is a monopolist (enjoying a 70% or more share) in what it concedes is the relevant market—the DVDR Market (Mot. at 3 n.2)—has charged supra-competitive prices while simultaneously decreasing service quality.

Netflix's Motion reveals a fundamental lack of familiarity with the abundant evidence Plaintiffs have amassed. Discovery has confirmed that, instead of competing on price, quality and efficiency, Netflix pursued a strategy of excluding actual and potential competitors from the DVDR Market by agreement. It accomplished its mission primarily by leveraging the threat that it might resume new DVD sales. As a result, Netflix avoided further price cuts and stabilized prices in what was shaping up to be a more competitive DVDR Market.

As shown below, the factual record strongly supports Plaintiffs' claims. In fact, when all reasonable inferences are drawn in Plaintiffs' favor, as they must be, it is clear that this case must proceed to trial. Summary judgment should be denied.

II. STATEMENT OF FACTS

[redacted]

[redacted]

Netflix's efforts to exclude potential competitors from the DVDR Market. Netflix mentions, but underplays the significance of, a series of "promotional arrangements with several major sellers of new DVDs and DVD players." (Mot. at 4.) [redacted] And, while Netflix admits that at least one of these agreements "specifically precluded new sales" (Mot. at 4), the reality is that each of these "promotional arrangements" was, just like the Promotion Agreement at issue in this case, a market allocation agreement with the purpose and effect of keeping potential competitors out of the DVDR Market.

[redacted] In consideration for Netflix agreeing to allocate the market for new DVDs to Amazon, Amazon agreed to promote Netflix's DVD rental service and, thereby, to allocate the DVDR Market to Netflix. (Ex. 9.) Netflix contends that after the Amazon agreement expired "there was no contractual impediment to the sale of new DVDs by Netflix." (Mot. at 4.) This is false.

[redacted]

[redacted]

***Wal-Mart enters DVDR Market; Netflix's first competition is the* "*500-pound gorilla*."** (Ex.19.)

[redacted] Wal-Mart launched its service on June 10, 2003. (Ex. 24.)

Wal-Mart was the "first major competition for Netflix" in DVDR. (Ex. 25.) As one analyst commented, "'I wouldn't want to be Netflix, with a 500-pound gorilla chasing after it. . . . Certainly, Netflix had expected some competition but Wal-Mart can be a formidable competitor head-on.'" (Ex. 19 at *2860.) Netflix was deeply concerned. Upon hearing of Wal-Mart's imminent entry, Hastings called the new competition "unsettling," noting that "'[a]nybody who is not scared by that is foolish.'" (Ex. 27 at *2858.) [redacted]; *see* Ex. 29 (Wal-Mart could efficiently advertise to its 100 million shoppers.).)

As one analyst said, Wal-Mart's "advantage could be its pricing power, since the retailer can cut prices at any time, a step seen likely to lead to price wars." (Ex. 19 at *2860.) This concern was shared by Netflix, which put off an anticipated price increase because of Wal-Mart: [redacted]

[redacted]

[redacted]

[redacted] In fact, by late-October 2004, Wal-Mart boasted that the DVD rental business had "'grown beyond [its] expectations,'" that it was "'really bullish'" about the business, and that its "'customers [were] enthusiastic.'" (Ex. 46 at 2.) [redacted]

[redacted]; *see also* Ex. 52 (Wal-Mart – Yahoo! Partnership Proposed Term Sheet, Dec. 1, 2004).) [redacted]

[redacted]

A price war erupts when BBI enters and Amazon threatens to enter the DVDR Market. Netflix announced a 3U price increase (from $19.95 to $21.99) beginning June 15, 2004. (Ex. 55.) [redacted] But, when BBI launched its DVDR service on August 11, 2004, it undercut Netflix's 3U plan by 10% ($19.99/month). (Ex. 57.)

Netflix now had two significant competitors in the DVDR Market and, to make matters worse, there were rumors that a third potential competitor—Amazon—was poised to enter. Hastings, always proactive in trying to exclude competition, reached out to Amazon CEO Jeff Bezos on October 8, 2004, in an effort to get Amazon not to enter the market. (Ex. 58 at *136 (Hastings "[w]anted to know if we wanted to do a big deal with them where we send them customers as an alternative way to monetize dvd rental. It was clear that he knew we were preparing to launch.").) An Amazon employee responded: "[w]e should definitely talk to them" because of the "opportunity" for Amazon to make money by refraining from entering DVDR, referring customers to Netflix for rentals, and in exchange having Netflix refer customers to Amazon to buy DVDs. *Id*. at *135-36. The Amazon employee added candidly that Netflix in return "should commit to never sell new and used DVD's." *Id*. at *135.

[redacted] Hastings acknowledged that the price cut was due to increased pressure from Wal-Mart and others: "So it's Netflix up against Wal-Mart, Amazon, Blockbuster, and that gives anybody smart reason to worry. And it's why we're doing the price cut, it's why we're focused on growth, and it's why we're focused on extending our lead." (Ex. 61 at *710.) With the price cut announcement, Netflix's stock plunged, losing "more than a third of its value." (*Id*. at *709.) The next day, BBI turned up the heat, announcing that it immediately would lower its 3U price from $19.99 to $17.49/month. (Ex. 62.) [redacted]

[redacted] The motivation for initiating contact with one of his two major competitors is clear: "[L]et's think about what might get [Wal-Mart] as an anti-amazon partner. . . . [C]an we help them sell more against amazon if they help us rent more against amazon?" (Ex. 65.) Hastings intended to leverage the threat of Netflix entering new DVD sales to exclude a competitor (Wal-Mart) from DVDR, and reduce the number of competitors from three to two. [redacted]

Significantly, Netflix points to absolutely no evidence that Wal-Mart decided to exit DVDR prior to that October meeting initiated by Netflix. [redacted]

[redacted] Wal-Mart initially worried this might jeopardize its deal with Yahoo! (Weibell Ex. 62), [redacted]

[redacted] The same day that Wal-Mart lowered its price, Fleming explained that Wal-Mart's rental service was among its "very good businesses" that it was "focused on developing over the next year or two." (Ex. 79 at *941.) This sequence of events is plainly inconsistent with Netflix's litigation position that Wal-Mart "independently" decided to exit the market four days earlier on January 3, 2005. (Mot. at 13.) And so, the price war continued.

[redacted] But before it did so, Netflix decided to take one more shot at eliminating competition by persuading Wal-Mart to exit. On January 24, 2005, Hastings wrote to Fleming. (Ex. 85.) [redacted]

[redacted]

1 [redacted]

[redacted]

> [redacted]

[redacted] Netflix subsequently sold used DVDs but refrained from selling new DVDs. [redacted]

[redacted]

Hastings publicly acknowledges the positive impact on Netflix and, by extension, the negative impact on consumers, of going from a three-firm market to a two-firm market. On April 21, 2005, Hastings hinted at his motive for the still-not-publicly-announced deal with Wal-Mart, by stating that a three-firm market would result in smaller profits for Netflix (and thus lower prices for consumers). (Ex. 1 at *69.) Hastings, while knowing that Wal-Mart was about to exit, prognosticated that if the market were to become a two-firm market, profits could be substantial (at the expense of consumers who would be forced to pay supra-competitive prices). (*Id*.) [redacted] What he did not share is that consumers would suffer as Netflix profits rose due to the decreased competition.

A "Promotion Agreement" is announced and Wal-Mart exits the market. [redacted]

[redacted]

Prices stabilize and Netflix scales back its service. Thanks to the Wal-Mart deal, Netflix avoided the otherwise inevitable price drop to $16 for its 3U plan. [redacted]

[redacted] In the end, Netflix achieved its goal when BBI filed for bankruptcy on September 23, 2010. (Ex. 115.)

[redacted] Netflix kept prices for its service constant even though it now pays much less to obtain movies from the studios, and customers now have to wait an extra 28 days to get new releases.

III. STANDARD OF REVIEW

Summary judgment is appropriate only if the "movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). A genuine issue of material fact exists if "the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc*., 477 U.S. 242, 248 (1986). The party seeking summary judgment bears the burden of establishing that no genuine issue of material fact exists. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). When assessing a motion for summary judgment, a court must view the facts in the light most favorable to the non-moving party and draw all reasonable inferences in that party's favor. *Anderson*, 477 U.S. at 255. The trial court does not weigh conflicting evidence, judge the credibility of witnesses, or to determine the truth of the matter, but instead solely determines whether there is a genuine issue of triable fact. *See T.W. Elec. Serv., Inc. v. Pac. Elec. Contractors Ass'n.*, 809 F.2d 626, 630-32 (9th Cir. 1987).

Summary judgment is disfavored in complex antitrust cases that involve issues of motive or intent. *Id*. at 632. Courts must take special caution to give the plaintiffs "the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each." *In re Petroleum Prods. Antitrust Litig*., 906 F.2d 432, 441-42 n.2 (9th Cir. 1990) (quoting *Cont'l Ore Co. v. Union Carbide & Carbon Corp*., 370 U.S. 690, 699 (1962)) (internal quotation marks omitted).

IV. ARGUMENT

A. Defendants Entered into a Market Allocation Agreement that Unreasonably Restrained Trade in the DVDR Market

1. The Market Allocation Agreement Is *Per Se* Illegal

"A market allocation agreement between competitors at the same market level is a classic *per se* antitrust violation," *United States v. Brown*, 936 F.2d 1042, 1045 (9th Cir. 1991), and the Supreme Court has consistently held such agreements between *actual* or *potential* competitors to be *per se* unlawful. *See Palmer v. BRG of Ga., Inc.*, 498 U.S. 46, 49-50 (1990) (*per curiam*); *United States v. Topco Assocs*., 405 U.S. 596, 608 (1972); *see also Leegin Creative Leather Prods. v. PSKS, Inc*., 551 U.S. 877, 886 (2007) (describing market allocation as a *per se* offense). Such agreements are unlawful regardless of whether they allocate multiple markets or only a single market. *See In re Cardizem CD Antitrust Litig.*, 105 F. Supp. 2d 682, 701 (E.D. Mich. 2000), *aff'd*, 332 F.3d 896, 900 (6th Cir. 2003) (*per se* market allocation offense to keep potential competitor out of one market).[2] The identifying

[2] In its argument, Netflix overlooks that Plaintiffs state a *per se* market allocation claim where an agreement eliminates an actual or potential supplier in a single market or a competitor's access to a class of customers in a single market. *See, e.g., Engine Specialties, Inc. v. Bombardier, Ltd.*, 605 F.2d 1 (1st Cir. 1979) (*per se* unlawful market allocation for a maker of snowmobiles and a maker of minicycles to agree that the former would not enter the minicycle market as a manufacturer); *United States v. Gen. Electric Co*., No. CV 96-121-M-CCL, 1997 WL 269491 (D. Mont. Mar. 18, 1997) (government antitrust enforcement authorities stated a *per se* market allocation claim where agreements prevented potential competitor hospitals from competing with General Electric in the servicing of medical imaging equipment located at other medical facilities). In *Gerlinger v. Amazon.com, Inc*., 311 F. Supp. 2d 838, 851 (N.D. Cal. 2004), Judge Patel suggested that if evidence existed of a "separate and distinct 'online market segment,'" then plaintiffs raised a *per se* market allocation claim regarding an agreement under which Borders allegedly exited that market segment while transferring its customers to Amazon.com. Here, Netflix accepts that the "Online DVD Rental Market" is the relevant market. (Mot. at 3 n.2.)

(Continued...)

characteristic of an unlawful market allocation is that customers attempting to purchase products or services will have fewer firms competing for their business as a result of the agreement.

[redacted] There also is considerable evidence of a broader Market Allocation Agreement whereby Netflix and Wal-Mart agreed that Netflix would not sell DVDs in competition with Wal-Mart. Accordingly, there is both direct and circumstantial evidence of an unlawful agreement, which is more than sufficient to raise a genuine issue of material fact for the jury. *See Petroleum Prods*., 906 F.2d at 440-41 (discussing direct versus circumstantial evidence); *Petruzzi's IGA Supermarkets, Inc. v. Darling-Del. Co*., 998 F.2d 1224, 1230-34 (3rd Cir. 1993) (same).

a. *There is direct evidence of a market allocation agreement.*

A written contract unquestionably provides direct evidence of an agreement. *See Palmer*, 498 U.S. at 46 n.2, 49. The "Promotion Agreement," the written contract under which Wal-Mart agreed to exit DVD rentals and have its subscribers "transitioned" to Netflix, constitutes direct evidence of an unlawful market allocation. (Mot. at 7.) [redacted] Rather than accept this plain fact, Netflix contends that the Promotion Agreement cannot constitute an unlawful market allocation because it did not preclude Wal-Mart from re-entering DVDR. (Mot. at 22.) This contention is meritless. Even absent the significant barriers preventing Wal-Mart from simply re-entering the market, it is well-established that conspiracies under the Sherman Act are actionable upon their formation, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 244 n.9 (1940), and that abiding by the agreement, *for however long*, is similarly actionable. *See Brown*, 936 F.2d at 1044-45.

[redacted]

(...Continued)
Hence, the agreement whereby Netflix induced Wal-Mart to exit the "Online DVD Rental Market" while Netflix remained, is subject to a *per se* market allocation claim even in the absence of a *quid pro quo* with respect to some other market.

[redacted]

Moreover, in announcing the "Promotion Agreement," Defendants revealed the *quid pro quo* arrangement which resulted in the allocation of two markets (i.e., DVDR and new DVD sales). [redacted]

Wal-Mart and Netflix were actual competitors in the DVDR Market and potential competitors in the new DVD sales market. They then announced to the world that the companies had entered into an agreement whereby one (Netflix) would focus on one market (DVDR) and the other (Wal-Mart) would focus on the other market (new DVD sales). A reasonable juror could interpret this as an acknowledgement of a *quid pro quo* that Netflix would not sell new DVDs and Wal-Mart would not rent DVDs.

[redacted]

[3] [redacted]

[redacted] Unfortunately, what consumers got out of the deal was less competition in *both* markets.

[redacted] Further, Netflix conceded in the course of this litigation that the Wal-Mart deal was similar to the Amazon, Musicland and Best Buy deals. (Ex. 129.) [redacted]

b. *There is circumstantial evidence of a market allocation agreement.*

It has been long-established that, in Sherman Act cases, an agreement can be proved using only circumstantial evidence. *United States v. Champion Int'l Corp.*, 557 F.2d 1270, 1273 (9th Cir. 1977); *Indus. Bldg. Materials, Inc. v. Interchemical Corp.*, 437 F.2d 1336, 1343 (9th Cir. 1970). Such agreements need not be express or reduced to writing, but can be tacit. *United States v. Westinghouse Electric Corp.*, 471 F. Supp. 532, 536 (N.D. Cal. 1978), *aff'd in part, rev'd in part on other grounds*, 648 F.2d 642 (9th Cir. 1981) ("The defendants agree, as they must, that market allocations among horizontal competitors are illegal *per se* under Section 1 of the Sherman Act, and that if any of the parties did in fact have a tacit agreement not to compete in the United States, it would constitute a violation as the Government contends.") (citing *Topco*, 405 U.S. at 608).

Defendants had the motive, opportunity and *modus operandi* consistent with the allocation of the DVDR and new DVD sales markets alleged by Plaintiffs, which together offer sufficient circumstantial evidence to prove the existence of the Market Allocation Agreement even absent the direct evidence described above. *See Overseas Motors, Inc. v. Import Motors Ltd.*, 375 F. Supp. 499, 531-32 (E.D. Mich. 1974), *aff'd*, 519 F.2d 119 (6th Cir. 1975) (noting that conspiracies "are seldom capable of proof by direct testimony" and that circumstantial evidence of "motive, opportunity, and consistency of overt acts" can be used to infer collusion).

Netflix's Motive. Netflix had motive to exclude Wal-Mart from the DVDR, and Wal-Mart had motive to exclude Netflix from new DVD sales. In an email sent the same day he reached out to Fleming, Hastings explained to Kilgore the purpose for approaching Wal-Mart: "let's think about what might get [WMT] as an anti-amazon partner. . . . can we help them sell more against amazon if they help us rent more against amazon?" (Ex. 65.) [redacted] As discussed in more detail in Section IV(A)(2)(d) *infra*, Wal-Mart was a significant competitor in DVDR. Certainly, Netflix could have higher prices and greater profits if it could get Wal-Mart out of the market, as Hastings stated. (*See* Ex. 1 at *69.)

Wal-Mart's motive. [redacted]

[redacted]

Opportunity. [redacted] Thus, Defendants indisputably had the opportunity to allocate markets with respect to those core movie businesses (in fact, the language indicates that such an allocation actually occurred, not just that there was an opportunity).

Modus operandi. Most importantly, however, Netflix has a long history of approaching actual and potential competitors and trying to exclude them from the DVDR Market. [redacted]

Other circumstantial evidence. [redacted]

[redacted]

Netflix confuses the law and ignores Plaintiffs' evidence. Netflix largely ignores the wealth of circumstantial evidence raising the inference that Netflix and Wal-Mart allocated markets. Netflix also misstates the legal standard, claiming that "[i]n drawing factual inferences from circumstantial evidence, facts that are as consistent with lawful conduct as with a conspiracy are insufficient to defeat summary judgment." (Mot. at 10.) The law, however, is more nuanced than Netflix suggests:

> Nor do we think that *Matsushita* and *Monsanto* can be read as authorizing a court to award summary judgment to antitrust defendants whenever the evidence is plausibly consistent with both inferences of conspiracy and inferences of innocent conduct. Such an approach would imply that circumstantial evidence alone would rarely be sufficient to withstand summary judgment in an antitrust conspiracy case. After all, circumstantial evidence is nearly always evidence that is plausibly consistent with competing inferences.

See Petroleum Prods., 906 F.2d at 439. Judge Clark's dissent in *Palmer v. BRG of Georgia, Inc*., 874 F.2d 1417 (11th Cir. 1989)—a dissent that was embraced by both the Supreme Court in its *per curiam* opinion reversing the Eleventh Circuit panel opinion and the United States, as *amicus curiae,* 498 U.S. at 48 n.3 and n.4—emphasizes how misguided Netflix's argument is. He said that "*Matsushita's* holding is founded on the practical difficulties of differentiating between legitimate and illegitimate business practices (i.e. competitive pricing versus predatory pricing) when the plaintiff's asserted antitrust theory is speculative," 874 F.2d at 1430, and that it was "doubtful whether the standards announced in *Matsushita* and *Monsanto*" even applied in market allocation situations where "direct evidence of concerted action is manifest in explicit written agreements." *Id*. Assuming, contrary to fact, that Plaintiffs here advanced a novel theory and based their case *entirely* on circumstantial evidence, then, at most, they would only have to show circumstantial evidence that reasonably *tends* to exclude the possibility that defendants acted independently. *See In re High Fructose Corn Syrup Antitrust Litig*., 295 F.3d 651, 661-62 (7th Cir. 2002). The evidence assembled here tends to exclude the possibility that Defendants acted independently.

As for the two topics Netflix actually addressed—i.e., that "Netflix subscribers purchase[] a lot of DVDs" and "Netflix 'considered' selling new DVDs"—Netflix mischaracterizes Plaintiffs' arguments and the evidence. (Mot. at 10.) Although Netflix would like to portray its agreements with Best Buy and other potential DVD sales competitors as merely "promotions," the reality is that Netflix exited and never re-entered new DVD sales (despite having a great profit opportunity) as a result of a series of market allocation agreements which prevented it from doing so. *See supra* at Section IV(A)(1)(b). The fact that Netflix entered into the same type of market allocation agreement with Wal-Mart can reasonably be inferred from Netflix's explicit motive for approaching Wal-Mart (Ex. 65) (i.e., Netflix helps Wal-Mart sell more DVDs, Wal-Mart helps Netflix rent more)) [redacted]. All the same, nothing requires Plaintiffs to also prove, contrary to Netflix's argument, a "'conscious commitment to a common scheme' not to sell new DVDs" in order to survive summary judgment. (Mot. at 10.) Market allocation agreements are unlawful regardless of whether they allocate multiple markets or only a single market. *See Cardizem*, 105 F. Supp. 2d at 701.

c. *Netflix's argument the per se rule does not apply is spurious.*

Netflix's argues that the *per se* rule does not apply by suggesting an inapt analogy between the Promotion Agreement and a merger agreement. (Mot. at 11.) This argument gets Netflix nowhere, however, because what Netflix is trying to avoid is a trial. However, as the Supreme Court stated in *White Motor Co. v United States*, "in cases involving the question whether a particular merger will tend 'substantially to lessen competition', a trial rather than the use of summary judgment is normally necessary." 372 U.S. 253, 263 (1963) (citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 328-29 (1962). Moreover, the Supreme Court repeatedly has rejected the notion that horizontal market allocation agreements can escape the *per se* rule, and *Palmer*, 498 U.S. at 49, was decided after the authorities relied upon by Netflix were decided. (Mot. at 11.) *Per se* rules permit no debate about the potentially overlooked benefits of the proscribed acts. *See Ariz. v. Maricopa Cty. Med. Soc'y*, 457 U.S. 332, 343-55 (1982).

2. The Market Allocation Agreement Is an Unreasonable Restraint of Trade

Netflix's conduct violates Section 1 regardless of whether the assessment takes place under a "quick look" review or a traditional rule of reason analysis. Given the Promotion Agreement and Netflix's related conduct, which as explained, *supra*, constitutes market allocation (or, for sake of discussion in this section of the brief, something very much akin to market allocation), the restraint should be condemned via "quick look" review because it has "a great likelihood of anticompetitive effects," and because Netflix has not met its burden of putting forward empirical evidence of procompetitive effects.[4] *See Cal. Dental Ass'n v. Fed. Trade Comm'n*, 526 U.S. 756, 770-71 (1999).

Even under traditional rule of reason analysis, however, Plaintiffs can prove that Netflix's conduct imposes an unreasonable restraint on trade, and a jury should be allowed to so find. Appropriate factors to consider include specific information about the relevant business and the

[4] Netflix claims that "the average cost to a subscriber of a movie shipped or streamed plummeted from roughly $3 to $1" and that its subscriber numbers, which includes streaming-only customers, have increased 500%. (Mot. at 16.) But, as Netflix already conceded in its motion, the relevant market here is "the rental of DVDs online by subscription for delivery by mail in the United States." (*Id*. at 3, n.2.) So, these purported increases in output are irrelevant to the discussion at hand regarding this particular relevant market. Nor does Netflix's argument remedy the fact that each of these subscribers would rather pay $15.99/mo. rather than $17.99/mo. for their service. Furthermore, as discussed by Plaintiffs' expert Dr. John Beyer ("Dr. Beyer") and acknowledged by Hastings himself, the analysis cited by Netflix is flawed because it is wrong to equate streaming viewing time with DVD viewing time since there is a difference in what consumers are willing to pay for and they were not willing to pay for streaming until after the Class Period. (Exs. 141 at ¶¶ 19-25; 103-07; *id*. at ¶ 21 (quoting Netflix Earnings Conference Call Transcript, Q2 2009).) Even assuming *arguendo* that the average cost per movie shipped or streamed did decrease in 2007 (when Netflix first offered streaming), this is two years after both the Promotion Agreement and the start of the Class Period. (Mot. at 16 (citing to Weibell Ex. 29 ¶ 138) .) Thus, despite the fact that streaming is not even part of the relevant market, Netflix implicitly concedes almost two years of damages/impact to the Class.

challenged restraint's history, nature and effect, as well as whether the defendant has market power. *Leegin*, 551 U.S. at 885-86; *see also Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984) (equating the rule of reason with "an inquiry into market power and market structure designed to assess the [restraint's] actual effect").

There is no doubt that Netflix has market power, and it does not even attempt to argue otherwise. Evidence of supra-competitive prices is direct proof of market power and injury to competition. *Fed. Trade Comm'n v. Ind. Fed'n of Dentists*, 476 U.S. 447, 460-61 (1986). [redacted]

Market power can also be demonstrated by a firm's dominant share in a relevant market with significant barriers to entry. *Oahu Gas Serv., Inc. v. Pac. Res., Inc.*, 838 F.2d 360, 366 (9th Cir. 1988). [redacted] Courts routinely hold that defendants with such large market shares possess market power. *See, e.g.*, *Oahu Gas*, 838 F.2d at 366-67 (68% market share sufficient to establish market power); *Wilk v. Am. Med. Ass'n*, 895 F.2d 352, 360 (7th Cir. 1990) (market share greater than 50% sufficient to infer market power); IIB Areeda & Hovenkamp, *Antitrust Law* ¶ 532 (reasonable to presume that "high shares of a properly defined relevant market indicate individual firm [market] power"). The high barriers to entry in the DVDR Market are best illustrated by the fact that no new firm has entered the market despite Netflix's soaring profits. (*See* Ex. 141 at ¶ 26.) [redacted] Thus, it is indisputable that the fact-finder could reasonably conclude that Netflix possesses market power, and thus infer there was harm to competition.

The design and purpose of the rule of reason is to distinguish between restraints with anticompetitive effects from those that stimulate competition. *Leegin*, 551 U.S. at 886. Netflix's pattern and practice of eliminating all meaningful competition harms consumers instead of helping them. Netflix's explicit intent of restraining competition by getting Wal-Mart to exit and Amazon not to enter is also relevant to the analysis. *Cal. Dental*, 224 F.3d at 948.

According to Netflix, the Promotion Agreement did not hurt competition because Wal-Mart had no competitive significance in the relevant market. (Mot. at 12, 17-18.) But, then, as if to defeat the basic thrust of its argument, Netflix spends ten pages (of its 25-page brief) laboriously working through a myriad of "facts" to try and discount what is obvious from the face of the documents—Wal-Mart, with its vast resources and demonstrated ability to mount a steady and relentless attack—was viewed by Netflix and others as a competitive force. (*Id.*) By seeking to have the Court, rather than the finder of fact, endorse Netflix's spin on documents, Netflix impermissibly seeks to deprive Plaintiffs of "reasonable inferences" from the documents. This simply highlights that genuine issues of material fact need to be decided by the jury.

Furthermore, Netflix's assertions are not supported by the evidence. [redacted] Hastings acknowledged that Wal-Mart was at least in part responsible for the price cut which was announced on October 15, 2004: "So it's Netflix up against Wal-Mart, Amazon, Blockbuster, and that gives anybody smart reason to worry. And it's why we're doing the price cut, it's why we're focused on growth, and it's why we're focused on extending our lead." (Ex. 61 at *710.) [redacted]

a. *It can be presumed—as Netflix's CEO and experts have—that going from a three-firm to a two-firm market resulted in less competition.*

It is undisputed that market concentration increased after the Promotion Agreement, thereby suggesting an adverse effect on competition. (Ex. 142 ¶ 28 (describing and calculating market concentration for DVDR firms between 2005 and 2010).) In fact, Netflix's CEO [redacted] as much. (Exs. 147 at *69 (Hastings describing how Netflix would be more profitable if there were only two firms in the market); [redacted]; 148 at 4 (article co-authored by Coleman stating that "[i]t is probably in the mainstream of economics and antitrust that a merger in an industry with only three competitors in a well-defined market protected by barriers-to-entry is also likely to be problematic, absent convincing efficiencies or unusual facts."); [redacted])[5]

Going from three to two competitors not only reduces competition, but it makes tacit price collusion easier to accomplish. *See* IIB Areeda & Hovenkamp, *Antitrust Law* ¶ 532 (reasonable to presume that "high concentration indicates a significant danger of tacit price coordination among oligopolists, and vice versa."); [redacted]

[5] *See Colom. Metal Culvert Co. v. Kaiser Aluminum & Chem. Corp.*, 579 F.2d 20, 32 (3d Cir. 1978) ("departure of an independent producer in [a concentrated market] adversely affects competition"); *Kestenbaum v. Falstaff Brewing Corp.*, 575 F.2d 564, 571 (5th Cir. 1978) (increased concentration may be an indicator of anticompetitive effect).

b. *As a result of the market allocation agreement, Netflix stabilized prices at a supra-competitive level while reducing the quality of its DVDR service.*

Because it is well-settled that "[s]tabilizing prices as well as raising them is within the ban of §1 of the Sherman Act," the antitrust laws prohibit agreements that result in price increases, as well as those that prevent would-be-price decreases. *United States v. Container Corp. of Am.*, 393 U.S. 333, 337 (1969). Therefore, Netflix's assertion that it can avoid antitrust liability simply because it "did *not increase* its 3U price, but instead kept it the same level" after Wal-Mart's exit, is incorrect. (Mot. at 19.) In other words, the critical question is not "where's the price increase" but rather "what happened to all the price competition that existed *prior* to the Market Allocation Agreement?"[6]

The immediate result of the Market Allocation Agreement was the prevention of a price decrease that Netflix feared it would have to take but-for the agreement with Wal-Mart. In the midst of the price war, Netflix began modeling three different price changes it was actively contemplating for its 3U plan: $17, $16 and $15 (all of which were still profitable for Netflix). (Ex. 150.) [redacted]

In addition to the avoidance of a price decrease to $15.99, the Market Allocation Agreement further harmed consumers by a decrease in quality of the services they received. [redacted]

[6] Netflix's reliance on *Gerlinger v. Amazon.com Inc.*, 526 F.3d 1253 (9th Cir. 2008). is misplaced. (Mot. at 16.) In *Gerlinger*, the defendant Amazon presented affirmative evidence that the plaintiff paid lower prices as a result of the challenged agreement, which included a term obliging Amazon not to charge more to shoppers directed from Borders' website. *Id.* at 1255. The plaintiff was invited to provide evidence to rebut Amazon's evidentiary showing, but chose not to provide any evidence other than some academic articles. *Id.* Plaintiffs in the instant matter have substantial evidence that the Market Allocation Agreement stabilized prices in the DVDR Market and, specifically, prevented Netflix from having to take the $15.99 price cut on its 3U plan that it was otherwise going to be forced to take. In addition, Plaintiffs' expert, Dr. Beyer, opined that "[b]ut-for Wal-Mart's exit from the market, prices charged to Netflix subscribers from May 2005 until at least September 2010 would have been lower." (Ex. 141 at ¶ 6e.)

[redacted] But not making new releases available is exactly what happened: Netflix was able to negotiate better deals with the studios and, instead of passing these savings onto subscribers by lowering monthly rates, subscribers instead got the "benefit" of waiting an extra 28 days before they could rent new releases. This was a drastic decrease in value with no corresponding price reduction. In January 2010, Netflix began delaying the availability of certain new releases to its subscribers for 28 days beyond the traditional DVD rental release date. (Ex. 151.) This 28-day delay was extended to even more studios in April 2010. (Ex. 152; [redacted]

Therefore, a reasonable juror could easily conclude that the Market Allocation Agreement enabled Netflix to escape the price war and stabilize prices (avoiding an otherwise inevitable price cut to $15.99 on its 3U plan), and resulted in a reduction in service quality.

c. *Wal-Mart's exit was neither unilateral nor independent.*

Netflix argues that the Market Allocation Agreement could not have affected competition in the DVDR Market because Wal-Mart had already unilaterally and independently decided to exit on January 3, 2005. (Mot. at 13.) This argument is meritless for multiple reasons: (i) any decision on January 3 can hardly be deemed "independent" when two months prior, Netflix had already approached Wal-Mart and pitched the Market Allocation Agreement; [redacted]

[redacted] Netflix tries to escape this undisputed fact by asserting that Fleming told Hastings Wal-Mart was not interested and there were no plans for further discussion or follow up. (Mot. at 13.) [redacted]

[redacted] More importantly, Netflix's argument cannot change the fact that the market allocation option was already proposed; Netflix points to absolutely no evidence that Wal-Mart decided to exit DVDR prior to that October meeting initiated by Netflix. Therefore, even assuming *arguendo* that Wal-Mart had decided to exit on January 3, 2005, such a decision could hardly be considered "independent."

Nonetheless, a decision to exit clearly was *not* made at the January 3 meeting. Following that meeting, Sussman sent an email on January 12, 2005 to Wal-Mart's Carter Cast, Steve Nave and Kevin Swint ("Swint"), in which he noted that he was putting together an analysis that "reviews the shutdown option and all of its implications." (Ex. 155 at *6095.) A shutdown "option" is clearly and unequivocally *not* a shutdown "decision."

The lack of an exit decision is also evidenced by Wal-Mart's continued commitment to competing in the DVDR Market following that January 3 meeting. [redacted] This demonstrates that Wal-Mart continued to actively compete, and contradicts the notion that Wal-Mart had made a decision to exit. Further direct evidence that Wal-Mart had not decided to exit the business is found in a January 7, 2005 CNBC interview of John Fleming who explained that Wal-Mart's rental service was among its "very good businesses" that Wal-Mart "is focused on developing over the next year or two." (Ex. 79 *941.)

Moreover, even if Walmart.com executives had wanted to make a final decision on January 3 to shut down the DVDR business, they could not have done so. [redacted]

Netflix also claims that Wal-Mart decided to exit DVDR as a result of the BBI price cut on December 22, 2004, which made the Yahoo! deal that Wal-Mart was contemplating at the time not viable. (Mot. at 14.) This, too, is wrong. [redacted]

[redacted] This was a critical and express element of Wal-Mart's analysis that Netflix conveniently ignored. (*See* Weibell Ex. 62 (noting that, while the "Yahoo deal is at risk," the primary issue here is to find out if BBI's price cut was a temporary promotion).) [redacted][8]

Netflix cites as further evidence a reserve that Wal-Mart took at the end of its fiscal year. (Mot. at 14.) [redacted] Netflix argues that Wal-Mart did not disclose that it was going to exit (instead using it as a bargaining chip in negotiations), and that the "documents reflect the fact that Netflix did not know about Walmart's prior, independent decision to exit." (Mot. at 15.)

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[7] [redacted]

[8] *See also* Ex. 26 at ¶¶ 38-71 (analyzing Wal-Mart's marketing strategies and concluding that a sudden decision to exit as a result of the December 2004 BBI price reduction was inconsistent with those strategies and the fact that price competition is one of Wal-Mart's greatest strengths).

[redacted] Similarly, Netflix throughout its Motion, raises the red herring that Netflix in 2005 did not consider the announcement of the Promotion Agreement to be "material." (Mot. at 19-20.) This was another dodge set up to try and shield Netflix from antitrust scrutiny. [redacted]

d. *Despite its market share, Wal-Mart was a feared competitor in the DVDR Market.*

Netflix and its experts argue that Wal-Mart's exit from the market, and the corresponding increase in market concentration, did not adversely affect competition because Wal-Mart was an "entirely insignificant" competitor. (Mot. at 16.) This is demonstrably false, and Netflix's argument is belied by the words and actions of its executives, as well as those of other industry participants.

Despite all of its claims regarding Wal-Mart's supposed insignificance, Netflix cannot explain away one inconvenient question:

If Wal-Mart was such an insignificant competitor, why was Netflix trying so hard to get it to exit the market?

[redacted]

Netflix's argument is also inconsistent with both public and internal assessments of Wal-Mart as a competitor. [redacted]

[redacted] Hastings now says that, by September 2003, it was clear to him "that Walmart.com's DVD rental service was competitively insignificant and not a threat to [Netflix.]" (Hastings Decl. ¶ 9.) [redacted] Hastings' current position notwithstanding, in actuality, Netflix considered Wal-Mart a viable competitor in the DVDR Market up until the very end.

[redacted]

Similarly, Netflix's insistence that Wal-Mart's small market share and purportedly slow start made it "insignificant as a competitor" (Mot. at 16-18), is undermined by Netflix's assertion that it was concerned about competition from, and reduced price in response to, Amazon—a company that never entered the relevant market and had a zero percent share. (*Id.* at 3; *see* Ex. 61 (Netflix publicly acknowledging that it cut prices as a response to competition from "Wal-Mart, Amazon, [and] Blockbuster").) [redacted]

Give all of these statements, as well as Netflix's relentless efforts to get Wal-Mart to exit the DVDR Market, Wal-Mart's significance as a competitor is, if not conclusively established, at least a question for the jury to resolve.

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9 [redacted] Amazon similarly viewed Wal-Mart as a key competitor in the Online DVD Rental Market. (Exs. 172 at 180:18 - 181:2.)

e. *Wal-Mart was poised to rapidly grow its subscriber base.*

Given Netflix's dogged pursuit of Wal-Mart's exit, it is self-evident that Wal-Mart's subscriber base was not an accurate reflection of its competitive significance. Nonetheless, it is important to remember that Wal-Mart's DVD rental business was still young when Netflix approached Wal-Mart and offered the *quid pro quo* which resulted in the Market Allocation Agreement. It would be unrealistic to expect even a competitor as fierce as Wal-Mart to open its doors and immediately be profitable. Netflix took five years to turn a profit, finally posting a net income of $6.5 million for the year ending December 31, 2003. (*See* Ex. 173 at 11; *see* Ex. 174 at 115:8-15 (it was also understood by potential competitor Amazon that it would take at least four years to become profitable in DVD rental).)[10]

Wal-Mart successfully reached certain milestones more quickly than it took Netflix to achieve the same milestones. [redacted]

At the time Netflix approached Wal-Mart in late-2004 with the option of a *quid pro quo* that became the Market Allocation Agreement, [redacted]

[10] Netflix argues that Wal-Mart's Online DVD Rental business failed due to insufficient resources. (Mot. at 16-17.) [redacted]

[redacted] Netflix incorrectly states that the Yahoo! transaction required over 50,000 subscribers. (Mot. at 14.) [redacted] Accordingly, absent the Market Allocation Agreement, it is likely that Wal-Mart would have remained a significant competitor in DVDR.

B. Netflix Illegally Acquired, Maintained & Abused Its Monopoly Power in the DVDR Market

Netflix is not the passive beneficiary of a monopoly in DVDR, naturally conferred upon it by competitive forces as a result of superior business ability and efficiency. Quite the opposite is true: Netflix willfully acquired and maintained a monopoly through a series of unlawful agreements specifically designed to exclude competition by whatever means necessary. Such behavior harms competition and violates Section 2 of the Sherman Act. *See Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 596-601 (1985); *see also United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 116 (1975) ("The central message of the Sherman Act is that a business entity must find new customers and higher profits through internal expansion—that is, by competing successfully rather than by arranging treaties with its competitors."); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 428-29 (2d Cir. 1945) ("*Alcoa*") (monopolies are lawful only when "thrust upon" the party; monopolies that are "achieved" violate Section 2 of the Sherman Act).

1. Netflix Is An Unlawful Monopolist Because It Acquired Its Market Power Through a Series of Anticompetitive Agreements (as Opposed to Relying on Its Purportedly Superior Service)

To establish a monopolization offense, Plaintiffs must prove: (1) that Netflix possessed "monopoly power in the relevant market" and (2) that Netflix willfully acquired or maintained that power "as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966). The first element of the offense is easily proven because Netflix expressly conceded the relevant market (Mot. at

3 n.2) and it does not contest that it has a 70% (or greater) share of that market, thereby establishing its possession of monopoly power. (Ex. 142 ¶ 28.) *See Am. Tobacco Co. v. United States*, 328 U.S. 781, 797 (1946) (over two-thirds of the market is a monopoly); *Oahu Gas*, 838 F.2d at 366-67 (68% market share sufficient to establish monopolization).

Netflix instead argues that there is no evidence to establish the second element of the offense because the conduct leading to the Promotion Agreement and Wal-Mart's exit was not anticompetitive. (Mot. at 23-24.) As shown in Section II, *supra*, Plaintiffs have cited substantial evidence that Netflix has engaged in a course of conduct specifically designed to exclude actual and potential competitors in the DVDR Market by means other than the efficiency/superiority of its service. *See LePage's Inc. v. 3M*, 324 F.3d 141, 147 (3d Cir. 2003) ("A monopolist willfully acquires or maintains monopoly power when it competes on some basis other than the merits.") (en banc); *Aspen*, 472 U.S. at 605 (a firm's conduct can be fairly characterized as predatory or exclusionary if designed to exclude rivals on some basis other than efficiency). Plaintiffs have established an anticompetitive course of conduct that extends not just to the Market Allocation Agreement with Wal-Mart, but a whole series of predatory market allocation agreements between Netflix and Amazon, Musicland and Best Buy that have allowed Netflix to acquire and maintain monopoly power. (*See supra* at IV(A)(1)(b).) A firm that decides to exclude competition through a series of treaties with its competitors violates Section 2 of the Sherman Act. *Citizens*, 422 U.S. at 116.

In *Grinnell*, the Court found that defendant violated Section 2 because it engaged over time in a series of market allocation agreements and acquisitions to build and maintain its "empire." 384 U.S. at 571, 576; *see* IIB Areeda & Hovenkamp, *Antitrust Law* ¶ 703d ("If Alpha Company pays Beta, a threatening potential entrant, to stay out of Alpha's market, the result could leave Alpha as the only firm in the market, or could delay or hinder the development of competition in that market. As a result, even the unaccepted solicitation to divide a market could make out the conduct elements of a monopoly maintenance or attempt to monopolize offense and lead to illegality if the structural conditions are met"). Even the cases cited by Netflix show that while a so-called "acquisition" is not *necessarily* predatory conduct, it *certainly can be* if "'the acquisition was undertaken in order to acquire or maintain a monopoly position and prevent competition.'" (Mot. at 23-24 (citation omitted).) *See* IIB Areeda &

Hovenkamp, *Antitrust Law* ¶ 701c ("Acquisition of any firm with nontrivial potential as a substantial rival serves to maintain monopoly power"; "***To find a §2 monopoly is necessarily to declare the preciousness of any viable rival***.") (emphasis added).

Plainly, "evidence of intent is . . . relevant to the question of whether the challenged conduct is fairly characterized as 'exclusionary' or 'anticompetitive' . . . or 'predatory.'" *Aspen*, 472 U.S. at 602. *See also Alcoa*, 148 F.2d at 431-32 (finding Section 2 violation where plaintiff "show[ed] that many transactions, neutral on their face, were not in fact necessary to the development of [defendant's] business, and had no motive except to exclude others and perpetuate its hold upon [relevant] market"). Plaintiffs have provided evidence of Netflix's stated desire to transform DVDR into a two-firm market in order to reap greater profits (Ex. 147 at *69), [redacted]

2. Netflix Attempted to Monopolize the Relevant Market Through Predatory Conduct Aimed at Eliminating All Actual and Potential Competitors

For their attempt to monopolize claim, Plaintiffs must (and can) prove: "that (1) the defendant engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize, and (3) a dangerous probability of achieving monopoly power." *Spectrum Sports v. McQuillen*, 506 U.S. 447, 456 (1993). As noted already, Netflix conceded the relevant market and does not contest that it has a 70% (or greater) share of that market, thereby establishing that it has a dangerous probability of attaining monopoly power (if it does not already possess it). (*See* Section IV(B)(1), *supra*.)

As for the second element, Plaintiffs have evidence that Netflix had a "specific intent to destroy competition or build a monopoly." *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 626 (1953). Such evidence consists not only of the Market Allocation Agreement, but a series of market allocation agreements specifically designed at excluding actual and potential competitors by means other than price, service, efficiency, etc. (*See supra* at IV(A)(1)(b).) Improper exclusion—i.e., exclusion not the result of superior efficiency—is always deliberately intended and can be inferred from Netflix's anticompetitive conduct alone. *Aspen*, 472 U.S. at 603; *Twin City Sportservice, Inc. v. Charles O.*

Finley & Co., 676 F.2d 1291, 1309 (9th Cir. 1982). Thus, Plaintiffs can establish all three elements of their attempt to monopolize claim.

3. Netflix Conspired to Monopolize the Relevant Market by Entering Into a Series of Agreements with Actual and Potential Competitors

Defendants entered into a conspiracy to monopolize the market in violation of Section 2 of the Sherman Act, which requires: (1) a combination, conspiracy, or agreement; (2) specific intent to monopolize; and (3) an overt act to further the conspiracy. *Paladin Assoc., Inc. v. Mont. Power Co.*, 328 F.3d 1145, 1155 (9th Cir. 2003) (citing *United States v. Yellow Cab Co.*, 332 U.S. 218, 224-25 (1947)). These elements are also easily satisfied here.

[redacted] Netflix's specific intent to monopolize is manifest in the host of documentary evidence and testimony showing that for a decade or more Netflix specifically intended to develop and preserve a monopoly in on-line DVD rentals by forming agreements with potential competitors that they would not enter the relevant market (*e.g.*, Best Buy, Amazon, Musicland), and with actual competitors that they would exit the relevant market (Wal-Mart). (*See supra* at IV(A)(1)(b).) Through these overt acts, Netflix intended to keep Online DVD Rental prices higher than they would have been if competition had been allowed to flourish, and Wal-Mart and others conspired with Netflix to attain this objective.

V. CONCLUSION

For the foregoing reasons, Netflix's motion for summary judgment should be DENIED.

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Respectfully submitted,

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