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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 (JCS) MDL No. 2029 Hon. Phyllis J. Hamilton **DEFENDANT NETFLIX'S NOTICE OF MOTION AND MOTION FOR SUMMARY JUDGMENT**
This document relates to: ALL ACTIONS	Date: August 31, 2011 Time: 9:00 a.m.

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TABLE OF ABBREVIATIONS

Netflix	Netflix, Inc.
Walmart	Defendants Wal-Mart Stores, Inc. and Walmart.com, LLC, collectively
Walmart.com	Defendant Walmart.com, LLC
PA	The May 2005 Promotion Agreement submitted herewith as Ex. 1
VC	Indicates that a video clip can be viewed for the deposition excerpt cited by clicking on the hyperlink on the CD-ROM version of this document
1C (or 2C)	One-at-a-time (or two-at-a-time) DVD rental subscription plan capped at 2 (or 4) DVDs per month
1U, 2U, 3U, 4U	Unlimited DVD rental subscription plans with one-out, two-out, three-out, or four-out at a time, respectively
BBI	Blockbuster, Inc.
Compl.	Consolidated Amended Class Action Complaint, ECF No. 22
DVDR	DVD rental
Hastings Decl.	The Declaration of Reed Hastings submitted herewith
Hyman Decl.	The Declaration of David Hyman submitted herewith
Weibell Decl.	The Declaration of Anthony Weibell in Support of Netflix's Motion for Summary Judgment, Motion to Exclude the Testimony of John Beyer, and Motion to Exclude the Testimony of Gregory Gundlach, submitted herewith

NOTICE OF MOTION AND MOTION

PLEASE TAKE NOTICE that on August 31, 2011, at 9:00 a.m. in the courtroom of the Hon. Phyllis J. Hamilton, Courtroom 3, United States District Court, Northern District of California, 1301 Clay Street, Oakland, California, Defendant Netflix, Inc. ("Netflix") will and hereby does move pursuant to Federal Rule of Civil Procedure 56 for summary judgment in its favor on all claims asserted in all actions in this multidistrict litigation. The motion is based on this Notice of Motion and Motion, the Memorandum of Points and Authorities, the Declaration of Anthony Weibell, the Declaration of Reed Hastings, the Declaration of David Hyman, the pleadings and papers on file in this action, and any other submissions or arguments of counsel as may be presented to the Court.[1]

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION AND SUMMARY OF ARGUMENT

Plaintiffs claim that, in 2005, Netflix and Walmart entered into a "market allocation" agreement under which Netflix agreed not to sell new DVDs and Walmart agreed not to compete in the business of renting DVDs online. Massive and costly discovery over the past two years has demonstrated that there is no evidence to support any such claim.

There is no evidence of any agreement to allocate markets. In the May 2005 Promotion Agreement ("PA") (Ex. 1), Netflix agreed to take over the subscriptions of those Walmart online DVD rental subscribers who desired to switch upon Walmart's exit of the business. But there is no evidence – literally none at all – that Walmart and Netflix ever *discussed*, let alone agreed on, whether Netflix would sell new DVDs. The evidence is uncontroverted, moreover, that Walmart decided *independently* to close its online DVD rental service prior to any agreement with Netflix. To that end, Walmart, without telling Netflix or anyone else, set up a formal reserve on its books for the closure as of January 31, 2005. The simple reason for Walmart's unilateral decision to exit was that its online DVD rental business had failed and, in fact, had been a failure from the start. Walmart's DVD rental business never received the support it desperately needed from

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[1] References to "Ex. __" refer to exhibits to the Weibell Declaration unless otherwise stated.

Wal-Mart Stores, Inc., and it had less than 50,000 subscribers – less than 1.5% of online renters – when it made its decision to shut down in January 2005.

Plaintiffs argue that, even without "market allocation," Walmart's exit itself harmed competition. But the objective, undisputed facts demonstrate beyond doubt that competition was not reduced in the slightest. Since Walmart's exit, prices have declined, quality (such as delivery speed) has improved, innovative features such as streaming have been added, and output has increased dramatically. The average cost to a subscriber of a movie shipped or streamed has decreased from roughly $3 to $1. Output has increased over 700%.

Plaintiffs' own expert conceded that Walmart was so insignificant in online DVD rental that neither Netflix nor Blockbuster ever responded competitively to Walmart by lowering prices or otherwise. On the contrary, Netflix's first price change following Walmart's entry into online DVD rentals was a price *increase* in June 2004. Amazon, similarly, paid no attention to Walmart in deciding whether or not to enter the online DVD rental business.

Walmart's impact was so trivial that Netflix felt compelled to issue a press release alerting the public that the PA was not a material event for investors. And the consequent lack of any potential harm to competition led the Federal Trade Commission and, later, two state attorneys general to abandon any investigation of the transaction. This, then, appears to be the first case in history to challenge a transaction not only deemed benign by government antitrust officials, but specifically announced to the investing public as immaterial.

Plaintiffs cannot demonstrate "market allocation," or impact on competition, or injury-in-fact. Summary judgment should be entered in favor of Netflix accordingly.

II. STATEMENT OF THE CASE

A. PLAINTIFFS' ALLEGATIONS

Although the PA was publicly announced by Walmart and Netflix in May 2005, Plaintiffs waited almost four years, until January 2009, to file this case. Their Complaint alleges four causes of action, all under Sections 1 or 2 of the Sherman Act, 15 U.S.C. §§ 1-2. ECF No. 22 ¶¶ 74-92. Plaintiffs allege that the "Online DVD Rental Market" is the relevant market for purposes of their antitrust claims, defined as "the rental of DVDs online by subscription for delivery by mail in the United States." *Id.* ¶ 27.[2] The Complaint alleges that Netflix and Walmart "entered into an illegal anticompetitive agreement (the 'Market Allocation Agreement') to divide the market for sales and online rentals of DVDs in the United States." *Id.* ¶ 2. Plaintiffs assert that Walmart had a "strong motive" to conspire with Netflix, because "it obtains substantial revenues from sales of new DVDs." *Id.* ¶ 20. The Complaint further alleges that Walmart would not have wanted to exit online DVD rental and transfer its subscribers to Netflix "absent substantial consideration from Netflix, such as an agreement not to compete for new DVD retail sales." *Id.* ¶ 57.

Plaintiffs claim that they were harmed by the alleged "anticompetitive activity" because they purportedly "paid higher subscription prices to Netflix than they otherwise would have paid." *Id.* ¶ 60. According to Plaintiffs, the alleged "Market Allocation Agreement" allowed Netflix's prices to be "maintained at artificially high and supracompetitive levels." *Id.* Plaintiffs' economic expert opined that, absent the PA, Netflix would have lowered the price of its 3U subscription to $15.99 at some unstated point prior to May 2005, and would have maintained that price through September 2010. Ex. 25 ¶ 78.[3]

B. STATEMENT OF FACTS

Initial years. Netflix was founded in 1997 as an online service to deliver movies and other video entertainment to consumers. Hastings Decl. ¶¶ 2-3; Ex. 32 at 1, F-7. Initially, Netflix offered DVD-by-mail rentals under a pay-per-rental model ($4 per rental plus tax), and also sold DVDs as well. Hastings Decl. ¶ 3. At first, Netflix's business model was not particularly successful, and its co-founder, Reed Hastings, then assumed the role of Chief Executive Officer in late 1998. Hastings Decl. ¶ 3. One of his first actions as CEO was to recommend that Netflix stop selling new DVDs, because he had concluded that Netflix needed to

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[2] For purposes of this motion only, Netflix assumes *arguendo* that this is a relevant antitrust market, but does not otherwise waive its objections to Plaintiffs' market definition.

[3] Subscription plans are referred to by the number of DVDs out at a time and whether the user could get unlimited DVDs in a month or whether there was a monthly cap on the number of DVDs. *E.g.*, a "3U" plan is a 3-DVD-out-at-a-time, unlimited plan. A "2C" plan is a 2-DVD-out-at-a-time, capped plan, limited to four rentals per month.

focus its business on developing and offering a quality online DVD rental business. *Id.* ¶ 4; *see also* Ex. 2 at 34:14-35:3 (VC). Hastings also believed that DVD sales would be a distraction in an area in which Netflix had no competitive advantage and faced formidable and larger competitors, such as Amazon. Hastings Decl. ¶ 4. Netflix discontinued new DVD sales in 1999, and also changed to a subscription rental model rather than pay-per-rental. *Id.* ¶ 5. Netflix quickly became popular with consumers and began experiencing robust growth.

After deciding to stop selling new DVDs, Netflix entered into promotional arrangements with several major sellers of new DVDs and DVD players. Hastings Decl. ¶ 6. For example, in 1998, Netflix agreed to promote sales of DVDs by Amazon, and Amazon agreed to promote Netflix on the Amazon website. *Id.* When that agreement terminated, Netflix entered into an agreement with Musicland providing for Musicland's promotion of rentals through Netflix and Netflix's promotion of DVD sales by Musicland. *Id.* In 2001, Netflix entered into a similar arrangement with Best Buy. *Id.*; Ex. 33. After termination of the 1998 Amazon agreement (which specifically precluded new sales), there was no contractual impediment to the sale of new DVDs by Netflix. Hastings Decl. ¶ 7. Nor did Netflix ever have any informal understanding with anyone that Netflix would not sell new DVDs. *Id.* Since 1999, Netflix's CEO has continuously held the strong belief that Netflix should not be in the business of selling new DVDs, and, although the subject has come up from time to time, Netflix never seriously considered it. *Id.*; Ex. 3 at 319:8-321:13 (VC), 327:2-329:22.

Walmart enters. In June 2003, Walmart launched its own online DVD rental service. Ex. 34. The price for Walmart's 3U plan at the time of launch was $18.76/month, lower than Netflix's 3U plan, which was priced at $19.95/month. Ex. 29, App. 1. Its entry had no competitive impact. Netflix did not lower prices in response, and, in fact, Netflix's first price change thereafter was to *increase* the price on its 3U plan to $21.99 in June 2004. *Id.*; Hastings Decl. ¶¶ 9-11. Netflix executives observed consistently that Walmart's online DVD rental service was insignificant and not a threat to Netflix: Walmart had inadequate service levels and catalogue depth, and Netflix's analysis of its cancellation data confirmed that Walmart was not a factor in subscribers' decisions to cancel their Netflix service. Hastings Decl. ¶ 9; Ex. 35 at *580

(Walmart's "[c]ustomers state[d] they would rather pay the $1 or $2 more a month with Netflix and get the guaranteed 1 to 2 day delivery turnaround" and found the site "not customer friendly"); Ex. 36 ("Decreasing delivery times is the number one thing that we can do to make our customers happier and minimize attrition rates" and "[o]ur main competitor has 30 DCs and reaches 75% of the country by 1 day mail. We are currently at 20%"); Ex. 37 at 1-2; Ex. 38 at *928; Ex. 4 at 174:19-176:8; *see also infra* Section III.B.2.b.

BBI and the threat of Amazon entry. In August 2004, BBI entered the online DVD rental business, offering a 3U plan at $19.99 that also included 2 free monthly coupons for in-store rentals. Ex. 39. In October 2004, concerned by seemingly reliable reports that Amazon.com was about to enter online DVD rental, Netflix slashed its price for the 3U plan from $21.99 to $17.99. Ex. 40; Ex. 41; Ex. 42; Hastings Decl. ¶¶ 13, 16. Shortly thereafter, Walmart lowered its 3U price to $17.36, and BBI lowered its price to $17.49. Ex. 29, App. 1. The evidence is uncontroverted that Walmart was not a factor in Netflix's decision to reduce price. *See, e.g.*, Ex. 40; Ex. 41; Ex. 42; *see also* Hastings Decl. ¶ 15.

October 2004 meeting. On October 27, 2004, Hastings met with John Fleming, the CEO of Walmart, in pursuit of an alliance to improve Netflix's ability to compete against Amazon. Hastings Decl. ¶¶ 17-19; Ex. 43. Hastings believed that Walmart could see that its online DVD rental service was not gaining traction, and he suggested developing an arrangement that would help Walmart to compete with Amazon in sales of DVDs, while helping Netflix to compete against Amazon in online DVD rentals. Hastings Decl. ¶ 17; Ex. 43. Hastings also sought to gauge whether Walmart might be looking for a suitor to acquire its rental subscriber base. Hastings Decl. ¶ 17; Ex. 2 at 170:18-171:21 (VC). However, Fleming informed Hastings at that meeting that Walmart was not interested in pursuing any potential transaction with Netflix. Ex. 2 at 171:22-172:6 (VC). No agreement was reached, and there was no plan for follow up. *Id*; Ex. 22 at 78:3-17; Hastings Decl. ¶ 19. During the course of that meeting, the subject of new DVD sales by Netflix never came up. Hastings Decl. ¶ 19; Ex. 7 at 20:5-21:6 (VC).

Walmart decides to exit. At the time of the October meeting, Walmart was pursuing a different partnership – one with Yahoo!. It realized that its online DVD rental business was failing. Ex. 8 at 121:16-122:12; Ex. 9 at 14:3-15 (VC). Its subscriber base had never gone above 60,000 subscribers – compared to over 2 million for Netflix and over 400,000 for BBI as of December 2004 – and was in decline. Ex. 29 ¶¶ 23, 32, 41. In addition to the Yahoo! arrangement, it was also considering just exiting the business. Ex. 10 at 127:12-128:8.

On December 22, 2004, BBI announced a dramatic price cut, reducing the price of its 3U plan to $14.99. Ex. 44. Already a fast-growing competitor, BBI hoped that the lower price would increase its subscriber growth even more. Ex. 14 at 194:20-195:8. Netflix, however, chose to keep its 3U plan price at $17.99. Ex. 29, App. 1. Walmart was not a factor in either BBI's decision or Netflix's. Ex. 45; Ex. 46 at *698; Ex. 15 at 347:3-14.

The BBI price cut was devastating to Walmart.com. As Mr. Fleming put it, the price cut "changed the world for us" by "[taking] all the economics out of it," and became "the tipping point for we gotta get out of this." Ex. 7 at 249:15-251:20 (VC). It effectively ended Walmart's ability to consummate the marketing partnership it had been negotiating with Yahoo!. Ex. 9 at 16:10-24; *see also* Ex. 47; Ex. 48. Walmart would have had to lower its price to compete with BBI and, under all projected scenarios, this would have led to heavier losses in subscribers and revenue. Ex. 49. On January 3, 2005, at a meeting of senior executives, Walmart made the decision to exit the online DVD rental business. Ex. 7 at 23:4-9 (VC), 30:8-11 (VC); Ex. 50; Ex. 9 at 24:17-19 (VC); Ex. 13 at 121:11-122:12 (VC). As one of the steps in the shutdown, Walmart decided to "have conversations with BBI and NFLX to figure out what subs are worth and disc salvage value is." Ex. 50. Walmart made this decision independently, and not as a result of any discussions or agreements with Netflix. Ex. 7 at 33:2-11. At the time of the January 3, 2005 shutdown decision, there were no discussions occurring between Netflix and Walmart. Hastings Decl. ¶¶ 23-24; Ex. 7 at 21:7-16, 37:10-14; Ex. 22 at 79:6-13. Walmart recorded a formal financial reserve on its books to cover the losses from the closure effective January 31, 2005 (the end of its fiscal year). Ex. 7 at 32:6-33:1; Ex. 51; Ex. 9 at 26:1-13.

Promotion Agreement. The next substantive communication between Hastings and Fleming was on February 9, 2005. Hastings Decl. ¶ 24; Ex. 7 at 21:7-16, 37:10-14. Hastings renewed his approach to Fleming notwithstanding Fleming's prior rejection because he believed that recent changes in the business might lead Walmart to change its mind. Hastings Decl. ¶ 23. During their February 9 meeting, in order to preserve bargaining leverage, Fleming did not communicate to Hastings that Walmart had already decided to leave the online DVD rental business. Ex. 7 at 36:13-38:2 (VC); Ex. 52; Ex. 53 at 1. No agreement was reached during that meeting, but Fleming expressed willingness to continue discussions. Hastings Decl. ¶ 25.

By March 17, 2005, Hastings and Fleming reached a verbal agreement in principle. Hastings Decl. ¶ 27; Ex. 54. The agreement provided that Walmart DVD rental subscribers would be transitioned to Netflix if they so chose at the same price as their Walmart subscription, and Netflix would import their rental selection "queues." Hastings Decl. ¶ 27. Netflix would pay Walmart for each subscriber that elected to transfer or who was referred via promotions on the Walmart website. *Id.* Finally, Netflix would provide some limited promotion for Walmart DVD sales. *Id.*; Ex. 54. The agreement in principle included nothing regarding sales of DVDs by Netflix. There were no covenants not to compete. Hastings Decl. ¶¶ 28-29; Ex. 54. Walmart remained free to re-enter online DVD rentals at any time. Hastings Decl. ¶¶ 28-29.; Ex. 1 § 3.14; Ex. 7 at 43:3-20.

Between March 2005 and May 2005, Netflix's Jessie Becker worked with Walmart to finalize the details of the agreement. Hastings Decl. ¶ 27; Ex. 5 at 127:19-129:20. The final written agreement mirrored the terms of the verbal agreement: there were no covenants not to compete; nothing in it even addressed (much less prohibited) new DVD sales by Netflix; and nothing restricted Walmart from offering an online DVD rental service. Ex. 1. Netflix agreed to pay a 10% revenue share to Walmart for each subscriber who transferred to Netflix, and a $36 bounty for each new subscriber Netflix gained via a referral from Walmart. *Id.* at 5 §§ 3.12, 4.2. The PA was publicly announced May 19, 2005. Ex. 55. Later the same day, Netflix issued a separate press release warning investors that the PA was not a material event due to the small number of Walmart subscribers. Hastings Decl., Ex. A.

Shortly after the announcement of the PA, the Federal Trade Commission conducted a preliminary inquiry to determine whether there were grounds for a formal investigation of the Promotion Agreement. Hyman Decl. ¶¶ 3-5. Netflix spoke with the FTC investigator and explained the circumstances of the PA, including the competitive insignificance of Walmart and the lack of any restrictions on the businesses of Netflix or Wal-Mart in the PA. *Id.* The FTC decided not to issue a civil investigative demand, and took no further action on the matter. *Id.* Later, in 2009, after this action was filed, Netflix received communications from the attorneys general of Florida and West Virginia seeking additional information about the PA. *Id.* ¶¶ 6-14. After learning the facts concerning the absence of any market allocation or competitive impact, these agencies likewise declined to pursue investigations. *Id.*

When Walmart exited the business in mid-2005, Netflix did not increase its prices. Its 3U price remained at $17.99 from October 2004 (well before Wal-Mart's exit) through July 2007, when it decreased the price of this plan to $16.99 following a similar price reduction by BBI. Ex. 29, App. 1. Over time, Netflix's prices have decreased, led by the low-cost ($9.99) 1U plan, which has become (by far) its most popular. At the same time, Netflix has significantly increased the value provided to its subscribers by adding the functionality of "Watch Instantly" video streaming over the Internet. *Id.* ¶¶ 24-25, 138. Today, Netflix is primarily a streaming company; its subscribers watch more hours of video streamed by Netflix over the Internet than they do on DVDs sent by Netflix through the mail. Hastings Decl. ¶ 36; Ex. 56 at 1; Ex. 57 at 3, 5-6. One of Netflix's competitors is Walmart, which in February 2010 acquired Vudu.com, a service that offers movie rentals to consumers through Internet streaming. Ex. 11 at 111:3-112:13; Hastings Decl. ¶ 29.

III. ARGUMENT

To proceed with this antitrust case, Plaintiffs must demonstrate either a per se violation of the antitrust laws or an unreasonable restraint under the rule of reason. *Texaco, Inc. v. Dagher*, 547 U.S. 1, 5 (2006); *Paladin Assocs., Inc. v. Montana Power Co.*, 328 F.3d 1145, 1154-56 (9th Cir. 2003). They must also prove injury-in-fact by showing that prices for Netflix subscribers were higher as a result of the claimed violation. *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562 (1931). Plaintiffs have failed to raise any issue of fact on any of these essential elements of their claims. Consequently, summary judgment should be entered in favor of Netflix. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323-24 (1986) (courts use summary judgment "to isolate and dispose of factually unsupported claims"). Summary judgment is particularly appropriate where unfounded, speculative claims would lead to a massive and costly – but pointless – trial. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 593-94 (1986); *see also PepsiCo v. Coca-Cola Co.*, 315 F.3d 101, 104 (2d Cir. 2002) (Kearse & Newman, JJ.); *Bhan v. NME Hosps., Inc.*, 929 F.2d 1404, 1409 (9th Cir. 1991) ("an appropriate award of summary judgment may save the parties and the courts from unnecessarily spending the extraordinary resources required for a full-blown antitrust trial"); *In re ATM Fee Antitrust Litig.*, 554 F. Supp. 2d 1003, 1010 (N.D. Cal. 2008) ("any presumption against the granting of summary judgment in complex antitrust cases has now disappeared").

A. NO PER SE VIOLATION OF THE ANTITRUST LAWS

1. There Is No Evidence of A Market Allocation Agreement. Plaintiffs' claims fail first and foremost because there is no evidence of any "market allocation" agreement. A market allocation agreement is one in which two companies agree not to compete in each other's market and in which there are no procompetitive efficiencies. *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46, 49-50 (1990); *Turf Paradise, Inc. v. Arizona Downs*, 670 F.2d 813, 821-22 (9th Cir. 1982). Here, there is no evidence that Netflix agreed not to compete in the sale of new DVDs. The evidence is undisputed that Walmart and Netflix never even *discussed* – let alone agreed to – an arrangement under which Netflix would not sell new DVDs. *In re Citric Acid Litig.*, 191 F.3d 1090, 1103 (9th Cir. 1999) (even evidence of discussions, without more, would not suffice to establish conspiracy); *see also Abraham v. Intermountain Health Care, Inc.*, 461 F.3d 1249, 1258-59 (10th Cir. 2006).

There is no direct evidence of any conspiracy. The PA itself has no terms that relate to Netflix refraining from new DVD sales, the purported "quid pro quo" for Walmart exiting the online rental business. It is undisputed that nothing in the agreement inhibited Netflix from selling new DVDs at any time. Likewise, the PA does not limit Walmart's ability to re-enter the online DVD rental business. Nothing in the agreement itself, the testimony of witnesses, or the documents produced in discovery remotely suggests any agreement between Netflix and Walmart to allocate markets. To the contrary, the testimony was consistent and uncontroverted that no such agreement was made or even discussed. Hastings Decl. ¶¶ 27-29; Ex. 7 at 20:5-21:6 (VC), 43:3-20; Ex. 8 at 121:1-15, 126:17-127:14; Ex. 9 at 36:22-38:2 (VC).

There is no circumstantial evidence of market allocation. In drawing inferences from circumstantial evidence, facts that are as consistent with lawful conduct as with a conspiracy are insufficient to defeat summary judgment. *Matsushita*, 475 U.S. at 587-88; *Sun Microsystems, Inc. v. Hynix Semiconductor, Inc.*, 608 F. Supp. 2d 1166, 1175-76, 1192-93 (N.D. Cal. 2009). That Netflix agreed to promote Walmart DVD sales (as it had previously done with Musicland and Best Buy) is entirely consistent with an ability to begin selling new DVDs if Netflix chose.

Plaintiffs' argument is that Netflix subscribers purchased a lot of DVDs and that DVD sales therefore would have been profitable. Ex. 25 ¶¶ 61-62. But if selling DVDs would have been profitable – a conclusion the professionals at Netflix consistently rejected (Hastings Decl. ¶ 4; Ex. 3 at 319:8-321:13 (VC), 327:2-329:22; Ex. 58 at *651) – that would have been equally true before, during, and after any agreement with Walmart. The purported profitability of new DVD sales provides no evidence that Netflix *agreed with Walmart* not to sell DVDs.

Plaintiffs also argue that Netflix "considered" selling new DVDs. That is true: Netflix considered *and consistently rejected* the idea. This consideration (and rejection) of new sales by Netflix prior to the PA provides no evidence of a commitment to Walmart to refrain from new sales, especially in light of undisputed evidence that Netflix gave the same consideration (and rejection) to the idea *after the PA was signed*. *E.g.*, Ex. 59 at *499 (November 2005 consideration of new DVD sales). Since ending DVD sales in 1999, Netflix has consistently held the strong belief that it will fare best, not by selling new DVDs, but by promoting DVD sales by companies like Best Buy – who do it well – in return for their promotion of Netflix DVD rentals. Hastings Decl. ¶ 6; Ex. 3 at 319:8-321:13 (VC), 327:2-329:22; Ex. 58 at *651.

There is simply no evidence of the "conscious commitment to a common scheme" not to sell new DVDs that Plaintiffs must show to survive summary judgment. *Matsushita*, 475 U.S. at 587-88; *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 (1984). Plaintiffs conceded as much in discovery. Responding to an interrogatory requiring all supporting facts, Plaintiffs were unable to point to any evidence showing an agreement by Netflix to refrain from new DVD sales. Ex. 31. Plaintiffs' own expert expressly admitted the lack of evidence of any commitment by Netflix to Walmart to refrain from selling new DVDs. Ex. 22 at 29:12-31:18 (VC).

This is a case, moreover, in which there are millions of documents – with an email or other document for virtually every minute of Netflix's working days, covering any and all subjects. Had there been any hint of some agreement not to sell new DVDs, it is inconceivable that there would be no reference to it. The absence of any such document confirms what all the witnesses testified – the subject was never part of any agreement and was never even discussed.

2. The Per Se Rule Does Not Apply. In the absence of any "quid pro quo" agreement to allocate markets, the May 2005 agreement was functionally an acquisition by Netflix of Walmart's online DVD rental subscriber base. Ex. 22 at 134:1-135:14 (VC). Mergers and acquisitions are evaluated under the rule of reason to determine whether there are any anticompetitive effects and, if so, whether they are outweighed by procompetitive efficiencies. *United States v. Columbia Steel Co.*, 334 U.S. 495, 529-30 (1948); *United States v. Rockford Mem'l Corp.*, 898 F.2d 1278, 1282 (7th Cir. 1990); *see also Gerlinger v. Amazon.com Inc.*, 526 F.3d 1253, 1256 (9th Cir. 2008) (dismissing "market allocation" challenge to Amazon-Borders agreement under which Amazon assumed operations of the Borders.com site). As an acquisition, the agreement at issue here cannot be subject to condemnation under the per se rule.

In addition, even if Netflix had agreed not to sell new DVDs, the per se rule would not apply. Per se analysis applies only where the "practice facially appears to be one that would always or almost always tend to restrict competition and decrease output" rather than "one designed to 'increase economic efficiency and render markets more, rather than less, competitive.'" *Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 289-90 (1985); *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 19-20 (1979); *Paladin*, 328 F.3d at 1154-56. The PA here had a number of plausible efficiencies, designed to enhance output in both online DVD rentals and in DVD sales, placing it outside the scope of any per se rule. Output in rentals was increased by Walmart's promotion of the Netflix service, and by providing a "soft landing" for Walmart subscribers – a major consideration for a consumer-focused company. Ex. 7 at 36:10-40:15; Ex. 6 at 53:9-22; Ex. 3 at 240:7-12. They were allowed seamlessly to join Netflix at the same price they had paid previously; to maintain their rental queues; and to enjoy Netflix's service levels – rather than abruptly losing their accounts and service. The arrangement therefore left no subscriber worse off, and provided added value to those who elected to switch – efficiencies that could not have been achieved without the agreement. On the DVD sale side, the agreement enhanced output through the parties' options to promote DVD sales through Walmart, and by focusing Walmart's movie business on maximizing DVD sales. These plausible consumer benefits preclude per se treatment. *Nw. Wholesale Stationers,* 472 U.S. at 293-95; *Northrop Corp. v. McDonnell Douglas Corp.*, 705 F.2d 1030, 1050-53 (9th Cir. 1983) (agreement that restricted Northrop to selling one type of aircraft and McDonnell Douglas to another had procompetitive merit).

B. No Unreasonable Restraint of Trade Under the Rule of Reason

Because Plaintiffs can articulate no viable theory of per se liability, the PA must be tested under the rule of reason. *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877, 885-87 (2007); *Texaco*, 547 U.S. at 5. An agreement will be found to restrain trade unreasonably only if its actual or probable effect is to raise prices, restrict output, reduce quality, or otherwise harm consumers in a significant way. *NCAA v. Bd. of Regents*, 468 U.S. 85, 98 (1984); *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 139 (1998); *R.C. Dick Geothermal Corp. v. Thermogenics, Inc.*, 890 F.2d 139, 151-52 (9th Cir. 1989) (en banc) (finding no effect on prices or output); *Levine v. Cent. Fla. Med. Affiliates*, 72 F.3d 1538, 1551 (11th Cir. 1996); *Capital Imaging Assocs. v. Mohawk Valley Med. Assocs.*, 996 F.2d 537, 546 (2d Cir. 1993) (exclusion of plaintiff radiology group did not increase price or decrease quality); *Bhan*, 929 F.2d at 1414. "The core question in antitrust is output. Unless a contract reduces output in some market, to the detriment of consumers, there is no antitrust problem." *Chicago Prof'l Sports Ltd. v. NBA*, 95 F.3d 593, 597 (7th Cir. 1996).

The PA had no such effects. Plaintiffs' own economic expert, in fact, conceded that, absent proof of a market allocation agreement, the acquisition by Netflix of Walmart's subscriber base was fully "within the law." Ex. 22 at 134:1-135:14 (VC). As explained below, it is beyond genuine dispute that the PA did not reduce competition in any significant way.

1. Walmart Unilaterally Decided To Exit Online DVD Rental. The evidence is uncontroverted that Walmart made an independent decision to exit online DVD rentals on January 3, 2005 – at a time when there were no discussions occurring between Netflix and Walmart. The PA therefore had no effect on whether Walmart stayed in the business or not. Plaintiffs' own economic expert concedes that a conclusion that Walmart decided independently to exit in January 2005 means that competition was not harmed. Ex. 22 at 12:25-13:20.

When Netflix CEO Hastings and Walmart.com CEO Fleming met in October 2004, Fleming told Hastings that Walmart was not interested in a transaction with Netflix, and there were no plans for any further discussion or follow up. Hastings Decl. ¶ 19; Ex. 22 at 78:3-17. After the beginning of November 2004, there was no contact between Hastings and Fleming again until Hastings emailed Fleming on January 25, 2005 to suggest scheduling another meeting, and the meeting itself did not occur until February 9, 2005. Hastings Decl. ¶¶ 23-24; Ex. 22 at 79:6-13; Ex. 60; Ex. 7 at 21:7-16, 37:10-14.

In late 2004, Walmart.com's business was on a negative trajectory, losing subscribers in the face of substantial growth by Netflix and BBI. Ex. 29 ¶¶ 23, 32, 41. Walmart.com went from tiny (56,852 subscribers in September 2004) to tinier (49,686 subscribers in December 2004). *Id.* ¶ 32. In the same period, Netflix increased its subscribers from 2.2 million to 2.6 million, and BBI went up from 194,000 to 410,000 subscribers. *Id.* ¶¶ 32, 41.

In an effort to save its failing online DVD rental business, Walmart.com pursued an alliance with Yahoo!. Ex. 61; Ex. 10 at 127:16-128:8. However, when BBI cut its price for its 3U plan to $14.99 on December 22, 2004, Walmart realized that the financial assumptions essential to the Yahoo! deal could no longer be achieved. Ex. 10 at 141:19-142:18 (VC); Ex. 62 ("The Yahoo deal is at risk because the economics no longer work."). As Ari Sussman, the manager of Walmart.com's online DVD rental business, wrote in an email dated December 23, 2004: "BB took their subscription price down to $14.99 . . . [s]o it will most likely screw up my Yahoo deal and mean will need to close shop." Ex. 48; *see* Ex. 63 (12/22/04 internal Walmart email: "It may be time to exit this business."); Ex. 47 at *192 (BBI price move makes "the deal with Yahoo not viable"). The Yahoo! term sheet included a provision allowing either party to terminate in the event the average selling price (ASP) of Walmart's online DVD rental subscriptions went below $16.90. Ex. 61 at 5. On December 10, 2004, the Walmart ASP was approximately $17.18, already very close to the ASP that would trigger the termination right. Ex. 29 at n.138. When BBI cut its price to $14.99 on December 22, 2004, any material price reduction undertaken by Walmart would push its ASP below the $16.90 threshold and thereby activate the termination provision. *Id.* ¶ 85. Yet without a price reduction, Walmart would have no platform to increase its subscriber base over 50,000, as the Yahoo! transaction required. Ex. 64. The proposed Yahoo! agreement fell through and was never signed. Ex. 10 at 141:19-142:18 (VC); Ex. 9 at 16:10-24 (VC).

In evaluating the price changes that Walmart would have to make in order to respond to Blockbuster's 3U plan decrease to $14.99, Walmart projected a number of different scenarios. Ex. 49; Ex. 65. All of the scenarios predicted significant decreases in subscriber numbers, as well as short and long term financial losses for the online DVD rental business. Ex. 49; Ex. 66; Ex. 9 at 20:13-23. On January 3, 2005, following a meeting of Walmart.com's top managers, Walmart.com made the decision to shut down its online DVD rental business. Ex. 67; Ex. 50; Ex. 9 at 24:17-19 (VC); Ex. 13 at 121:11-122:12 (VC); Ex. 7 at 23:4-9 (VC), 30:8-11 (VC). The steps leading up to the shutdown included: (i) lowering the 2U plan price to $12.97 (above the $11.99 Netflix was charging for its 2C plan, but low enough to keep *some* customer base to sell); (ii) discontinuing the 3U and 4U plans for new sign-ups; (iii) terminating all network expansion plans; and (iv) beginning conversations with BBI and Netflix about "what subs [subscribers] are worth and disc salvage value." Ex. 50; *see also* Ex. 68. This shutdown plan was kept strictly confidential. Ex. 50. Next, Walmart set up an impairment reserve on its books for the closure of the business as of January 31, 2005, the end of its fiscal year. Ex. 7 at 32:6-33:1; Ex. 22 at 110:2-6; Ex. 51; Ex. 12 at 121:11-123:9.

There is no evidence whatsoever that any communication with or from Netflix had anything to do with Walmart's decision to exit the online DVD rental business and set up the reserve. *See* Ex. 7 at 33:7-11. The subsequent agreement that Netflix would take over willing subscribers upon Walmart's exit was a *result* of Walmart's independent determination to exit, not a cause. Although Walmart had already decided on January 3, 2005 to exit online DVD rental, Fleming did not disclose that fact to Hastings when they met on February 9, 2005, because Walmart wanted to preserve bargaining leverage in the negotiations. Ex. 7 at 37:15-18, 39:19-40:15. As it turned out, Walmart's planned exit was not a source of leverage anyway: during the negotiations, Walmart came to the realization that Netflix "doesn't place much value on us leaving the business (we're either no longer a threat to them or they believe we're leaving anyway)." Ex. 69.

Plaintiffs rely on a number of internal Netflix documents that refer to "agreement" with Walmart that it would exit DVD rentals. *E.g.*, Ex. 70. Those documents reflect the fact that Netflix did not know about Walmart's prior, independent decision to exit. In proposing the February 9, 2005, meeting, Mr. Hastings had suggested an arrangement under which Netflix and Walmart.com would be positioned side-by-side, with Netflix as a "premium" service and Walmart as a "value" service. Hastings Decl. ¶¶ 23-26; Ex. 60. Netflix's CMO, Leslie Kilgore, however, expressed the view that this approach would leave the impression with consumers that Netflix was expensive, which was likely to harm its business. Hastings Decl. ¶ 26; Ex. 4 at 179:17-182:11. Accordingly, the Netflix representatives sought an arrangement under which there would be one surviving service, Netflix's, not Walmart's; and that contemplated Walmart's exit. None of this negates the undisputed evidence that Walmart had made a prior, wholly independent decision to exit the business. The can be no genuine dispute that "agreement" on Walmart's exit served only to reconfirm that previously-determined fact.

2. No Competitive Harm Regardless of Why Walmart Exited. Even if Plaintiffs could show that Walmart exited online DVD rental only as a result of an agreement with Netflix, rather than independently – an assertion contrary to all the evidence – there was no competitive harm resulting from Walmart's exit in any event.

a. *No Evidence of Consumer Harm.* Walmart's exit resulted in no increase in price, reduction in output, or decrease in quality or service. Quite the opposite, by every possible measure, the value provided to consumers has improved.

Netflix's prices have declined in the years since the PA – both in absolute terms, *see* Ex. 29, App. 1, as well as in terms of the cost per movie viewed. From the beginning to the end of the class period, the average cost to a subscriber of a movie shipped or streamed plummeted from roughly $3 to $1. Ex. 29 ¶ 138 & Chart 7. Further, output has increased dramatically as Netflix's subscriber base has grown and the number of movie rentals provided by Netflix has increased. From the time of the May 2005 agreement to the present, the total number of all online DVD subscribers has increased more than 500%, from about 4 million to over 20 million. *Id*. ¶ 23. In addition, service quality has improved, with faster delivery, more titles, and the introduction of a new and valuable capability (Internet streaming) *at no charge*. *Id*. ¶¶ 24-25. Where, as here, there have been no negative impacts on price, output, or quality, no antitrust claim is available as a matter of law. *R.C. Dick Geothermal*, 890 F.2d at 151-52 (arrangements having no adverse effect on price, output, or quality are not unreasonable as a matter of law); *Chicago Prof'l Sports*, 95 F.3d at 597.

The Ninth Circuit's decision in *Gerlinger v. Amazon.com Inc*., 526 F.3d 1253 (9th Cir. 2008), is on point. In that case, very much like here, Amazon took over operation of Borders' online sales and was charged with "market allocation." But the case was dismissed because prices remained the same or decreased – negating any suggestion of consumer harm – notwithstanding the plaintiff's argument that, had Borders remained independent, prices would have been even lower. *Id.* at 1254-56. The court's rationale was that there was no injury to consumers and, therefore, no *standing*. *Id.* That same rationale means equally that there was no consumer harm of the sort a *violation* of the Sherman Act requires.

b. *Walmart Had No Competitive Impact.* Plaintiffs cannot show that consumers would have benefited even more if Walmart had stayed in the market because Walmart was entirely insignificant as a competitor and its presence or absence in the market did not impact competition in any way.

Wal-Mart Stores provided Walmart.com insufficient resources*.* In January 2005, Walmart's subscriber share was 1.5% and declining rapidly. Ex. 29 ¶ 76 & Chart 4. One of the reasons for Walmart.com's inability to gain traction was the failure of Wal-Mart Stores, Inc. to provide sufficient resources for online DVD rental, in large part because it saw other online businesses as being more profitable. Ex. 71 (1/25/05: "right now the payback for [a DVDR] investment versus other investments the company can make is not as compelling"); Ex. 72 at *153 (Walmart.com "may not have the ability to absorb [a $1.3mm] loss in the DVDR business"). The online DVD rental business had only three full-time salaried employees who worked solely on that business. Ex. 10 at 43:12-44:16; Ex. 73. It was also provided with very limited funds for marketing. One Walmart financial projection showed marketing expenditures of only $2.525 million for the period covering fiscal years 2003 through 2006. Ex. 74 at *480; *see also, e.g.*, Ex. 75 at *839 ("we simply cannot compete with the advertisers out there, who are willing to spend $30+ per [customer for] acquisition."). By contrast, Netflix reported over $325 million in marketing expenditures for the equivalent time period (Ex. 76 at 11; Ex. 77 at 22) and BBI was investing heavily as well (Ex. 78 at *850; Ex. 15 at 368:17-370:2). Walmart executives also testified to the severe resource constraints under which the online DVD rental business operated, including with respect to marketing, technology, and distribution. Ex. 7 at 15:21-17:2 (VC); Ex. 9 at 12:20-13:15 (VC), 14:3-15 (VC); Ex. 10 at 121:20-122:17 (VC). These constraints left Walmart unable to create a compelling offering, with quality and service levels far below Netflix's in every respect. *See, e.g.*, Ex. 35; Ex. 36.

Netflix viewed Walmart as insignificant. Walmart's lack of serious commitment to the online DVD rental business was evident to outside observers. Netflix's board minutes from September 2003 note that Walmart had "very little traction in the DVD rental space, primarily due to their inferior service and lack of word-of-mouth." Ex. 37 at *049. A presentation from the same board meeting indicated that Netflix had felt "no impact" from Walmart's service, and that it was not likely Walmart's service would impact Netflix's business going forward. Ex. 38 at *929. During the first quarter 2004 analyst conference call, Hastings characterized Walmart as "not very active in the market," and online DVD rentals as "a fairly minor initiative for them." Ex. 79 at 7. The irrelevance of Walmart's online DVD rental business persisted through the duration of its existence. As Netflix's CMO Leslie Kilgore testified, "Wal-Mart's DVD rental service had never amounted to anything. It was, you know, absolutely inconsequential." Ex. 4

at 174:15-18. Netflix's customer research also reinforced this point: customers did not mention Walmart as an alternative to Netflix, and cancellation data showed that Walmart was not a factor for customers in deciding to leave Netflix's service. *Id*. at 174:19-176:8; Hastings Decl. ¶ 9. Even the lead Plaintiffs in this case who became Netflix subscribers while Walmart's service was available conceded that they also did not consider Walmart as a viable alternative: in fact, they had never even *heard* of Walmart's service. Ex. 19 at 53:12-14; Ex. 20 at 30:14-16, 82:13-23; Ex. 21 at 23:24-24:3.

Consequently, Walmart had zero impact on how Netflix competed in online DVD rental. As Plaintiffs' economic expert agreed, from the time of its entry until its exit, Walmart had no effect on Netflix's pricing behavior. Ex. 22 at 184:6-16 (VC). Netflix never made a decision to lower prices, nor to change any other aspect of its service, in response to anything Walmart did in online DVD rentals. *Id.*; Hastings Decl. ¶ 10.

Other market participants viewed Walmart as insignificant. The same was true with respect to the next largest market participant, BBI. As Plaintiffs' economic expert conceded, there was "no competitive response by Blockbuster to anything that Wal-Mart ever did." Ex. 22 at 182:19-183:1 (VC). Every BBI executive testified that "Wal-Mart didn't impact our pricing decision." Ex. 15 at 347:7-14; *see also* Ex. 14 at 76:3-11; Ex. 16 at 94:6-20, 95:22-96:6; Ex. 17 at 98:12-101:5, 101:20-102:9, 106:16-107:1. Blockbuster's reaction to Walmart's decision to shut down was that it was "logical" that Wal-Mart would exit, because "[Walmart's] distribution network wasn't in place. Title count wasn't there. I mean, the service levels weren't in a position to compete." Ex. 15 at 394:22-396:6.

Similarly, when Amazon.com was researching the online DVD business in preparation for possible entry, it did not view Walmart as a threat. Ex. 18 at 205:2-6, 234:16-235:9 ("[Wal-Mart's online DVD rental business] looked completely sub par. . . . [W]e didn't really spend much time really worrying about [Wal-Mart] in any . . . material way, shape or form."); Ex. 80 at *993 ("Walmart bites."). Walmart's small subscriber base and poor service levels led Amazon.com to disregard Walmart as a competitor in online DVD rental. Ex. 18 at 232:17-233:4 ("The way we were thinking about Walmart is that they weren't taking it seriously; they had one distribution center; they had limited selection; they had faulty systems that didn't really work; and that they weren't taking it seriously. So we really spent next to no time thinking about Walmart. And if you would have asked me back in 2004 do I think that Walmart will be a big player in this space going forward, I am sure that at that point I would have said no."); *id*. at 233:17-234:4 ("So [Walmart's] overall user experience was bad. And they were tiny.").

The <u>objective</u> facts are that Walmart had no competitive significance. When Walmart entered in June 2003, Netflix did not lower its 3U price in response to the lower price charged by Walmart. To the contrary, Netflix kept its 3U price the same for a year, and then the very next price change Netflix implemented to the 3U plan was to *increase* it to $21.99 in June 2004. Ex. 29, App. 1. The introduction of Walmart's tiny, poorly implemented service exerted no competitive pressure on Netflix. Similarly, when Walmart exited the market in mid-2005, Netflix did *not increase* its 3U price, but instead kept it the same level – further demonstrating that the exit of Walmart was a non-event that had no effect on competitive conditions. *Id*. Netflix's next price change on the 3U plan, in mid-2007, was a price *decrease*. *Id*.

Furthermore, Netflix often acted as a price leader downwards by introducing new, inexpensive subscription plans. While Plaintiffs focus almost exclusively on prices for the 3U plan, in fact there were numerous plans available at different price points. In December 2004, Netflix lowered the price of its 2C plan to $11.99, which was then the lowest priced plan available from any service. *Id*. In May 2005, Netflix introduced an even less expensive subscription for $9.99 (the 1U plan), again giving it the lowest price of any service. In July 2006, Netflix began offering a $5.99 subscription (the 1C plan), which also became the lowest-priced plan available in the market. *Id*. Netflix's price decreases occurred both before and after Walmart's exit, demonstrating that the presence or absence of Walmart as a nominal competitor did not affect Netflix's price-leading behavior.

It is beyond genuine dispute that Walmart's exit led to no reduction in any aspect of competition.

Netflix issued a press release advising that the PA was immaterial. The insignificance of Walmart as a competitor in the online DVD rental space was so pronounced that Netflix even felt it necessary to issue a press release at the time the PA was announced to advise investors specifically that the PA was immaterial to Netflix's financial performance. Hastings Decl. ¶ 31 & Ex. A. Walmart's subscriber base was so small that the number of additional subscribers Netflix stood to acquire under the PA had no material effect on Netflix's results. *Id.* Instead, Netflix considered the benefits of the PA to be in the form of promotion on the Walmart website, and the public relations benefit of being able to characterize Netflix as having succeeded in a space where the world's largest retailer had not. *Id.*

Comments about Walmart in the media raise no issue of fact. Plaintiffs rely on an interview of Mr. Hastings on CNBC in October 2004, in which he remarked that online DVD rentals was "heating up a lot faster than we thought it would. Blockbuster is coming in, Amazon is coming in, Wal-Mart has been in the market for two years," adding further that anyone would be "worried" about Wal-Mart, BBI, and Amazon. Ex. 81. The statement was an acknowledgment that Walmart was one of the firms in the online DVD rental arena, not a contradiction of all the company's contemporaneous internal documents that Walmart was not an effective competitor. Plaintiffs simply ignore Mr. Hastings' comments in a quarterly earnings call held at the same time, in October 2004, in which he was asked if Netflix had "noticed any sort of impact on growth or customer acquisition" from Walmart.com, and he responded by saying that "Wal-Mart is not very active in the market . . . . I just think it's a fairly minor initiative for them." Ex. 79 at *387; Hastings Decl. ¶ 37.

Plaintiffs also rely on an earnings call in April 2005, after agreement in principle had been reached between Walmart and Netflix, in which Mr. Hastings remarked that "[i]f 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 profits would likely be small." Ex. 82 at 3 (emphasis added). What was clear from the context was that Walmart was not a "major" competitor. Nothing in Mr. Hastings' remarks suggested otherwise. Hastings Decl. ¶ 37.

The media comments on which Plaintiffs rely do not change the uncontroverted, *objective* evidence that Walmart had no competitive significance.

Walmart's exit was not an unreasonable restraint of trade. Because Walmart had zero competitive significance, an agreement between Netflix and Walmart that Walmart would exit the online DVDR business in mid-2005 could have no adverse effect on competition and, therefore, could not be an unreasonable restraint of trade. *United States. v. Gen. Dynamics Corp.*, 415 U.S. 486, 510 (1974) (acquisition not unlawful where acquired firm lacked ability "to compete on a significant scale"). Plaintiffs cannot simply rely on a claim that Walmart was a part of the "competitive equation." Rather, they must show that Walmart itself had some impact in the market, so that its removal made a difference. *See United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1166-73 (N.D. Cal. 2004) (Oracle's acquisition of PeopleSoft upheld because elimination of PeopleSoft as independent competitor was not likely to lessen competition substantially in light of continued competition from SAP and others); *FTC v. Arch Coal Inc.*, 329 F. Supp. 2d 109, 147 (D.D.C. 2004) (approving acquisition where acquired firm "does not lead or even influence pricing in the market, does not compete aggressively, and does not have a history of [aggressive] bidding on contracts" such that it was "unlikely that [the acquired firm] will become any more competitive in the marketplace than it is right now").

3. The PA Did Not Eliminate Any Significant Potential Competition.

There is also no basis for Plaintiffs to argue that the PA eliminated significant *potential* competition. An acquisition cannot be condemned on the basis that it eliminates potential competition absent proof, among other things, that the competition in question would be likely and significant. *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602 (1974). Those requirements have not even arguably been satisfied here.

Walmart's actual performance in the online DVD rental business eliminates any claim that it was a source of significant potential competition. There is no need for conjecture. Walmart actually entered online rentals, but it did not succeed. Moreover, its prospects at the time of its exit were dismal. At the close of 2004, Walmart predicted nothing but steady losses in the online business. Ex. 49; Ex. 65; Ex. 66. Its contemporaneous projections showed that, if it maintained the same level of support, it would have much less than 1% of online rentals in four more years, after having incurred substantial losses. Ex. 22 at 116:18-118:13. The projections also showed that investing more to grow its business would result in dramatically larger losses, and that it would never exceed 5% of online rentals in even the most optimistic scenario. *Id*. at 117:3-19; Ex. 29 ¶ 86 & n.141. Walmart's "potential" to compete in the online DVD rental business, then, can only be described as poor. In light of these negative financial projections, there is no reason whatsoever to think that Walmart would have suddenly reversed course and succeeded in the online DVD rental business.

In addition, nothing in the PA inhibited Walmart from reentering online DVD rental at any time. If Walmart were in fact a significant potential competitor in May 2005, allowing Netflix to attract less than 50,000 subscribers (in return for financial compensation for each one who transferred) in no way precluded it from launching a new online DVD rental business of equal potential competitive significance as soon as the next day. The PA did nothing to eliminate any potential competition. In fact, Walmart did later re-enter online movie rental with its acquisition of VuDu.com in February 2010. Ex. 11 at 111:3-112:13.

4. The Testimony of Plaintiffs' Experts Creates No Issue of Fact.

Plaintiffs have disclosed two purported expert witnesses: John Beyer (economics) and Gregory Gundlach (marketing). Beyer opines that it was not in Walmart's economic interest to exit the online DVD rental market and, absent the PA, it would likely have remained in the business and increased in significance over time. Ex. 25 ¶ 10. He further claims that Netflix would have lowered its prices at some date prior to the date of the PA, and Plaintiffs were injured by paying "supracompetitive" prices. *Id.* Gundlach opines that Walmart's resources and marketing strategies would have led to "continued growth" if it had stayed in online DVD rental, which would "inevitably" have had a "significant downward impact on prices." Ex. 27 ¶ 9.

The testimony of these experts creates no genuine issue of fact. As set forth in more detail in the accompanying Motions to Exclude Expert Testimony, these experts ignore the market facts in order to reach conclusions that are inconsistent with all of the evidence in the case. Therefore, as set forth in the accompanying Motions to Exclude, Plaintiffs' expert testimony does not meet the requirements of Federal Rule of Evidence 702 and is inadmissible under *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993), and *Kumho Tire Co. v.*

Carmichael, 526 U.S. 137 (1999). But even if the testimony is not excluded under Rule 702, it is not sufficient to raise a factual dispute:

> When an expert opinion is not supported by sufficient facts to validate it in the eyes of the law, or when indisputable record facts contradict or otherwise render the opinion unreasonable, it cannot support a jury's verdict. Expert testimony is useful as a guide to interpreting market facts, but it is not a substitute for them. As we observed in *Matsushita*, "expert opinion evidence . . . has little probative value in comparison with the economic factors" that may dictate a particular conclusion.

Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1436 (9th Cir. 1995) (quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 242 (1993)).

Even with the glaring deficiencies in their testimony, the most significant aspect of Plaintiffs' expert testimony is its confirmation of the critical points in the case. Dr. Beyer specifically conceded (i) that there was no commitment by Netflix to refrain from selling new DVDs; (ii) that, absent agreement not to sell new DVDs, an acquisition of Walmart's service by Netflix was "within the law"; and (iii) that Walmart's service engendered no competitive response by Netflix, BBI, or anyone else. Ex. 22 at 29:12-31:18 (VC), 134:1-135:14 (VC), 184:6-16 (VC). Those concessions are fatal to Plaintiffs' case.

C. No Monopolization Under Sherman Act Section 2

Plaintiffs' various monopolization claims pursuant to Section 2 of the Sherman Act also fail as a matter of law. Section 2 claims, whether based on allegations of conspiracy to monopolize, attempt to monopolize, or actual monopolization, all require proof of anticompetitive conduct. *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004) ("To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive *conduct*."); *Rebel Oil*, 51 F.3d at 1433. The only conduct alleged here to be anticompetitive, however, is the same conduct leading to the PA and Walmart's exit discussed immediately above.

For the same reasons that there was no unreasonable restraint of trade, there was no anticompetitive conduct under Section 2. Acquiring a competitor's business is not, on its own, predatory conduct. *Lektro-Vend Corp. v. Vendo Co.*, 660 F.2d 255, 271 (7th Cir. 1981) ("acquisitions can sometimes provide evidence of predatory conduct [but] are not generally considered predatory"); *Corsearch, Inc. v. Thomson & Thomson*, 792 F. Supp. 305, 325 (S.D.N.Y. 1992) (no Section 2 violation where there was "no evidence that the acquisition was undertaken in order to acquire or maintain a monopoly position and prevent competition"). As demonstrated above, the PA had no negative effects on competition. Where an agreement is found not to be anticompetitive and does not constitute an unreasonable restraint of trade in violation of Sherman Act § 1, there is likewise no basis for a monopolization claim under Section 2. *Nova Designs, Inc. v. Scuba Retailers Ass'n*, 202 F.3d 1088, 1092 (9th Cir. 2000); *Sicor Ltd. v. Cetus Corp.*, 51 F.3d 848, 856 (9th Cir. 1995); *Williams v. I.B. Fischer Nevada*, 999 F.2d 445, 448 (9th Cir. 1993).

D. PLAINTIFFS SUFFERED NO INJURY IN FACT

An essential element of any claim for damages under the antitrust laws is causal injury-in-fact. *J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 562 (1981); *Rebel Oil*, 51 F.3d at 1433 ("causal antitrust injury, is an element of all antitrust suits brought by private parties seeking damages under Section 4 of the Clayton Act."). Here, in light of the insignificance of Walmart as a competitor, and the lack of any impact on competition from its exit, Plaintiffs can show no injury caused by the PA, and therefore their antitrust claims fail as a matter of law.

Because Walmart had no effect on price or other aspects of competition, Plaintiffs suffered no harm from that exit. No participant in the online DVD rental market ever made any pricing changes as a reaction to Walmart. *See supra* Section III.B.2.b. Consequently, there is simply no basis for Plaintiffs to assert that there was any effect on prices whatsoever from the PA or Walmart's exit. And, in fact, after the exit of Walmart, Netflix began introducing new lower-priced plans while its 3U price remained unchanged for over two years, at which point the price was *lowered*. Ex. 29, App. 1. Plaintiffs paid the same or lower prices for their Netflix subscriptions both before and after the PA – a fact that is dispositive on the lack of injury. *Gerlinger*, 526 F.3d 1253 (plaintiffs demonstrated no injury resulting from Amazon.com's takeover of Borders.com online bookselling website when book prices remained the same or lower after the agreement as compared to before).

Because Walmart's exit did not cause any actual market prices to change, Plaintiffs posit a purely speculative theory of injury that is not only unsupported by any evidence; it is utterly implausible in light of actual market pricing behavior. Since Plaintiffs cannot show that prices increased following the PA, they contend that Netflix would have *reduced* its 3U price to $15.99 *prior* to May 19, 2005 if Walmart had not exited. But that speculation is baseless. In December 2004, BBI lowered its 3U price to $14.99, well below not only Netflix's $17.99 price but Walmart's $17.36 price as well. Ex. 29, App. 1. BBI had become a formidable competitor in online rentals, with a fast-growing share in excess of 20%. *Id.* ¶ 41 & Chart 4. Yet Netflix elected *not* to reduce its 3U price in response to BBI's dramatic price drop to $14.99. Hastings Decl. ¶ 21; Ex. 45; Ex. 46 at *698. It simply makes no sense to argue that Netflix would have lowered its 3U price to $15.99 in response to the *higher* $17.36 price of Walmart, a firm with a declining 1.5% subscriber share, when it chose *not* to lower prices in response to the $14.99 price of BBI, a firm with a growing share of 20%. Walmart itself did not even lower its 3U price in response to the BBI $14.99 price. And even if Walmart *had* matched the BBI $14.99 price, there is no rational basis to suggest that the move would have affected Netflix at all. Walmart's prices had *always* been lower than Netflix's, and Netflix never changed price even once in response. It is therefore absurd to suggest that, absent negotiations with Walmart leading to the PA, Walmart's continued presence would have led to a 3U price reduction. *Gerlinger*, 526 F.3d at 1255 (dismissing antitrust claim where no evidence supported plaintiffs' theory that book prices would have been even lower but for Amazon.com agreement to take over Borders.com online bookselling website).

IV. CONCLUSION

For the reasons set forth, summary judgment in favor of Netflix should be granted.

Dated: May 11, 2011

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