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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

IN RE ONLINE DVD RENTAL ANTITRUST LITIGATION	Master File No. M:09-CV-2029 PJH MDL No. 2029 Hon. Phyllis J. Hamilton
This document relates to: ALL ACTIONS	**DEFENDANTS' MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO PLAINTIFF'S MOTION FOR CLASS CERTIFICATION** DATE: September 1, 2010 TIME: 9:00 a.m. PLACE: Courtroom 3

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I. STATEMENT OF ISSUES

The issues to be decided are whether plaintiffs have established: (1) a viable class-wide methodology for showing antitrust injury and damages to the proposed class of current and former Netflix subscribers from Wal-Mart's[1] June 2005 exit from the online DVD rental business; and (2) that they and their counsel could adequately represent the proposed class.

II. INTRODUCTION

Plaintiffs cannot show antitrust injury throughout the five-year class period through common, class-wide methodologies – as they must to obtain class certification. Most fundamentally, plaintiffs have failed to conduct the necessary empirical assessment of competitive conditions in the online DVD rental business to determine whether Wal-Mart's discontinuation of its service had any effect on Netflix's pricing consistently throughout the five-year class period. In ignoring critical facts and resting their motion on baseless assumptions, plaintiffs, among other things, (1) rely on an expert opinion that is fundamentally unsound; (2) fail to offer a methodology to rule out the prospect that at least some class members were not injured at all, given the lack of evidence that Wal-Mart's trivial online DVD rental business would have affected prices throughout the five-year class period; and (3) fail to consider the conflict among class members that would exist in plaintiffs' but-for world. These critical facts include:

The online DVD rental business is not "substantially commoditized." Contrary to plaintiffs' assumptions, there is uncontroverted evidence – including testimony from the plaintiffs themselves – that factors like next-day shipping, broad selection, and ready availability were important determinants of growth in the online DVD business, and that consumers were willing to pay a premium for quality. There is thus no basis for plaintiffs' reliance on a methodology that simply *assumes*, without analysis, that continued competition from Wal-Mart would have caused Netflix to reduce its prices throughout the five-year class period.

Wal-Mart was not a major competitor in the online DVD rental business and would

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[1] Distinctions between Wal-Mart Stores, Inc. and Walmart.com raise potential merits issues that are not relevant here. Accordingly, defendants will refer to both entities as "Wal-Mart."

1 **not have remained in that business.** When Wal-Mart exited the DVD rental business, it had
2 approximately 50,000 subscribers, compared with more than 3 million Netflix subscribers and
3 approximately 950,000 Blockbuster subscribers. (*See* Expert Report of Professor Janusz Ordover
4 ("Ordover Report") at ¶¶ 28, 35.) Despite Wal-Mart's paltry presence in the online DVD rental
5 business, plaintiffs' expert economist, Dr. Beyer, *assumes* that, absent the alleged agreement,
6 continued competition from Wal-Mart would have caused Netflix to reduce its prices and to "fully
7 implement" those price reductions before May 19, 2005. (*See* Expert Report of John C. Beyer
8 ("Beyer Report") ¶ 9(c).) But: (1) even while Wal-Mart was in the online DVD rental business,
9 Netflix never reduced its prices in response to lower Wal-Mart prices; and (2) by early 2005, Wal-
10 Mart had concluded that its online DVD rental business was not viable and had decided to shut it
11 down. Given these and other issues, described below, plaintiffs cannot simply assume Wal-Mart
12 would have remained in the online DVD business forever and caused Netflix to charge
13 consistently lower prices throughout a five-year class period.

14 **Netflix's investments in marketing and product enhancements enabled it to grow**
15 **from 3 million subscribers to over 14 million subscribers during the five-year class period.**
16 Plaintiffs' methodology *assumes* that *all* of the 11 million subscribers who began subscribing to
17 Netflix after Wal-Mart's exit would have done so in a but-for world in which Wal-Mart remained
18 in the market. However, Netflix's ability to attract those new subscribers was driven, at least in
19 part, by its investment of hundreds of millions of dollars in marketing and service improvements.
20 Plaintiffs assert that competition from Wal-Mart "would have inevitably driven prices down to the
21 cost of supplying the market" (Beyer Report ¶ 62), but have offered no methodology to assess
22 whether Netflix would have made the same investments in a but-for world in which its prices
23 matched its costs, as plaintiffs claim, or for assessing how many subscribers Netflix would gain in
24 that but-for world. Much less do they acknowledge the conflict between class members who
25 would have valued the lower prices plaintiffs claim would prevail in the but-for world, versus
26 those who valued online streaming, faster delivery, broader selection, and the other service
27 enhancements that Netflix's pricing and investments in the real world made possible.

28 **Netflix faced substantial competition from Blockbuster and other sources.**

Throughout the proposed five-year class period, Netflix faced competition from Blockbuster, which started its own online DVD rental business in 2004. Netflix also had to consider potential competition from Amazon, as well as from other sources of home entertainment, including cable, satellite, DVRs, "brick and mortar" rentals, rental kiosks, and digital distribution services. Plaintiffs do not offer any methodology to assess whether other sources of competition constrained Netflix's pricing sufficiently to overcome any competitive effects resulting from Wal-Mart's exit.

The pricing of Netflix's various plans is not interdependent. Plaintiffs contend, without analytical support, that pricing across Netflix's various subscription plans was "standardized" such that increased competition causing one plan to be reduced would result in the reduction of the prices for its other plans. But plaintiffs' analysis fails to consider evidence that each of Netflix's plans was priced independently. Moreover, plaintiffs cannot *assume* that Wal-Mart would have offered a full range of subscription plans, or that Netflix would have reduced prices across all its plans in response to a competitor offering a limited menu of plans, without a methodology for assessing how Wal-Mart's business would have developed during the class period.

Plaintiffs' failure to address the complexities of assessing impact and damages is fatal to their motion. Plaintiffs' so-called "methodologies" for assessing antitrust impact and damages are not methodologies at all; rather, they boil down to the *assumption* that continued competition from Wal-Mart would have caused Netflix to charge lower prices. Plaintiffs do not offer *any* quantitative analysis of Wal-Mart's incentives or ability to compete effectively in online DVD rentals throughout the five-year class period; of when, whether, or by how much Netflix would have reduced its pricing in response to Wal-Mart's offering lower prices; or of other potential competitive constraints on Netflix's pricing practices over the course of the class period. When actual facts are analyzed, it becomes apparent that at least some class members were not injured at all, and that at least some would be worse off, in plaintiffs' proposed but-for world.

Finally, even if some class might be certified to pursue these claims, it could not be adequately represented by class counsel or the class representatives. The simultaneous representation by plaintiffs' counsel of putative classes of both Netflix *and* Blockbuster subscribers creates irreconcilable conflicts of interest. Moreover, the testimony of the named class

witnesses suggests that they themselves cannot claim to have been injured by the challenged conduct and are subject to individualized defenses. Consequently, the motion also should be denied for failure to meet the adequacy of representation requirement of Rule 23(a)(4).

III. FACTUAL BACKGROUND

A. The development of the online DVD rental business.

Netflix began its subscription-based online DVD rental business in Los Gatos, California in 1999. (Declaration of Sara Walsh ("Walsh Decl.") Ex. 1 at 2.) Netflix offered a business model in which consumers would pay a monthly subscription fee to select DVDs from the Netflix web site, receive those DVDs in the mail, and return them at their convenience in postage-paid envelopes provided by Netflix. (*Id.* at 4.) Starting in October 2000, Netflix charged $19.95 per month for a three-out unlimited plan. (*Id.* at 11-12.)

By 2003, Netflix already had grown to more than 1 million subscribers. (Walsh Decl. Ex. 2.) In July 2003, Walmart.com, which had started its retail web site in January 2000, launched an online DVD rental business of its own. Wal-Mart's online DVD rental business was not successful. As defendants' expert economist, Professor Janusz Ordover, describes, although Wal-Mart's DVD rental prices often were significantly lower than Netflix's prices (at times as much as $3 per month lower), Wal-Mart never generated subscribers at anywhere near the rate of Netflix. (Ordover Report at ¶¶ 35-36.) During the two years it remained in the online DVD rental business, Wal-Mart never had more than 55,000 subscribers, and its share of online DVD rental subscribers never exceeded 2.1%. (*Id.* at ¶ 13.) By the time Wal-Mart shut down its online DVD rental business, its share of online DVD rental subscribers had dwindled to less than 1%. (*Id.*) During the period Wal-Mart was in the online DVD rental business, Netflix never reduced its prices in response to competition from Wal-Mart; rather, it *increased* the price of its 3-out unlimited plan in the second quarter of 2004, from $19.99 to $21.99, and nonetheless was able to increase subscribers approximately *600 times* faster than Wal-Mart. (*Id.* at ¶ 36.)

Blockbuster, the largest of the "brick and mortar" movie rental chains, launched its own online DVD rental business in August 2004. (Walsh Decl. Ex. 3; Ordover Report at ¶ 41.) Blockbuster's 3-out plan was $19.99 per month, $2 per month less than Netflix's price, and $1 per

month more than Walmart.com's $18.76. (Walsh Decl. Ex. 3; Ordover Report at ¶ 76.) On October 14, 2004, Netflix announced that it would reduce its price to $17.99 per month. (Walsh Decl. Ex. 4 at 3-4.) On October 18, 2004, Blockbuster announced a price reduction for its 3-out plan to $17.49 per month (Walsh Decl. Ex. 5), and, in December of 2004, further reduced the price to $14.99 per month. (Walsh Dec. Ex. 6, at 19.) Blockbuster was able to generate more than a million subscribers in its first 16 months. (Walsh Dec. Ex. 7, at 2.)

(Declaration of Genevieve Vose ("Vose Decl."), Ex. 1 (Deposition of Jorrit Van der Meulen) at 215:1-18.)

B. Wal-Mart's discontinuation of its online DVD business and the continued growth of Netflix, Blockbuster, and other movie rental businesses.

On May 19, 2005, Walmart.com and Netflix issued a press release announcing an agreement relating to their online DVD rental services ("Promotion Agreement"). (Vose Decl. Ex. 2.) As part of this agreement, Walmart.com offered its existing customers the opportunity to transition to the Netflix service at their lower Walmart.com prices for the first year, if they chose to do so, with Netflix paying Wal-Mart a referral fee for each transitioning customer. (*Id.*; *see also* Vose Decl. Ex. 3.) Each company agreed to have the option of providing promotional advertising support for the other on their respective web sites. (Vose Decl. Ex. 3.) When the agreement was announced, Wal-Mart had approximately 50,000 subscribers; Netflix had more than 3 million. (*See* Ordover Report ¶ 35, A-4; Walsh Decl. Ex. 8.)

During the last five years, Netflix has continued investing significantly in improving its service and attracting new subscribers. (Ordover Report at ¶ 33; Walsh Decl. Exs 9-12.) Usage of the Netflix digital streaming service, which launched in 2007 and is included in the base subscription price, has increased dramatically over the past two years, such that more than half of Netflix subscribers have used that component of the service. (Walsh Decl. Ex. 13 at 15.) Netflix now has more than 14 million subscribers across its various plans, over 400% more than it had in June 2005. (*See* Ordover Report A-4; Walsh Decl. Ex. 14.)

Netflix has not increased its subscription prices at any point over the past five-year proposed class period. The only price change for Netflix's 3-out plan during that period was a price *decrease*, implemented in July 2007, which lowered the price for that plan from $17.99 per month to $16.99 per month, matching a Blockbuster price decrease from the prior month. (Walsh Decl. Ex. 15.) At the same time, Netflix also reduced prices for its 1-out and 2-out plans. (*Id.*)

C. Plaintiffs' proposed class.

In January 2009 – almost four years after Wal-Mart and Netflix announced the Promotion Agreement and Wal-Mart discontinued its online DVD rental service – plaintiffs filed these lawsuits. Plaintiffs contend that the Promotion Agreement was in fact a "Market Allocation Agreement," under which Netflix agreed not to sell DVDs in exchange for Walmart.com's agreeing to exit the online DVD rental business. (Pls.' Mem. in Supp. of Mot. for Class Certification ("Pls.' Mem.") at 4-5.) Plaintiffs assert that, absent the agreement, Walmart.com would have remained in the online DVD rental business, and that if it had done so, Netflix's prices would have been even lower. (*Id.* at 7.) By their motion, plaintiffs ask the Court to certify a class that would include (with certain exclusions not relevant here) "any person or entity in the United States that paid a subscription fee to Netflix on or after May 19, 2005 up to and including the date of class certification." (*Id.* at 1.) The class thus would include all current and former Netflix subscribers from the past five years, regardless of which Netflix plan they participated in, even though none of those Netflix subscribers has ever experienced a price increase, and many have experienced a price *decrease*, over the course of the class period.

D. Dr. Beyer's proposed methodology.

Plaintiffs' motion is based principally on the declaration of their economist, Dr. John Beyer. According to Dr. Beyer, common methodologies can be used to show that Wal-Mart's exit from the online DVD rental business in June 2005 enabled Netflix to forego further price decreases throughout the five-year class period. (Beyer Report ¶ 12.) Dr. Beyer's opinion that antitrust injury from Wal-Mart's exit can be shown on a class-wide basis is premised on his conclusions that, *inter alia*: (1) the online DVD rental market is "substantially commoditized" in that "[o]nline DVD service providers primarily compete on price" (Beyer Report ¶ 12(d), 37-43);

and (2) Wal-Mart was a sufficiently strong competitor in the online DVD rental business that if it had remained in the business and charged prices that were lower than Netflix's prices, Netflix would have been forced to lower its own prices. (Beyer Report ¶¶ 12(d), 18-21, 49-51.)

At the request of plaintiffs' counsel, Dr. Beyer additionally assumed that, absent the Promotion Agreement and Wal-Mart's exit from the market, Netflix would have been forced to reduce its prices by no later than May 19, 2005, the start of the class period. (*Id.* ¶ 9(d).) Dr. Beyer claims that what matters is the "perception beforehand" that Wal-Mart was a significant competitor (Vose Decl. Ex. 4 (Deposition of John C. Beyer (hereafter "Beyer Dep.")) at 226:12-229:1), and that he can determine the fact of injury "without any analysis of what Wal-Mart's business would have looked like during the class period. (*Id.* at 232:2-238:5.)[2] Based on the radical assumption that "[t]he fact of impact . . . needs only to occur at one time" to conclude that there was impact throughout the class period (*id.* at 234:7-238:5), Dr. Beyer's proposed methodology thus does not include any empirical analysis of, *inter alia*, whether Wal-Mart would have remained in the online DVD business throughout the class period, how Wal-Mart's business would have developed over time, changes in the composition of the relevant market, or how Wal-Mart would have priced its service at any given time.

With respect to damages, Dr. Beyer has offered two "methodologies" that he opines may be used to calculate class-wide damages. (Beyer Report at 38-42.) First, Dr. Beyer describes a "price-cost margin" methodology, under which Netflix's gross profit margins while Wal-Mart remained in the business would be compared with Netflix's gross profit margins after Wal-Mart's exit. (*Id.* at 38-39.) Dr. Beyer then assumes that, if Wal-Mart had remained in the business, Netflix's margins would have remained the same as they were while Wal-Mart actually was in the market, such that an "overcharge" may be calculated based on the prices Netflix would have charged based on such margins. (*Id.*) Dr. Beyer has not offered any methodology that could be

[2] As the cited portions of Dr. Beyer's deposition transcript illustrate, Dr. Beyer – a highly experienced, professional expert witness – was repeatedly coached by speaking objections throughout his deposition. Those speaking objections violated the Court's case management order, which allows objections only to form, and, defendants submit, further undermine Dr. Beyer's overall credibility.

used to determine whether Netflix's margins actually would have been lower at any point since June 2004 if Wal-Mart had remained in the market or whether, and to what extent, gross margins directly determine Netflix's price.

Alternatively, Dr. Beyer suggests that an "overcharge" may be calculated by assuming that, if Wal-Mart had remained in the business, Netflix's prices would have been lower than they actually were, and then subtracting the lower "benchmark" price from the higher price and multiplying it by the number of class members to calculate damages. (*Id.* at 40-41.) Dr. Beyer has not offered any methodology for determining what the proper benchmark should be, or for analyzing the competitive conditions that would have prevailed if Wal-Mart had remained in the business to determine whether there was an overcharge at any particular time.

IV. ARGUMENT

As in many antitrust class actions, the question of whether plaintiffs have satisfied their burden of establishing a basis for class certification turns on whether they have identified common, class-wide methodologies for assessing the issues of antitrust injury and damages, as required by Federal Rule of Civil Procedure 23(b)(3). *See, e.g., California v. Infineon Tech. AG*, No. C 06-4333 PJH, 2008 WL 4155665, at *7 (N.D. Cal. Sept. 5, 2008). Defendants do not dispute that: (1) the proposed class numbers in the millions and thus satisfies the numerosity requirement of Rule 23(a)(1); (2) there are common questions with respect to the legality of the Promotion Agreement under the antitrust laws, as required by Rule 23(a)(2); (3) the claims of the proposed class representatives appear to be sufficiently typical of the class to satisfy Rule 23(a)(3).

With respect to the predominance requirement of Rule 23(b)(3), however, plaintiffs' motion falls far short. "[C]lass certification is precluded where plaintiffs have not shown that the fact of injury element [of their antitrust claims] can be proven for all class members with common evidence." *Allied Orthopedic Appliance, Inc. v. Tyco Healthcare Group, L.P.*, 247 F.R.D. 156, 165 (C.D. Cal. 2007); *see also In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 311-12 (3d Cir. 2009). Class certification is appropriate only if plaintiffs "advance[ ] a plausible methodology to demonstrate that antitrust injury can be proven on a class-wide basis." *Infineon Tech.*, 2008 WL 4155665, at *9. In considering this issue, the Court is required to conduct a "rigorous

1 analysis" of the proffered methodologies to determine whether plaintiffs have satisfied their
2 burden. *Id.*; *see also Dukes v. Wal-Mart Stores, Inc.*, __ F.3d __, 2010 WL 1644259, at *5 (9th
3 Cir. Apr. 26, 2010) (en banc).[3]

4 Thus, plaintiffs' motion for class certification must fail absent their showing that a
5 plausible methodology exists, based on common, class-wide proof, for showing that *every* member
6 of the class was worse off in the actual world than they would have been in a "but-for world" in
7 which the challenged conduct did not occur. *In re Dynamic Access Memory Antitrust Litig.*
8 ("*DRAM*"), No. M 02-1486 PJH, 2006 WL 1530166, at *7 (N.D. Cal. June 5, 2006); *Allied*
9 *Orthopedic*, 247 F.R.D. at 165; Ordover Report ¶¶ 12-13. Moreover, to show that the
10 methodology is plausible, an expert must do more than just assert that the proposed methodology
11 works. Rather, the expert must actually analyze the available data and information to test whether
12 the proposed methodology is plausible on the facts of the particular case. In *In re Graphics*
13 *Processing Units Antitrust Litigation* ("*GPU*"), 253 F.R.D. 478 (N.D. Cal. 2008), for example, the
14 court denied class certification in a price fixing case where the plaintiffs failed to provide a "viable
15 method" for demonstrating class-wide injury and offered econometric models that were "grossly
16 lacking." *Id.* at 497. The Court faulted the plaintiffs' expert for seeking to "evade[] the very
17 burden he was supposed to shoulder." *Id.* at 493.

18 Here, plaintiffs and their expert, Dr. Beyer, likewise have sought to "evade the very burden
19 they were supposed to shoulder" by ignoring the facts that render it impossible to determine that
20 Wal-Mart's exit from the online DVD rental business in June 2005 caused antitrust injury
21 throughout the five-year class period. Instead of developing a methodology for assessing the
22 effects of the alleged conduct, plaintiffs instead pretend that this case is just like price fixing cases,
23 such as *DRAM*, in which the fact of antitrust injury can be readily determined. But this is not such
24 a case. Rather, as detailed below and in the report of defendants' expert economist, Professor
25 Ordover, any assessment of the competitive effects of Wal-Mart's exit from the online DVD rental
26

27 [3] *Dukes* involved the certification of an injunctive relief class under Rule 23(b)(2), *id.* at *35, and
28 consequently did not address predominance under Rule 23(b)(3). The Court's holding that class certification was appropriate in that employment discrimination case is thus inapplicable here.

business would require a detailed analysis of factual circumstances that Dr. Beyer's proposed methodology either assumes away or refuses to address. When those factual circumstances are examined, it becomes clear that at least some (if not all) class members were not injured, and that there would be conflicts among class members in plaintiffs' but-for world.

Additionally, plaintiffs' counsel suffer from conflicts arising from their simultaneous representation of a proposed class of Blockbuster subscribers, while the named plaintiffs are subject to individualized defenses based on their deposition testimony. Accordingly, plaintiffs' motion also fails the adequacy of representation requirement of Rule 23(a)(4).

A. Plaintiffs ignore the fact that this is not a price fixing case.

Plaintiffs' fail to acknowledge a critical distinction between this case and a price fixing case. In price fixing cases – and particularly price fixing cases involving commodity products – antitrust injury is often easy to establish, even presumed. *See, e.g.*, *DRAM*, 2006 WL 1530166, at *7-*8. This is in large part because the "but-for world" in a price fixing case is straightforward: the price fix would not have existed and lower prices resulting from competition would have prevailed. Impact and damages in a price fixing case are both based on the "overcharge," *i.e.*, the differential between the higher fixed price and the lower competitive price. Thus, while there of course may be complicating factors in any particular case, courts often certify classes in price fixing cases. *Id.*; *see also Infineon Tech.*, 2008 WL 4155665, at *5 ("[C]ourts often find the predominance element satisfied in horizontal price-fixing cases such as this one.") (citing *Paper Sys., Inc. v. Mitsubishi Corp*, 193 F.R.D. 601, 612 (E.D. Wis. 2000); *In re Commercial Tissue Prods.*, 183 F.R.D. 589, 595 (N.D. Fla. 1998)).

However, the straightforward analysis of competitive impact that often applies in a price fixing case is wholly inapplicable in cases, such as this one, where the claim depends on showing that the allegedly anticompetitive conduct actually eliminated competition in a manner that led to inflated pricing over the course of the class period. *Allied Orthopedic*, 247 F.R.D. at 166. Such cases involve "much more than a simple showing that the plaintiffs purchased an item in a world where average prices were inflated." *Id.* To obtain class certification in a case that involves the alleged elimination of competition, the plaintiff must offer a method for constructing a viable

"but-for world" for assessing impact and damages that allows for a thorough consideration of how the exiting seller (here Wal-Mart) would have affected competition had it remained in the market during the proposed class period. *Id.*

There are numerous circumstances in which competition from an exiting firm would not affect prices at all, including if (1) the exiting firm would have discontinued operations during the class period even absent the alleged antitrust violation; (2) the exiting firm was not a sufficiently strong competitor to influence the incumbent firm's pricing; or (3) the incumbent firm faced sufficient competition from other sources that any additional competition from the exiting firm would not have caused it to change its pricing. In a case involving claims that additional competition would have led to lower prices, class certification should be denied unless the antitrust plaintiff puts forward a viable methodology for assessing the potential existence of those circumstances throughout the class period. *Id.* at 165, 172.

Plaintiffs fail to do so. Instead, plaintiffs rely on a simplistic table reflecting a few alleged similarities between this case and *DRAM*. A more accurate version of the table from page 15 of plaintiffs' brief, attached hereto as Appendix A, confirms that this case is very different from *DRAM*, and raises numerous questions regarding antitrust impact and damages that simply were not present in that case.

B. Plaintiffs have not offered common, class-wide methodologies for assessing antitrust impact.

Plaintiffs' failure to analyze impact and damages adequately is highlighted in the conclusory opinions offered by their expert, Dr. Beyer. Instead of identifying a methodology for assessing the competitive significance (if any) that Wal-Mart's online DVD rental business would have had throughout the class period, Dr. Beyer simply assumed – at the instruction of plaintiffs' counsel – that continued competition from Wal-Mart would have caused Netflix to reduce its prices by May 19, 2005. Then, as if by magic rather than through any actual economic analysis, Dr. Beyer asserts that any price impact from Wal-Mart's exit that existed as of the beginning of the class period *necessarily would have extended throughout the five-year class period.* (Beyer Dep. at 234:7-238:5.)

1 Dr. Beyer then asserts that this conclusion can be drawn *without even considering*
2 Wal-Mart's pricing and subscriber data (which he has had since January 2010), without analyzing
3 how consumers responded to differences between Wal-Mart's pricing and Netflix's pricing during
4 the two years that Wal-Mart operated its online DVD rental business, without any quantitative
5 assessment of how Wal-Mart would have performed in a "but-for world" had it remained in the
6 online DVD rental business, and without any analysis of how Netflix would have reacted over a
7 five-year period to continued competition from Wal-Mart. Dr. Beyer's approach epitomizes the
8 sort of outcome-oriented, unreasoned, and non-economic assessment of antitrust impact that courts
9 have consistently rejected when offered as a basis for class certification. *See, e.g., Infineon Tech.*,
10 2008 WL 4155665, at *11 (stating that because of plaintiffs' expert's "total failure to sufficiently
11 take divergent variables into account (notwithstanding his promise to do so in the future), the court
12 sincerely doubts whether it is even possible for any methodology to do so"); *GPU*, 253 F.R.D. at
13 496 (concluding that even if the many variables at issue did have a systematic impact with respect
14 to the class, the plaintiff's expert's proposed model "hardly shows how he . . . accounted for
15 them"); *Somers v. Apple, Inc.*, 258 F.R.D. 354, 361 (N.D. Cal. 2009) (finding that proposed
16 methodology did not account for complexity of issues that could potentially affect pricing during
17 proposed class period); *Freeland v. AT&T Corp.*, 238 F.R.D. 130, 144 (S.D.N.Y. 2006) (denying
18 certification where plaintiff's expert "fail[ed] to test for the obvious and significant alternative
19 explanations" of the observed price differences).

20 Indeed, this is not the first time that Dr. Beyer has failed to undertake the effort needed to
21 develop a viable method for assessing impact and damages. In *Allied Orthopedic*, as in this case,
22 Dr. Beyer relied on the assertion that the pulse oximetry sensor market at issue in that case was a
23 substantially commoditized market in which price was the primary basis for competition. 247
24 F.R.D. at 165. Rather than engaging in any meaningful quantitative assessment of how
25 additional competition from excluded firms would have affected pricing over time, Dr. Beyer
26 relied on anecdotal evidence drawn from a skewed handful of defendants' documents, just as he
27 does here. *Id.* at 172-73. The court rejected Dr. Beyer's analysis as "poorly reasoned and
28 conclusory," *id.* at 167, just as other courts have observed gross deficiencies in his analysis. *Blue*

Cross & Blue Shield United v. Marshfield Clinic, 152 F.3d 588, 593 (7th Cir. 1998) (Posner, J.) (calling Beyer's analysis of antitrust damages "worthless"); *Lantec, Inc. v. Novell, Inc.*, Case No. 2:95-CV-97-ST, 2001 U.S. Dist. LEXIS 24816, *19-*20 (D. Utah Feb. 13, 2001) (stating that Dr. Beyer "fail[ed] to address in sufficient manner or degree salient factors not attributable to defendant's alleged wrongdoing" and that his failure to do so "condemn[ed] his credibility").

Plaintiffs' and Dr. Beyer's failure to confront the realities of the online DVD rental business likewise should condemn their effort to obtain class certification here. As detailed below, plaintiffs and Dr. Beyer have relied on assumptions and conclusions that are demonstrably unsupportable, failed to confront complicating market conditions that render their proposed methods inadequate, and improperly relied on anecdotal evidence drawn from selected documents rather than analyzing the actual available data and information.

1. There is no basis for Dr. Beyer's conclusion that the online DVD rental market is "substantially commoditized."

Dr. Beyer's conclusion that class-wide methodologies for assessing antitrust impact depends on his fundamental premise that the online DVD rental business is "substantially commoditized," similar to markets for other commodities, like crude oil or winter wheat. (Beyer Report ¶ 40 ("[T]he online DVD rental market is typical of other commodity products, and, as such, competes primarily on price.") In a commoditized market, price is the principal basis for competition among the firms in the market (*id.* ¶¶ 37-40), and as a matter of basic economics, it is reasonable to assume that additional competition from a lower priced firm would cause the incumbent firms to reduce their prices. (Beyer Report ¶¶ 60-62.) Dr. Beyer thus posits that *if* Wal-Mart had remained in the online DVD business, and *if* Wal-Mart had charged prices that were lower than Netflix's prices, Netflix would have been forced to reduce its own prices and retain them throughout the five-year class period, such that antitrust impact can be shown on a class-wide basis. (*Id.*) By contrast, if the market for online DVD rentals was differentiated, rather than commoditized, it cannot be assumed that additional competition from Wal-Mart or anyone else would result in lower prices, because consumers may conclude that the additional competitor provided a less desirable service. (Ordover Report at ¶¶ 18, 25, 47; Beyer Dep. at

155:21-156:15.)

Dr. Beyer's conclusion that the online DVD rental business is "substantially commoditized" is both unsubstantiated and contrary to the available data and information. Just as he did in *Allied Orthopedic*, to reach his conclusions, Dr. Beyer relies on selected snippets from a handful of defendants' documents and public statements (Beyer Report ¶¶ 40-41), and ignores evidence that contradicts his conclusions. For instance, based on his assessment of an internal Netflix presentation, Dr. Beyer testified that by 2005, Netflix had concluded that it should no longer "spend time and resources in trying to create a form of differentiation because it cannot occur." (Beyer Dep. at 152:18-153:12 & Report ¶ 40.) But the document Dr. Beyer relies on contains an extended discussion of how Netflix was differentiating itself from its competitors. (Walsh Decl. Ex. 16 at 6700-01.) The reality is that Netflix invested heavily during the class period in features that differentiate its service (Walsh Decl. Exs. 9-12), and has been consistently rated number one by independent surveys of consumer satisfaction in the ecommerce sector. (Walsh Decl. Exs. 9, 11.) Indeed, as detailed in Professor Ordover's report, there are numerous and substantial differences among online DVD rental services that contradict Dr. Beyer's conclusion that the market was "substantially commoditized." (Ordover Report at ¶ 25.)

More fundamentally, Dr. Beyer has failed to consider data that belies his assertion that this was a commoditized market. Dr. Beyer ***did not consider Wal-Mart's subscriber data at all***, claiming alternatively that he had not done the calculations, that he only had data for "particularized points in time," that the data was "not the relevant consideration," or – by way of an objection interposed by plaintiffs' counsel – that "[t]he problem is you producing things as PDF's." (Beyer Dep. at 70:14-73:11, 163:18-164:17.) As explained by defendants' expert Professor Ordover, the available data in fact show that Wal-Mart's prices were *significantly lower* than Netflix's prices for most of the two-year period that Wal-Mart was in the online DVD rental business, but that Wal-Mart's share of online DVD subscribers never exceeded 2.1%. (Ordover Report at ¶ 13 & A-1.) This undisputed fact drawn from the available data – which Dr. Beyer *did not even consider* – undermines the conclusion that the online DVD rental market was

"substantially commoditized," and forecloses plaintiffs' claim that they have presented a common, class-wide methodology for assessing antitrust impact. (*Id.* ("[W]ere the DVD rental services substantially homogenous, as Dr. Beyer asserts, it is implausible that Netflix would have been able to charge higher prices and, at the same time, retain the subscriber base nearly 70 times the size of Wal-Mart's.").)

At the very least, Dr. Beyer should have developed a methodology for analyzing *whether* the online DVD business was substantially commoditized throughout the class period, so that the trier of fact would have a reasonable basis for testing his conclusion that additional competition from Wal-Mart necessarily would have resulted in lower Netflix prices. Instead, Dr. Beyer has relied entirely on assertions rather than analysis. But assertions are not proper substitutes for analysis in any antitrust case. Accordingly, plaintiffs' have failed to establish the critical predicate to their proposed methodology for assessing antitrust impact.[4]

2. There is no basis for Dr. Beyer's conclusion that Wal-Mart was a major competitor that could influence Netflix's prices.

Dr. Beyer's conclusion that continued competition from Wal-Mart would have caused Netflix to reduce its pricing throughout the class period is also premised on his opinion that Wal-Mart was a major competitor in the online DVD rental business. (Beyer Report ¶¶ 12(d), 18-19, 62-64.) As Professor Ordover explains, unless Wal-Mart was a major competitor, there would not have been any reason for Netflix to reduce its prices in response to Wal-Mart's prices. (Ordover Report ¶ 47, 67-77.)

Dr. Beyer asserts that Wal-Mart *already was* a major competitor by May 19, 2005, the beginning of the class period, such that Netflix would have reduced its prices in response to Wal-Mart before that date if Wal-Mart had continued to compete rather than entering into the

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[4] Apparently recognizing the weakness of his claim that the online DVD market is substantially commoditized, at his deposition Dr. Beyer sought to backtrack from the conclusion in his report that the market was "substantially commoditized," testifying that "it's not a perfectly competitive market and prices, in fact, were not the primary consideration." (Beyer Dep. at 165:19-21). This testimony confirms that there is no basis for plaintiffs' reliance on an impact methodology that is predicated on the existence of a commoditized market, and does not contemplate any actual, empirical analysis of whether an ongoing Wal-Mart DVD rental business would have affected Netflix's pricing.

1 alleged agreement with Netflix. (Beyer Report ¶ 9(c).) But this opinion is not based on any
2 economic analysis: rather, it is based on an assumption that *plaintiffs' counsel* asked Dr. Beyer to
3 make. (*Id.* ("I have . . . been asked to assume [Netflix's] price reductions would have been fully
4 implemented by May 19, 2005.").) And the available economic data show that Wal-Mart in fact
5 *was not* a sufficiently major competitor to influence Netflix's pricing during the two years it
6 remained in the market. During that timeframe, Wal-Mart's prices were lower than Netflix's
7 prices, but Netflix *never responded* to Wal-Mart's prices by lowering its own prices, and Wal-
8 Mart nonetheless was unable to capture any significant share of online DVD rental subscribers.
9 (Ordover Report at ¶ 53 ("[D]espite the lower prices charged by Wal-Mart, the number of new
10 Wal-Mart subscribers was consistently just a small fraction of the number of new subscribers
11 that Netflix was adding month after month.").) This was in part because Netflix and Wal-Mart
12 devoted vastly different amounts of resources to their online DVD rental businesses; for instance,
13 as Professor Ordover observes (but Dr. Beyer ignored), Wal-Mart's business plans called for
14 $2.525 million in marketing expenditures between 2003 and 2006, whereas Netflix planned to
15 spend $325.76 million during the same period. (*Id.* at ¶ 33.)

16 Moreover, for plaintiffs to establish a common methodology for showing antitrust injury
17 throughout the class period, it is not enough to suggest that Wal-Mart would have been a
18 sufficiently "major competitor" at some point in time. Rather, because impact for any particular
19 class member at any particular point depends on the theory that Wal-Mart would have been a
20 sufficiently strong competitor at the same time in the but-for world, any viable methodology for
21 assessing impact would need to include a basis for showing that Wal-Mart would have been a
22 strong competitor *throughout* the five-year class period. (*Id.* at ¶¶ 67, 94-106.) For any time
23 periods during which Wal-Mart would not have been a strong competitor, there is no competitive
24 impact from its exit from the online DVD business and thus no injury to subscribers.
25 Accordingly, even if one assumes, contrary to facts, that Wal-Mart would have emerged as a
26 significant enough rival to Netflix to force Netflix to further lower its prices at some point in
27 time, the proposed class includes at least some percentage of Netflix subscribers who were not
28 injured at all as a result of Wal-Mart's exit. (Ordover Report ¶ 104.) This fact alone ought to

doom plaintiffs' motion.

Finally, there is no basis for Dr. Beyer to assume that Wal-Mart would have remained in business *at all* throughout the class period, let alone that it would have been a sufficiently strong competitor that it could have caused further reductions of Netflix's prices. By late 2004, Wal-Mart had recognized that its online DVD business was unprofitable and was unlikely to become profitable. (Ordover Report at 45 n.142.) By the end of January 2005, well *before* the alleged agreement that serves as the basis for plaintiffs' claims, Wal-Mart had already recorded a loss reserve reflecting its plan to shut down its online DVD rental business. (*Id.*) Thus, one cannot simply assume, as plaintiffs do, that Wal-Mart would have remained in the online DVD business throughout the five-year class period if it had not entered into the challenged agreement with Netflix. Nor is there any basis for asserting, as Dr. Beyer did at his deposition, that any antitrust impact that occurred at the beginning of the class period would be a sufficient basis for finding impact throughout the five-year class period. (Beyer Dep. at 232:2-234:21 (claiming that fact of impact "needs only to occur one time" and that it does not matter whether Wal-Mart's exit affected prices for "one day, ten days, two months, two years, etc.") .)[5]

3. Dr. Beyer's methodology fails to account for Netflix's growth during the five-year class period.

During the five-year class period, Netflix grew by more than *400%*, adding more than *11 million* subscribers to the 3 million it had in May 2005. Plaintiffs' proposed class includes *all* of those new Netflix subscribers, even though plaintiffs' proposed impact and damages methodology does not include any basis for concluding that those new subscribers actually would have become Netflix subscribers in their but-for world. Dr. Beyer asserts that, in a but-for world in which Wal-Mart had remained in the market, "competition would have inevitably driven prices down to the cost of supplying the market." (Beyer Report ¶ 62.) But if, as Dr. Beyer asserts, Netflix would have been forced to sell its products at cost throughout the five-year

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[5] The Court need not resolve the issue of whether Wal-Mart would have remained in the online DVD business, or for how long, to conclude that plaintiffs' proposed methodology for assessing impact is inadequate. Rather, plaintiffs' proposed methodology is inadequate because it does not include any reasoned basis for addressing these issues *at all*.

class period, the assumption that Netflix still would have made the hundreds of millions of dollars in investments in product development and marketing that it made in the real world to attract those 11 million new subscribers is implausible.

Plaintiffs blithely include the 11 million new Netflix subscribers in their proposed class without the necessary assessment of what investments in marketing and product development Netflix would have made in their but-for world, and how reductions in those expenditures would have affected the rate at which it attracted new subscribers. For instance, to evaluate the impact of Wal-Mart's exit on these new subscribers, plaintiffs would need to account for whether Netflix would have been able to introduce its streaming service as early as it did, and, if not, whether any delay in the introduction of that service (or inability to offer it at all) would have affected Netflix's subscriber growth. Dr. Beyer's proposed methodology does not address that issue, or any other issue arising from the reduced expenditures that likely would have resulted from the reduced prices he claims would have prevailed in the but-for world.

In addition to demonstrating a gross deficiency in plaintiffs' proferred methodology for showing class-wide antitrust injury, plaintiffs' failure to consider the rate at which Netflix would have attracted new subscribers in a but-for world highlights an intraclass conflict between existing subscribers as of May 19, 2005 and Netflix subscribers who joined thereafter. Because the existing customers already were Netflix subscribers as of May 19, 2005, plaintiffs need not show that these subscribers would have joined Netflix in the but-for world. As for Netflix subscribers who joined after May 19, 2005, by contrast, plaintiffs would need to show that Netflix's marketing and product expenditures in fact still would have been made in the but-for world, or that those subscribers would have joined Netflix even in the absence of those expenditures. Plaintiffs have neither acknowledged this intraclass conflict nor identified any way to resolve it, and this provides yet another basis for denying their motion.

4. Dr. Beyer's methodology does not provide a basis for testing his assumption that lower prices resulted from "three firm competition."

Dr. Beyer's opinion that Wal-Mart's exit from the online DVD rental business resulted in lower prices stems from his theory that the "three firm competition" that prevailed while Wal-

Mart, Netflix and Blockbuster all offered competing online DVD rental services resulted in price competition that could not have existed with only two firms in the market. Dr. Beyer cites several experimental economic papers suggesting that, in certain circumstances – and, specifically, in commoditized markets – three-firm markets may be more competitive and have lower prices than markets with two competitors. (Beyer Report at ¶¶ 50, 61; Beyer Dep. at 217:9-218:10.) Based on that theoretical evidence, Dr. Beyer asserts that it was the mere fact of three-firm competition – and not any other factor – that caused prices for online DVD rental services to decline following Blockbuster's launch of its online DVD rental business in August 2004, and that the continuation of three-firm competition would have resulted in lower prices if Wal-Mart had remained in the market rather than exiting in June 2005. (Beyer Report at ¶ 62.)

It is at least equally plausible, if not far more so, that Blockbuster would have entered the market with the same aggressive pricing strategy in a two-firm market; indeed, Blockbuster launched its 3-out plan at a price that was more than $1 per month *higher* that Wal-Mart's 3-out plan; its pricing was seemingly unaffected by Wal-Mart's presence. (Beyer Report ¶ 27.) A viable methodology for assessing antitrust impact in this case would need to include some reasoned basis, beyond an expert's unsupported assertion, for concluding that pricing patterns among online DVD rental services between August 2004 and May 2005 resulted from "three firm competition" rather than short-term pricing strategies that Blockbuster would have adopted regardless of Wal-Mart's presence, and for showing that the mere fact of three-firm competition would have continued to lead to lower prices throughout the five-year class period. But plaintiffs and Dr. Beyer have instead offered only the conclusory assertion that three-firm competition would have resulted in lower prices. As Professor Ordover explains, Dr. Beyer's claim "rests on an unstated assumption that all that matters for competition is the number of firms and not their capabilities." (Ordover Report at ¶ 79.)

5. Dr. Beyer's methodologies do not allow for the consideration of changes in the marketplace over the course of the class period.

Dr. Beyer's proposed methodology for assessing antitrust impact further suffers from a complete failure to consider potential constraints on Netflix's pricing over the course of the class

period. Throughout the proposed five-year class period potential Netflix subscribers had other available alternatives for obtaining movies to watch at home. Those alternatives included the introduction of high-definition DVR boxes, "brick and mortar" retail chains like Blockbuster, video rental kiosks like Redbox, and video-on-demand services such as those offered by Apple and by cable and satellite providers like Comcast, Time-Warner and DirecTV. (Ordover Report at ¶ 104.) Indeed, throughout a significant portion of the class period, Wal-Mart itself has hosted thousands of Redbox kiosks in its stores, providing customers an opportunity to rent DVDs for $1 per day (and thus undermining plaintiffs' claim that the challenged agreement eliminated competition from Wal-Mart). (Vose Decl. ¶ 12.) It is entirely plausible that these other channels of distribution, the relative composition and relative importance of which changed over the course of the class period, placed sufficient competitive constraints on Netflix's pricing to prevent Netflix from charging supracompetitive prices, thus eliminating any possible antitrust impact from Wal-Mart's exit. (Ordover Report at ¶ 104.) Potential entry from other rival online DVD service providers, such as Amazon, also could have influenced Netflix's pricing, prevented it from charging supracompetitive prices, and eliminated impact. (*Id.*) Any viable methodology for assessing antitrust impact in this case would need to consider those possibilities, but plaintiffs' does not and is therefore inadequate.

6. Dr. Beyer has not adequately considered individualized issues relating to Netflix's plans and plan pricing.

Plaintiffs claim that the pricing across Netflix's various plans was "interlinked" such that lower prices for one plan necessarily would have resulted in lower prices for the other plans. (Beyer Report at 30-35.) In fact, however, Netflix's plan offerings have changed significantly over time, and Netflix has at times changed its prices for some plans without changing its prices for others. (Ordover Report at ¶ 16.) Moreover, when Wal-Mart exited the market, it only had three subscription plans: a two-out plan, a three-out plan, and a four-out plan. (*Id.* at ¶ 107.) To assess the competitive impact of Wal-Mart in a but-for world in which it had remained in the online DVD rental business throughout the class period, it thus would be necessary to develop a methodology for determining whether or not Wal-Mart ultimately would have developed a full

menu of plan options to compete with Netflix and Blockbuster, and whether this hypothetical Wal-Mart DVD service (whether with or without the full menu of subscription alternatives offered by its competitors) would have caused Netflix to decrease prices for all of its plans. (*Id.* at ¶ 108-113) Plaintiffs have not developed any such methodology; instead, they rely on the conclusory assertion that pricing across Netflix's was necessarily interdependent.

7. Dr. Beyer's reliance on carefully-selected, out of context portions of documents rather than data is misplaced.

Dr. Beyer's flawed assumptions and inadequate methodologies described above all stem from a common source: heavy reliance on anecdotal evidence and generalized theories rather than actual, empirical analysis of the data and other available information relating to competition in the online DVD rental business. Antitrust cases in which plaintiffs have successfully navigated class certification are characterized by proposed methodologies for assessing antitrust impact that are grounded in quantitative analysis of the available data over the course of the proposed class period. In *DRAM*, for instance, this Court credited plaintiffs' expert, Professor Noll from Stanford University, for developing methodologies for assessing impact and damages based on, *inter alia*, "actual sales and price data thus far produced in discovery." 2006 WL 1530166, at *8. In other cases in which antitrust classes have been certified, plaintiffs' expert economists have developed regression models or conducted other quantitative analyses that would allow a meaningful assessment of whether the challenged conduct resulted in any competitive impact throughout the course of the class period. *See, e.g.*, *In re TFT-LCD (Flat Panel) Antitrust Litig.*, __ F.R.D. __, 2010 WL 1286478, at *18 (N.D. Cal. Mar. 28, 2010) (certifying class where plaintiffs' expert developed "three types of regression models" for showing class-wide impact based on defendants' actual transactional data); *In re Tableware Antitrust Litig.*, 241 F.R.D 644, 651-53 (N.D. Cal. 2007) (certifying class where plaintiffs' methodology was based on reports from two economists who "identified at least three formulae" based on available pricing data and "performed a regression analysis" to demonstrate methodology for assessing class-wide impact).

1 Dr. Beyer has not done that here. Instead, like the experts in other antitrust cases in
2 which class certification has been denied, Dr. Beyer has relied entirely on document snippets and
3 conclusory assertions to support his opinion that competitive impact can be shown on a class-
4 wide basis. *Allied Orthopedic,* 247 F.R.D. at 173-74; *Infineon Tech.*, 2008 WL 4155665, at *6-
5 *9; *Somers*, 258 F.R.D. at 360 (denying class certification where plaintiffs offered "no proof that
6 [expert's] damages methodologies will work in this case"). As in those cases, class certification
7 should be denied here.

8 **C. The testimony of plaintiffs' class representatives confirms there are**
9 **individualized issues as to antitrust impact.**

10 The flaws in the fundamental assumptions underlying plaintiffs' proposed methodologies
11 for assessing antitrust impact on a class-wide basis are further highlighted by the testimony of
12 plaintiffs' own class representatives. Plaintiffs' own class representatives have testified that they
13 were not even aware of Wal-Mart's online DVD rental service prior to Wal-Mart's exit from the
14 market, and, in some cases, prior to the filing of this litigation. (Vose Decl. Ex. 5 (Orozco Dep.
15 at 53:12-14); Ex. 6 (Resnick Dep. at 30:14-16); Ex. 7 (Latham Dep. 88:13-18); Ex. 8 (Wiener
16 Dep. at 23:9-24:3); Ex. 9 (Eastman Dep. at 12:14-13:2).) Indeed, one proposed class
17 representative *still* was not aware that Wal-Mart had an online DVD rental service. (Vose Decl.
18 Ex. 10 (Salvi Dep. 45:7-12, 60:3-12).) Plaintiffs' own class representatives have likewise
19 confirmed that they are satisfied with their Netflix subscriptions, would not have considered
20 switching from Netflix to Wal-Mart's DVD service, that quality differences would influence
21 their decision to remain with Netflix, and that they would have remained with Netflix even if
22 Netflix's prices were as much as $1 or $2 per month higher than its competitors' prices. (Vose
23 Decl. Ex. 5 (Orozco Dep. at 53:3-5, 53:15-54:15, 55:17-57:19); Ex. 7 (Latham Dep. at 30:11-
24 13); Ex. 8 (Wiener Dep. at 23:17-24:3, 28:17-29:10 ("Just because somebody throws a dollar out
25 doesn't mean I'm going to switch.")); Ex. 9 (Eastman Dep. at 54:1-7); Ex. 10 (Salvi Dep. at
26 45:12-25).)

27 Given this testimony, it would be impossible to conclude, based on plaintiffs' proposed
28 class-wide methodologies, that the class representatives themselves suffered any impact from

1 Wal-Mart's exit from the online DVD rental business. And since plaintiffs' testimony casts
2 serious doubt as to whether they suffered any competitive impact, antitrust impact across the
3 millions of Netflix subscribers within the proposed class cannot be assumed. A viable
4 methodology must actually consider whether Wal-Mart would have had a sufficiently strong
5 online DVD rental business to impact Netflix's pricing throughout the five-year class period –
6 something that plaintiffs' proposed methodologies do not do.

7 In addition to demonstrating that plaintiffs do not have any viable class-wide
8 methodology for assessing antitrust injury, this testimony also shows that class certification
9 should be denied under Rule 23(a)(4) because plaintiffs' class representatives are subject to
10 individualized defenses. Based on the testimony cited above, the named plaintiffs are unlikely to
11 prevail on any claim that they were harmed by Wal-Mart's exit from the online DVD rental
12 business and thus, they are not adequate representatives of a claim that depends on showing
13 competitive injury resulting from Wal-Mart's exit.

14 **D. Plaintiffs' proposed methodologies for assessing damages also are wholly**
15 **inadequate.**

16 Plaintiffs also have failed to identify any workable methodology for calculating damages
17 on a class-wide basis using common proof. At the class certification stage, courts are generally
18 deferential to plaintiffs' proposed damages methodologies so long as they "offer a proposed
19 method for determining damages that is not 'so insubstantial as to amount to no method at all.'"
20 *DRAM*, 2006 WL 1530166, at *10 (quoting *In re Potash Antitrust Litig*, 159 F.R.D. 682, 697 (D.
21 Minn. 1995)). However, a proposed damages methodology may be found inadequate if the
22 plaintiff offers only "unspecified proposals as to how he might be able to prove damages" without
23 actually developing a model that could be applied to the facts of the case. *Somers*, 258 F.R.D. at
24 361.

25 Here, Dr. Beyer has identified two proposed methods for calculating damages. The first,
26 which Dr. Beyer refers to as a "price-cost margin" approach, is based on a simple comparison of
27 Netflix's gross profit margins while Wal-Mart remained in the online DVD rental business with its
28 higher gross profit margins after Wal-Mart's exit in June 2005. (Beyer Report at ¶ 69.) Dr. Beyer

then assumes that Netflix's gross profit margins would have remained low if Wal-Mart had remained in the online DVD rental business, and suggests calculating a "but-for" price that would be used to determine damages for the class. (Beyer Report at ¶ 72.) The problem with this proposed approach is that it does not include any method for considering whether changes in Netflix's gross profit margins over time had anything to do with Wal-Mart. As Professor Ordover explains, there are numerous factors influencing Netflix's gross profit margins at any particular point in time. (Ordover Report at ¶ 132.) Without any consideration of alternative explanations for Netflix's gross margins, Dr. Beyer's assumption that they would have stayed as they were while Wal-Mart remained in the market is arbitrary and speculative. It does not amount to any methodology at all.

Dr. Beyer's second proposed method for calculating damages, which is based on subtracting a lower "benchmark" price from Netflix's actual prices during the class period to calculate damages (Beyer Report at ¶ 75), is likewise based on pure speculation. Dr. Beyer merely asserts that a benchmark could be used, but offers no coherent explanation of why it would make sense to use any particular benchmark, or how he would go about determining whether it did, for the millions of people in the proposed class over the entire duration of the five-year class period. Again, Dr. Beyer has offered a conclusory label – the "benchmark method" – rather than an actual methodology for calculating damages on the facts of this case.

In short, Dr. Beyer's proposed methodologies for calculating damages are not methodologies at all, and they do not provide any basis for certifying plaintiffs' proposed class.

E. Plaintiffs' counsel are inadequate under Rule 23(a)(4).

Plaintiffs also fail to meet the adequacy of representation requirement of Rule 23(a)(4). All the counsel representing the putative Netflix subscriber class also represent the putative Blockbuster subscriber class, and there is an irreconcilable conflict of interest between the two. This conflict not only operates as a bar to the conflicting representations; it also precludes class certification for failure to meet the requirements of Rule 23(a)(4). *See In re Microsoft Corp. Antitrust Litig.*, 218 F.R.D. 449, 452 (D. Md. 2003); *see also Kayes v. Pacific Lumber Co.*, 51 F.3d 1449, 1465 (9th Cir. 1995).

The conflict arises from the allegations counsel have made to avoid dismissal of the Blockbuster plaintiffs' complaint. The first Netflix subscriber complaint, *Resnick*, was filed on January 2, 2009, and alleged injury commencing May 19, 2005 – a period within the four-year statute of limitations period. *See* 15 U.S.C. § 15b. Following dismissal of the first Blockbuster subscriber complaint, however, the Blockbuster plaintiffs – through the same counsel – are now maintaining, as this Court put it, "that the conspiratorial conduct previously alleged to have been engaged in by Netflix and Wal-Mart began in October 2004, and that the $17.99 price that Netflix maintained throughout late 2004 and the relevant 2005 time frame was itself an artificially maintained price throughout." (Order Granting Reconsideration, Jan. 29, 2010, at 1-2.)

These new contentions by counsel on behalf of their Blockbuster clients create statute of limitations problems for their Netflix clients – as they place the accrual of any cause of action at a date more than four years before the first Netflix subscriber complaint was filed. Counsel may try to avoid the problem by alleging "fraudulent concealment" to toll the statute, but any such argument would border on the frivolous in light of the publicity surrounding announcement of the Promotion Agreement in May 2005. *See, e.g.*, *Conmar Corp. v. Mitsui & Co.*, 858 F.2d 499, 505 (9th Cir. 1988) (no fraudulent concealment absent affirmative acts of concealment). But even if the contention were not defective, it still represents a serious and actual conflict of interest. *In order to salvage the Blockbuster plaintiffs' claim, counsel are jeopardizing the Netflix subscribers' claim.* That conflict precludes any finding of adequate representation under Rule 23(a)(4).

V. CONCLUSION

Plaintiffs have not developed a methodology that would provide anything beyond pure speculation as to whether, how, and to what extent Wal-Mart's continuation of its online DVD rental service could have affected Netflix's pricing over the past five years; they have not provided any viable methodology for calculating damages; and they and their class representatives cannot adequately represent the proposed class. Accordingly, their motion should be denied.

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Respectfully submitted,

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Appendix A

Facts supporting common class-wide proof of injury in *DRAM*	Plaintiffs' claimed "similar or stronger facts"	Reality
Product is a "commodity"	▪ There is no branding or other differentiation among Netflix plans ▪ Netflix and Blockbuster offer essentially the same services	▪ Netflix subscribers did not switch away from Netflix to lower-priced Wal-Mart or Blockbuster plans ▪ Netflix has invested hundreds of millions in marketing and other service differentiation ▪ Class representatives testified they value Netflix quality and would pay a premium

Facts supporting common class-wide proof of injury in *DRAM*	Plaintiffs' claimed "similar or stronger facts"	Reality
Defendants "possessed sufficient market power to raise prices (70%)"	▪ Netflix alone has a market share of roughly 75% ▪ Netflix and Blockbuster together have nearly the entire market	▪ Unlike in *DRAM*, prices have never increased during class period. ▪ Netflix pricing potentially constrained

		by other sources of movies
Market conditions "are such that effective price-fixing with respect to the sale of DRAM to some customers will raise the price of DRAM to other customers"	▪ Netflix uses standardized, non-negotiated pricing regardless of customers individualized situation. Any change in plan's price automatically affects all subscribers ▪ There are no long-term contracts. Customers can switch plans at any time. Changes in price can take effect very quickly. ▪ Competition is based on price	▪ Unlike in *DRAM*, this is not a price-fixing case. ▪ Consideration of the effect of Wal-Mart's exit does not depend on Netflix's "standardized" contracts, but rather requires analysis of competitive effect, if any, Wal-Mart would have had over the five-year class period. ▪ Service differentiation a as important as price
"all prices for DRAM products were linked and closely related"	▪ The prices of Netflix plans are closely correlated to each other and with those of Blockbuster plans. ▪ Within any given plan, prices are the same.	▪ Plan offerings, plan pricing, and relationships between plan pricing vary over class period.