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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	**EXPERT REPORT OF JANUSZ A. ORDOVER IN OPPOSITION TO CLASS CERTIFICATION** DATE: September 1, 2010 TIME: 9:00 a.m. PLACE: Courtroom 3

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I. Qualifications and Assignment

1. My name is Janusz A. Ordover. I am Professor of Economics and former Director of the Masters in Economics Program at New York University, where I have taught since 1973. I am a Special Consultant at Compass Lexecon, which is a division of FTI, Inc. During 1991-1992, I served as Deputy Assistant Attorney General for Economics at the Antitrust Division of the United States Department of Justice. As the chief economist for the Antitrust Division, I was responsible for formulating and implementing the economic aspects of antitrust policy and enforcement of the United States, including co-drafting the 1992 U.S. Department of Justice and the Federal Trade Commission Horizontal Merger Guidelines. I also had ultimate responsibility for all of the economic analyses conducted by the Department of Justice in connection with its antitrust investigations and litigation.

2. My areas of specialization include industrial organization, antitrust, and regulation economics. I have served as an advisor on antitrust and regulatory issues to many organizations, including the American Bar Association, the World Bank, the Organization for Economic Cooperation and Development, the Inter-American Development Bank, and the governments of Poland, Hungary, Russia, the Czech Republic, Australia and other countries. I have provided economic testimony in policy hearings conducted by the Department of Justice, the Federal Trade Commission and the United States Senate. I have also consulted and testified in a wide range of antitrust and intellectual property litigation matters.

3. My curriculum vitae, which includes a complete list of my publications, is attached as Exhibit 1. A list of matters in which I have given sworn testimony as an expert during the past several years, at trial or in deposition, is attached as Exhibit 2.

4. I have been engaged by counsel for the Defendants to provide an independent expert assessment, from an economic perspective, whether certification of the proposed class of Plaintiffs is appropriate in this matter. In particular, I have been asked to address whether, assuming conduct of the kind described in the Complaint, the Plaintiffs will be able to show, through common proof, that all or virtually all members of the

proposed class suffered economic injury as a result of the alleged practices. I have also been asked to opine on whether a formulaic approach or common methodology exists by which impact could be demonstrated and damages to the class could be reasonably calculated. Finally, I have been asked to examine and respond to the conclusions reached by Plaintiffs' expert, Dr. John C. Beyer, with respect to these issues.

5. A list of the materials I have considered is attached at Exhibit 3. My opinions expressed herein are based on those materials and on my knowledge and experience in industrial organization economics and antitrust economics, my experience in antitrust enforcement at the Department of Justice, and my experience in advising and consulting with clients on competition matters over the past 25 years, both here and abroad.

6. Compass Lexecon receives $900 per hour for my work in this case. I have been assisted in a customary manner by the staff at Compass Lexecon in the preparation of this report. The opinions expressed in this report reflect the information and facts I believe to be true at the time this report is filed. I reserve the right to revise my opinions if additional information and facts supplied in discovery or through subsequent expert reports make such revisions appropriate.

II. Background and Summary

A. Case Overview

7. Plaintiffs' case centers around an alleged agreement between Netflix, Inc. ("Netflix"), Wal-Mart Stores, Inc. and Wal-Mart.com USA LLC (collectively "Wal-Mart") pursuant to which Wal-Mart agreed to shut down its online Digital Video Disc ("DVD") rental business in exchange for Netflix's agreement not to enter the business of selling new DVDs.[1] For the purpose of assessing the issues pertinent to class

[1] Notice of Motion and Plaintiffs' Motion for Class Certification; Memorandum in Support Thereof, March 19, 2010 (Motion), at pp. 1-2.

certification, I have been instructed to assume that Plaintiffs can prove the alleged agreement between Defendants.

8. Plaintiffs contend that the alleged agreement induced Wal-Mart to exit the online DVD rental marketplace, thereby weakening the competitive constraints faced by Netflix and allowing Netflix to charge higher prices to its subscribers.[2] Plaintiffs seek certification of a class that includes "[a]ny 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."[3] According to Plaintiffs, because the putative conspiracy allowed Netflix to charge higher prices to its entire base of subscribers, class-wide impact can be shown with proof predominantly common to all (or almost all) members of the purported class.

9. I understand that, as a legal matter, there are several requirements that the Plaintiffs must satisfy in order for the proposed class to be certified. This report focuses, from an economic perspective, on two of those requirements: (i) the demonstration of class-wide impact using predominantly common proof, and (ii) the feasibility of a generalized or formulaic methodology to determine the quantum of injury sustained by individual class members.

10. Simply stated, the agreement alleged by Plaintiffs involves a market allocation scheme whereby Wal-Mart agreed to refrain from competing with Netflix in the online DVD rental business and Netflix, as a *quid pro quo*, agreed not to compete with Wal-Mart in the sale of new DVDs. For the purpose of assessing from an economic perspective whether the putative class should be certified, I accept as true the allegation that the Defendants did, in fact, reach such an agreement. However, even with this assumption, in order to address the issue of class-wide impact I still must assess the likely effects of the agreement on the key dimensions of competition,

[2] Id. at p. 2.

[3] Id. at p. 1.

such as prices, relative to the but-for world in which there is no such agreement. I also must assess whether the effect on these variables was such that common proof could be used to determine impact on a class-wide basis, both across proposed class members and across the entire putative class period. This assessment must consider, among other factors, (i) whether and to what extent Wal-Mart constrained Netflix's pricing of DVD rentals, (ii) whether Wal-Mart, assuming it continued to rent DVDs online, would have invested sufficiently to grow the business and gain market share, and (iii) whether and to what extent Wal-Mart, had it continued to rent DVDs online, would have constrained Netflix's pricing.

B. Summary of Conclusions

11. Based upon my analysis to date, it is my overarching conclusion that Plaintiffs have failed to provide an analytical framework that can be used to demonstrate with common evidence that all, or virtually all, members of the proposed class, over the entire class period, sustained antitrust injury as a result of Defendants' alleged market allocation agreement. Similarly, Plaintiffs have failed to put forward a common formulaic methodology or approach that can provide reasonable estimates of damage at the individual class member level. My findings that support this conclusion are summarized below. I reserve the right to revise or supplement my opinions if additional information and facts supplied in discovery or through subsequent expert reports make such revisions appropriate.

Dr. Beyer's but-for world is unreasonable and cannot serve as a basis for determining class-wide impact and damages.

12. In order to demonstrate class-wide impact and damages using common evidence, it is necessary to formulate a but-for world that reasonably models the state of competition that would have prevailed in the absence of the challenged conduct. Dr. Beyer's but-for world rests on several key assumptions that are demonstrably unreasonable.[4] As a

[4] These assumptions include: (i) online DVD rental services are substantially homogeneous and suppliers compete primarily on price; (ii) Wal-Mart was a major competitor in the online DVD rental marketplace and, at the time of its

(footnote continued ...)

result, his conclusions regarding class-wide impact and damages are without basis and should be rejected.

13. As an initial matter, the proposed but-for world must be linked to the period during which Wal-Mart offered online DVD rentals. Wal-Mart's competitive presence during that period is an informative metric with which to gauge its likely competitive significance in a but-for world. Dr. Beyer characterizes Wal-Mart as a "major" competitor, but in doing so he seems to rely upon nothing more than Wal-Mart's overall size and resources as a retailer. Dr. Beyer offers no economic analysis specific to Wal-Mart's online DVD rental business. He fails to demonstrate that while Wal-Mart was renting DVDs online, it had any material impact on Netflix's pricing or other strategic conduct. He does not explain why Wal-Mart should be considered a major competitor even though the quality of its service was substantially inferior as compared to Netflix's offerings, and its subscriber base during its roughly two years of operation never exceeded 2.1% of industry totals. In short, the evidence provides no indication that Netflix's pricing was effectively constrained by Wal-Mart's online DVD rental business. To the contrary, the evidence is consistent with the view that Wal-Mart did not influence Netflix's pricing decisions.[5]

(... footnote continued)

exit, was committed to growing and expanding its online DVD rental business; (iii) Netflix's pricing was affected by Wal-Mart's operation in the marketplace and, by extension, Netflix was able to charge higher prices following Wal-Mart's exit; and (iv) prices across Netflix's menu of rental plans tend to move together because of inter-plan substitution effects and Netflix's incentives to minimize cannibalization (*i.e.*, switching across plans).

[5] As a matter of basic economics, it is commonly agreed that the exit of a rival can, under a variety of market scenarios, result in higher prices. However, this is not true in every circumstance. *See, e.g.*, Horizontal Merger Guidelines For Public Comment: Released on April 20, 2010, at p. 15 ("Market shares can directly influence firms' competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm's existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does."). Of particular relevance is the competitive strength of the exiting firm's product (or service), in terms of its market presence, price and quality, marketing support, and investment, relative to its rivals. In markets in which firms offer differentiated products or services, the exit of one participant need not have a material effect on prices of the remaining firms. Such limited (or no) impact may be especially likely if firms generally implement price changes in non-trivial, discrete increments. Here, during the class period Netflix has always charged prices in the format $X.99 and modified prices in whole dollar increments.

Dr. Beyer provides no framework to determine when Wal-Mart would have emerged as a sufficiently viable competitive threat to compel Netflix to charge lower prices.

14. Because Wal-Mart was never an effective constraint on Netflix's pricing, there are two areas of inquiry that are highly relevant to the construction of a reasonable but-for world. First, it is necessary to determine when, if ever, Wal-Mart would have developed into a sufficiently potent competitor to provide a material degree of competitive pressure on Netflix's prices. The second area of inquiry entails estimating the magnitude of such an impact on Netflix's pricing. Dr. Beyer does not address these issues, or even indicate that he understands their relevance to the class certification inquiry. Rather, he simply assumes that the prices across all Netflix plans would have been lower no later than the start date of the proposed class period, had Wal-Mart not exited the business.

15. Perhaps Wal-Mart could have emerged as a viable competitive threat at some point during the proposed class period, but Dr. Beyer offers no analysis to inform this determination. This is a critical omission in Dr. Beyer's report. Moreover, those putative class members who terminated (and did not later re-activate) their Netflix service prior to the date by which Wal-Mart would have become a full-fledged rival did not sustain antitrust injury as a result of the alleged agreement.

Dr. Beyer fails to establish that had Wal-Mart stayed in the online DVD rental marketplace it would have forced Netflix to charge lower prices across its entire menu of subscription plans.

16. Wal-Mart's menu of rental plans was substantially more limited than the range of plans offered by Netflix. Nevertheless, Dr. Beyer asserts that competition from Wal-Mart would have driven down the price of all Netflix plans. To support his assertion, Dr. Beyer claims that Netflix must maintain a set relationship among relative prices across its plans in order to avoid subscribers switching across plans in response to changes in relative prices. Dr. Beyer's argument is incorrect. First, my analysis of Netflix pricing across plans and over time reveals significant changes in relative prices. Similar patterns are observed for Wal-Mart and Blockbuster. More specifically, in mid-2007 Netflix reduced the prices of its four plans that were most directly comparable to Blockbuster's plans and did not adjust the prices of other plans. Second, differences in subscriber behavior across plans suggest that a

substantial share of subscribers to Netflix's higher volume plans would not switch to lower volume plans over a relevant range of plausible changes in relative prices. Third, an empirical study of Netflix subscribers' switching behavior reveals that a drop in the prices of lower volume plans did not lead to a higher rate of switching to these plans. Dr. Beyer fails to show that hypothesized more intensive price competition for lower-volume plans would have induced Netflix to reduce its prices for higher-volume plans, and consequently, he fails to show that subscribers to Netflix's higher volume plans were harmed.

Dr. Beyer is wrong to conclude that price competition observed prior to Wal-Mart's exit resulted from "three-firm" competition. Instead, the evidence shows that Netflix lowered prices in the second half of 2004, shortly after Blockbuster's entry and coincident with Amazon's anticipated entry.

17. It is well understood among economists that an incumbent's responses to an entry event depends on the host of market factors and other considerations. This observation is borne out in the online DVD rental marketplace, where Netflix did not respond to the entry of Wal-Mart, the purported second competitor, but did change its prices following the entry of Blockbuster (and before the anticipated entry of Amazon). Dr. Beyer attempts to rationalize the evidence by claiming that there is something special in terms of the impact on price from entry of the third firm. Based on no evidence at all, he insinuates that Netflix and Wal-Mart tacitly colluded on price and that Blockbuster's entry "broke" this tacitly collusive equilibrium. He then concludes, again based on no evidence at all, that following Wal-Mart's exit, Netflix and Blockbuster restored the collusive outcome, to the detriment of Netflix subscribers. There is absolutely no basis in economics for these conclusions and, much more importantly, there is absolutely no empirical basis for his claims.

Dr. Beyer fails to demonstrate that his posited but-for world where Wal-Mart is a potent rival is the most plausible one.

18. Dr. Beyer considers only a but-for world in which competition from Wal-Mart forces Netflix to offer the same service as in the actual world but at substantially lower prices. He considers no other alternatives. His choice of the but-for world stems from the assumption that online DVD rental services are substantially homogeneous

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and competition among suppliers is primarily on price. This assumption is invalid, as I show in this report. In fact, the online DVD rental services of Netflix and Wal-Mart were highly differentiated – on several dimensions Netflix service was of substantially higher quality. Observed differentiation gives rise to plausible but-for world outcomes in which the economic interests of class members are in conflict.

Dr. Beyer's but-for world poses a serious risk of conflict among class members.

19. In Dr. Beyer's but-for world, serious competition from Wal-Mart compresses Netflix's margins and diverts a substantial number of subscribers from Netflix. As a result, Netflix's incentives to continue investing in quality-enhancing features and services (such as streaming or content breadth and depth) could be weakened. Under such a scenario, subscribers who would lose more value due to a decline in quality relative to the benefit they would receive from hypothesized lower prices would be worse off. Among this group of subscribers would be some who joined Netflix because of service quality attributes such as streaming, but who would have refrained from joining Netflix had such attributes not been available (or been available at some lesser level). Because some subscribers could be worse off in the but-for world (either because they derive greater utility from a higher-priced/higher-quality service relative to a lower-priced/lower-quality service or because they would not have subscribed to Netflix but-for the service's actual higher quality), their interests conflict with other subscribers who are relatively more price-sensitive and derive relatively less value from Netflix's service quality.

20. Alternatively, Netflix might have responded to but-for world competition from Wal-Mart by targeting subscribers who placed relatively higher values on the quality advantages of its service. Under this scenario, where Netflix focuses less on price competition with Wal-Mart and more on competition along quality dimensions, some number of relatively price-sensitive Netflix customers would switch to the inexpensive Wal-Mart service. By ceding its relatively price-sensitive customers to Wal-Mart, Netflix's remaining subscribers would be, on average, less price-sensitive, *i.e.*, they would have a higher average willingness to pay for Netflix service. Consequently, Netflix could plausibly charge them higher prices, leaving those

customers worse off in the but-for world. Dr. Beyer does not address either of these alternatives and, consequently, his but-for world formulation is incomplete and not properly supported.

Dr. Beyer fails to advance a methodology or formulaic approach that can be used to generate reasonable estimates of damage on an individual class member basis.

21. Dr. Beyer proposes two approaches to estimating class-wide damages. One approach relies on gross profit margins while the other approach is based on a price reduction that was considered by Netflix. His implementation of both approaches is unsound, and as a result neither represents a reasonable methodology for estimating class-wide damages in this case.

22. In his gross margin approach, Dr. Beyer posits that Netflix gross margins[6] observed prior to Wal-Mart's exit can serve as a benchmark for purposes of estimating Netflix prices in a but-for world in which Wal-Mart is assumed to continue its online DVD rental operation. Irrespective of whether the gross margin approach makes economic sense in the instant matter, Dr. Beyer's chosen gross margin benchmark, a relatively low figure based on Netflix's performance in late 2004, is unreasonable because it reflects factors other than competition from Wal-Mart, namely a steep price cut implemented by Netflix soon after Blockbuster Online launched a competing service. Because Dr. Beyer fails to demonstrate that the temporary dip in Netflix gross margins was connected in any way to competition from Wal-Mart, he has no basis to conclude that Netflix margins would have remained at low levels had Wal-Mart not exited the marketplace.

23. Dr. Beyer's second proposed methodology, based upon a price reduction "considered" by Netflix for its most popular plan at the time, is equally problematic. The main problem for Dr. Beyer is that he cannot demonstrate a connection between

[6] In general, gross margin is calculated as the difference between revenues and cost of goods sold, divided by revenues. In Netflix's case, cost of goods sold includes expenditures directly related to the provision of DVD rental service to subscribers, such as postage and fulfillment.

Netflix's decision not to implement the "considered" price and Wal-Mart's exit. Indeed, it is impossible to show such a link because Netflix chose to implement another price, *i.e.*, other than Dr. Beyer's benchmark price, in October 2004, when Wal-Mart was still in operation and prior to the round of negotiations that led to the purported market allocation agreement.

III. The Online DVD Rental Marketplace

A. Introduction

24. Suppliers of online DVD rentals offer subscription plans whereby customers pay a monthly fee that entitles them to receive and return DVDs through the U.S. mail. Two general types of plans are offered: unlimited and capped. Unlimited plans differ according to the number of DVDs a subscriber is permitted to check out at any given point in time. For example, under a three-unlimited (3U) plan, a subscriber is allowed to have up to three DVDs checked out at any one time. Unlimited plans have no pre-determined caps on the number of DVDs a subscriber can rent in a given month (there are, of course, practical limitations dictated by the time required to return a DVD and then receive the next DVD in a subscriber's queue).[7] Under a capped plan, limits apply both to the number of DVDs a subscriber can check out at one time and the maximum number of DVDs a subscriber can rent in a given month. For example, under a one-cap (1C) plan, a subscriber is permitted to rent one DVD at a time subject to a maximum of two rentals per month. Similarly, under a two-cap (2C) plan, a subscriber is allowed to rent two DVDs at a time subject to a cap of four rentals per month. There are no limits on the length of time a subscriber can keep the DVDs, and consequently, late fees are never imposed.

[7] A "queue" refers to the list of films and other content that a subscriber has requested for delivery. When a subscriber returns a DVD, she will receive the DVD that is next in her queue (unless that DVD is not available for immediate shipment).

25. Online DVD rental services are differentiated along a number of dimensions,[8] including, but not limited to, the breadth and depth[9] of available content, turnaround time, the ease with which subscribers can navigate a supplier's website, the ability to rate content already viewed and obtain recommendations for other content that might be of interest, the ability to stream content and view it on-demand, and the ability to exchange movies at physical store locations.[10]

26. An online DVD rental supplier needs a large scale in order to operate profitably, and therefore must undertake substantial expenditures on building up the scale of operations. Such expenditures include the acquisition and maintenance of a content library of tens of thousands of titles, development of a distribution network of shipping facilities, customer acquisition costs (*e.g.*, marketing), and the development of software to manage DVD inventories.[11] Given the scale economies associated with the business, standard economics would predict pricing in excess of marginal costs (perhaps substantially so).

27. In the remainder of this section, I discuss the online DVD rental services offered by Netflix, Wal-Mart, and Blockbuster. As part of this discussion, I present comparative metrics that demonstrate convincingly that Wal-Mart, at no point during its operation, was a sufficiently viable competitive threat to induce Netflix to lower its prices. This analysis is not only relevant to the merits of Plaintiffs' claims; it is crucial to the assessment of the validity of Dr. Beyer's conclusions regarding the extent of competition in the but-for world, and whether common proof can be used to

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[8] Dr. Beyer asserts that online DVD rental services are highly commoditized because the services offer the same DVDs and deliver them to subscribers in the same manner. (Expert Report of John C. Beyer, Ph.D. pursuant to Federal Rule 26(a)(2)(B) in Support of Class Certification ("Beyer Report"), at ¶ 37.) Later in my report I discuss why this assertion is incorrect.

[9] By "breadth" I mean the number of titles and "depth" refers to the number of copies of any given title.

[10] *See* Sections III(B-D) and IV *infra* for a detailed discussion of the various dimensions along which suppliers of online DVD rentals differentiate their services.

[11] *See* Sections III(B-D) and IV *infra* for a detailed discussion of the significant expenditures required to develop and operate a large-scale DVD rental service.

demonstrate that virtually all class members have been injured. In order to construct a reasonable but-for world, and in particular to gauge the extent to which, if any, Wal-Mart would have disciplined Netflix's pricing, it is necessary to develop an accurate depiction of Wal-Mart's competitive influence during the period of its operation.

B. Netflix

28. Netflix was incorporated in August 1997,[12] launched an online DVD subscription service in September 1999,[13] and has grown rapidly since then. The following table provides year-end subscriber counts since 2002.

Year End	Total Subscribers
2002	857,000
2003	1,487,000
2004	2,610,000
2005	4,179,000
2006	6,316,000
2007	7,479,000
2008	9,390,000
2009	12,268,000

Note: Counts include paid subscriptions and free trials.
Source: Netflix Form 10-K for the fiscal year ended December 31, 2004, at p. 19; Netflix Form 10-K for the period ending December 31, 2007, at p. 34; Netflix Form 10-K for the period ending December 31, 2009, at p. 32.

29. Netflix has identified the breadth and depth of its catalog of titles, its nationwide network of shipping (fulfillment) centers, and its proprietary recommendation engine as important drivers of its growth.[14] Over the years, the company has added significantly to its DVD library, both in terms of number of titles and total number of DVD copies. As of year-end 2002, the Netflix library included 14,500 titles and

[12] "Netflix, Inc. Form 10-K for the fiscal year ended December 31, 2003 (Netflix 2003 Form 10-K), at p. 7."

[13] Id. at p. 1.

[14] Id. at pp. 1-4.

more than five million DVD copies; by year-end 2008, those figures had swelled to 100,000 and 72 million, respectively.[15]

30. From the time of its entry, Netflix has continued to expand its network of shipping centers. A large and efficient national distribution network directly affects Netflix's ability to provide its subscribers with one-day delivery, *i.e.*, one day for a DVD returned by a subscriber to reach and go through processing at a Netflix shipping center and one day for the next available DVD in the subscriber's queue to arrive at the subscriber's designated delivery address. Not surprisingly, Netflix believes that one-day delivery is a significant contributor to the company's growth.[16]

31. As of year-end 2002, Netflix operated 13 shipping centers and was able to provide one-day or two-day delivery to more than 90% of the U.S. population.[17] By the end of 2003, Netflix was able to serve roughly 80% of its subscribers with one-day delivery,[18] and at year-end 2004, the company's distribution network had more than doubled to include 30 shipping centers.[19] At present, Netflix operates a total of 58 shipping centers that enable the company to provide at least 97% of its subscribers with one-day delivery.[20]

32. Netflix's proprietary recommendation engine has allowed the company to create a customized store (or site within the site) for each subscriber and to generate

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[15] Netflix, Inc. Form 10-K for the fiscal year ended December 31, 2002 (Netflix 2002 Form 10-K), at p. 7; Netflix, Inc. Form 10-K for the period ending December 31, 2008 (Netflix 2008 Form 10-K), at p. 5.

[16] Netflix 2008 Form 10-K, at p. 3.

[17] Netflix 2002 Form 10-K, at pp. 5, 7. *See also* NFLX – Q4 2002 Netflix.com Earnings Conference Call, Thomson StreetEvents, January 15, 2003, NETFLIX_IR_00000479-487, at 481 (Netflix can provide overnight delivery to more than 50 percent of its subscribers and two-day delivery to the balance.).

[18] Netflix 2003 Form 10-K, at p. 2.

[19] Netflix Form 10-K for the fiscal year ended December 31, 2004 (Netflix 2004 Form 10-K), at p. 6.

[20] Netflix Corporate Fact Sheet (available at http://files.shareholder.com/downloads/NFLX/882057732x0x295021/422b46fb-ca67-47a6-be19-36879cf977fe/IR_Fact_Sheet.pdf.).

personalized recommendations.[21] An individual subscriber's recommendations are based upon the subscriber's content ratings[22] and a comparison of those ratings with Netflix's entire database of ratings collected across its subscriber population.[23] Netflix believes that its recommendation technology contributes to greater customer satisfaction and facilitates broader use of the company's content library by subscribers.[24] As of year-end 2009, Netflix had collected approximately three billion content ratings, a ten-fold increase from the analogous figure as of year-end 2003.[25]

33. Netflix has consistently invested substantial sums into marketing efforts designed to attract new subscribers and to build and reinforce the Netflix brand name. In particular, Netflix has utilized online marketing tools such as paid search listings and banner ads, as well other media channels including radio, television, direct mail, print, and inserts placed into consumer packaging, such as DVD player boxes.[26] Netflix continues to spend a substantial percentage of its revenues on marketing.[27] The following table lists Netflix's annual marketing expenditures from 2002 through 2009.

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[21] Netflix 2004 Form 10-K, at p. 3.

[22] Any subscriber has the ability to rate any title included in Netflix's content library. The rating of content involves the assignment of one to five stars to a title. Upon returning a DVD to Netflix, a subscriber is asked as a matter of course to rate the title.

[23] Netflix 2004 Form 10-K, at p. 3.

[24] Netflix Form 10-K for the period ending December 31, 2009 (Netflix 2009 Form 10-K), at pp. 3-4. For 2009, Netflix reported that titles other than new releases accounted for 70% of shipped DVDs.

[25] Netflix 2003 Form 10-K, at p. 1; Netflix 2009 Form 10-K, at p. 4.

[26] Netflix 2004 Form 10-K, at p. 5; Netflix 2009 Form 10-K, at pp. 5-6.

[27] Over the period 2002 through 2009, Netflix marketing expenditures ranged from 14% to 23% of revenues.

Year	Marketing Expenses (in $000s)[28]
2002	35,783
2003	49,949
2004	98,027
2005	144,562
2006	225,524
2007	218,280
2008	199,713
2009	237,744

Sources: Netflix Form 10-K for the fiscal year ended December 31, 2004, at p. 22; Netflix Form 10-K for the period ending December 31, 2007, at p. 36; Netflix Form 10-K for the period ending December 31, 2009, at p. 35.

34. In January 2007, Netflix launched on a phased roll-out basis a feature that delivers film and other content for immediate viewing directly to a subscriber's personal computer.[29] As of February 2007, more than 1,000 titles were available on the company's website for immediate viewing.[30] By early 2008, the number of titles had expanded to more than 6,000, and Netflix had begun to work with consumer electronics manufacturers to develop set-top boxes and other devices that would enable content accessed through the instant watch feature to be viewed on subscribers' televisions.[31] One year later, more than 12,000 titles were available through Netflix's instant watch feature, and content could be streamed to personal computers (PC and Mac). Additionally, content could be streamed to televisions using Netflix controlled software running on a variety of devices, including Internet connected Blu-ray players, set-top boxes, and game consoles.[32] Today, Netflix offers

[28] Marketing expenses include advertising and payroll and related expenses. Advertising spend accounts for the vast majority of marketing and captures marketing program expenditures and other promotional activities, including revenue sharing expenses, postage and packaging expenses, and amortization of the company's DVD inventory related to free trial periods. (*See, e.g.*, Netflix Form 10-K for the period ending fiscal year December 31, 2004, at pp. 22, F-11.)

[29] Netflix Form 10-K for period ending December 31, 2006, at pp. 1, 3.

[30] Id. at p. 2.

[31] Netflix Form 10-K for the period ending December 31, 2007, at pp. 1, 12.

[32] Netflix Form 10-K for the period ending December 31, 2008, at p. 1.

more than 15,000 titles for immediate viewing, and nearly one-half of the company's subscribers use the instant watch feature.[33] Ever since the launch of the instant watch feature Netflix has provided it together with its DVD subscription plans at no additional charge.[34]

C. Wal-Mart

35. Wal-Mart began testing an online DVD rental service in October 2002[35] and launched the business in June 2003.[36] Unlike Netflix, Wal-Mart's online DVD rental service did not experience rapid growth. Indeed, over the course of approximately two years of operation, the business failed to gain any material traction in the marketplace. The following table presents subscriber counts for Wal-Mart and corresponding figures for Netflix for comparison.

Date	Wal-Mart Subs	Netflix Subs	Netflix:Wal-Mart
June 2003	17,114	1,147,000	67:1
Sep. 2003	21,654	1,291,000	60:1
Dec. 2003	37,291	1,487,000	40:1
March 2004	39,837	1,932,000	48:1
June 2004	50,182	2,093,000	42:1
Sep. 2004	56,852	2,229,000	39:1
Dec. 2004	49,686	2,610,000	53:1
March 2005	51,618	3,018,000	58:1

Note: Counts include paid subscriptions and free trials.

Sources: Wal-Mart subscriber data; Netflix Form 10-Q for the quarterly period ended June 30, 2003, at p. 15; Netflix Form 10-Q for the quarterly period ended September 30, 2003, at p. 15; Netflix Form 10-K for the fiscal year ended December 31, 2003, at p. 17;

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[33] Netflix 2009 Form 10-K, at pp. 1, 4.

[34] Unlimited streaming is available at no additional charge for subscribers to Netflix's unlimited plans (1U to 8U). Subscribers to Netflix's 1C plan are entitled to two hours of streaming per-month to a personal computer only. Under the terms of a 1C plan, a subscriber is not allowed to stream content to a television set *via* a Netflix ready device. (Netflix Corporate Fact Sheet)

[35] "Wal-Mart Tests Online DVD Rental Service," The Write News, October 25, 2002 (available at http://www.writenews.com/2002/102502_walmart_dvdrentals.htm).

[36] "Wal-Mart Starts Full-Time Online DVD Rental Business," AllBusiness, June 11, 2003 (available at http://www.allbusiness.com/retail-trade/food-stores/4479102-1.html).

Netflix Form 10-Q for the quarterly period ended March 31, 2004, at p. 17; Netflix Form 10-Q for the quarterly period ended June 30, 2004, at p. 18; Netflix Form 10-Q for the quarterly period ended September 30, 2004, at p. 19; Netflix Form 10-K for the fiscal year ended December 31, 2004, at p. 19; Netflix Form 10-Q for the quarterly period ended March 31, 2005, at p. 16.

36. The subscriber counts presented above indicate that Wal-Mart was unable to mount a material challenge to Netflix.[37] While Netflix, on average, added more than 250,000 net subscribers per quarter, Wal-Mart added on net an average of fewer than 5,000, or less than two percent Netflix's rate of net subscriber additions. In fact, as the table shows, from June 2004 through March 2005, Wal-Mart added on a net basis only 1,436 subscribers.[38] Netflix over the same period added 925,000 subscribers on net, or nearly 650 times the analogous Wal-Mart figure. Over that same period, Wal-Mart's subscriber count relative to Netflix's declined from an already minuscule level.

37. Wal-Mart's own documents demonstrate that the company provided quite limited financial and other resources to its online DVD rental business, certainly relative to Netflix. For example:

a. In late September 2003, John Fleming, who at the time was president and CEO of Walmart.com, noted that the company's online DVD rental business was supported by a "dedicated team of 3," as compared to a team of 400 at Netflix.[39]

b. As of February 2004 seven distribution centers serviced Wal-Mart subscribers,[40] and 10% of subscribers received one-day delivery.[41] Wal-Mart viewed its inability

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[37] According to a Netflix spokesperson interviewed around the time of Wal-Mart's full-scale entry, Wal-Mart would not be a threat until it reached 100,000 subscribers. ("Wal-Mart Starts Full-Time Online DVD Rental Business," AllBusiness, June 11, 2003 (available at http://www.allbusiness.com/retail-trade/food-stores/4479102-1.html). One may interpret this statement as an absolute threshold, *i.e.*, 100,000 subscribers, which Wal-Mart never approached, or as a threshold defined according to a ratio of Wal-Mart to Netflix subscribers at that time. At the time the statement was made, Netflix had roughly one million subscribers, suggesting a threshold ratio of 10% of Netflix subscriber base, which Wal-Mart's online DVD rental service never approached.

[38] As the table shows, from September 2004 through March 2005 Wal-Mart's subscriber base actually contracted by roughly nine percent, as compared to nearly 33 percent growth in Netflix's subscriber population.

[39] WMHOe-001421-002-00002417.

[40] WMHOe-100768-002-00001291.

[41] WMHOe-100768-002-00001437-1438; WMHOe-100779-003-00003581-3582. By comparison, at that time Netflix was able to provide one-day delivery to roughly 80% of its subscribers. (Netflix Form 10-K for the fiscal year ended December 31, 2003, at p. 2.)

> to provide one-day delivery to all but a small fraction of its subscriber base as the primary reason for its subscriber churn (attrition), and the construction of additional distribution centers as necessary in order "to be able to compete with Netflix."[42] It appears that Wal-Mart's limited distribution network, and difficulties in obtaining budgeting approval for the construction of additional centers, prompted one company executive to remark that, "[W]e have one foot in this business right now and we have to commit to it to get it profitable."[43]

38. As compared to Netflix, Wal-Mart operated a more limited network of distribution centers and was able to serve a substantially smaller percentage of its overall subscriber population with one-day delivery. As noted above, seven distribution centers served Wal-Mart subscribers as of February 2004, a figure that increased to 12 by July[44] and to 14 as of October.[45] By contrast, Netflix operated 30 distribution centers as of year-end 2004. In terms of delivery times, a June 2004 Wal-Mart email notes that the company was able to reach 20% of its subscribers with one-day delivery. At that same time, Netflix was able to offer one-day delivery to 75% of its subscribers.[46]

39. Finally, the evidence indicates that, as compared to Netflix, Wal-Mart devoted scant resources towards marketing its online DVD rental service. Prior to launching its DVD subscription operation, Wal-Mart prepared a study that evaluated two separate scenarios for entry into the business: organic development (*i.e.*, Wal-Mart builds the business) or acquisition of Netflix. Under the assumption of organic development, the associated financial pro-forma projects marketing expenditures of $2.525 million for the period covering fiscal years 2003 through 2006 (March 2002 through February

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[42] WMHOe-100768-002-00001437-1438.

[43] Id.

[44] Walmart.com Positioning Distribution Networks, July 23, 2004, WMHOe-100779-003-00002059.

[45] "Amazon DVD rentals? Rivals start worrying; Speculation has led to lowered prices," *International Herald Tribune*, October 28, 2004.

[46] WMHOe-100768-002-00001285.

2006).[47] While this might sound like a substantial sum, to put the budgeted figure in perspective, consider that over the roughly equivalent period of calendar years 2002 through 2005, Netflix reported marketing expenditures of $325.76 million.[48]

40. It appears that Wal-Mart did not modify its plans to provide limited marketing support for its online DVD rental business. For example, a July 2003 analyst report noted that Wal-Mart had not begun to market its service aggressively.[49] A report from November 2003 indicated that Wal-Mart to date had not made significant investments either in marketing or its website,[50] and a report from March 2004 stated that Wal-Mart had not made significant investments either in marketing or its content library.[51] As it turns out Walmart.com was not well placed to drive traffic to online DVD rentals and thus the rental business did not experience complementarities with Wal-Mart's overall online operations. It is worth noting that Netflix had more unique visitors to its website relative to all of Walmart.com; with respect to just the online DVD rental section of Walmart.com, one analyst described visitor counts as "relatively small."[52]

D. Blockbuster

41. Blockbuster is an operator of a chain of brick-and-mortar stores through which it rents and sells motion picture DVDs and other content. It launched an online DVD

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[47] "DVD Rental Subscription Opportunity," WMHOe-100768-001-00015459-481 at 480.

[48] Netflix Form 10-K for the fiscal year ended December 31, 2004; Netflix Form 10-K for period ending December 31, 2005.

[49] "NFLX: Higher Burn Leads To Lower Churn; 2Q Better Than Expected," Thomas Weisel Partners, July 17, 2003, NETFLIX_IR_00000744-762 at 745, 748.

[50] "NFLX: Initiating Coverage With A Buy," WR Hambrecht & Co., November 21, 2003, NETFLIX_IR_00000880-894 at 882.

[51] "Netflix, Inc.," SG Cowen & Co., May 26, 2004, NETFLIX_IR_00001244-267 at 246. The report also noted that "The entry of Wal-Mart in mid-2003 into the online rental business has had no impact on Netflix." (Id.)

[52] "Online DVD Rental Survey A Positive For NFLX; Blockbuster Threat Overestimated," Piper Jaffray & Co., September 20, 2004, NETFLIX_IR_00001837-843 at 839.

subscription service, Blockbuster Online, in August 2004.[53] Unlike Wal-Mart's online DVD rental service, Blockbuster Online was immediately successful at attracting a substantial volume of subscribers. The following table presents subscriber counts for the first eight quarters of operation for Blockbuster Online, and for comparison purposes the eight quarters of Wal-Mart's activity in the marketplace.

Date	Blockbuster Subs	Wal-Mart Subs	Blockbuster:Wal-Mart
Qtr 1	194,000	17,114	11:1
Qtr 2	410,000	21,654	19:1
Qtr 3	822,000	37,291	22:1
Qtr 4	995,000	39,837	25:1
Qtr 5	1,057,000	50,182	21:1
Qtr 6	1,195,000	56,852	21:1
Qtr 7	1,300,000	49,686	26:1
Qtr 8	1,400,000	51,618	27:1

Note: Quarter 1 for Wal-Mart ends June 30, 2003; Quarter 1 for Blockbuster ends September 30, 2004.
Sources: Wal-Mart subscriber data; "Netflix Board Meeting," September 2006, NETFLIX_CORPORATE_00004269 – 486 at 300.

42. As the above table shows, Blockbuster Online quickly achieved significant penetration in the marketplace and posed a material threat to Netflix's continuing growth. By contrast, Wal-Mart gained minimal traction and struggled to attract and retain subscribers.

43. Blockbuster poured substantial amounts of capital into its online DVD rental service. Netflix reported in January 2005 that Blockbuster had invested $100 million in its online service over the first six months following its full-scale launch.[54] Netflix later estimated that Blockbuster's total investment in Blockbuster Online would reach $400 million by roughly the middle of 2006.[55] It appears that a substantial portion of

[53] Blockbuster Inc. Form 10-K for the fiscal year ended December 31, 2004, at p. 5.

[54] "NFLX – Netflix Fourth Quarter and Fiscal Year 2004 Earnings Conference Call," Thomson StreetEvents, January 24, 2005, P-00981-994 at 984.

[55] "Conference Call Transcript; NFLX – Q1 2005 Netflix.com Earnings Conference Call," Thomson StreetEvents, April 21, 2005, NETFLIX_SAVAGE_00080354-367 at 356.

Blockbuster's expenditures related to the marketing of its service to consumers, including "plentiful advertising" during the Super Bowl and the NCAA college basketball tournament (March Madness).[56] [redacted][57]

E. Conclusion

44. A principal finding from the above discussion is that substantial investments are required in order to move beyond a niche or fringe status in the online DVD rental business. Netflix committed substantial resources towards building and maintaining a subscriber base that today is approximately 14 million,[58] and similarly, Blockbuster invested hundreds of millions of dollars in its online venture. By comparison, Wal-Mart's online DVD rental business received limited financial and other resources, resulting in a service that was substantially inferior and thus unable to attract and retain much more than 50,000 subscribers.

IV. Dr. Beyer's Opinion

A. Overview

45. In his report, Dr. Beyer asserts that in the absence of the alleged market allocation agreement between Netflix and Wal-Mart, Netflix would have been compelled, due to more robust competition from Wal-Mart, to charge lower prices for all of its subscription plans.[59] Dr. Beyer was asked to assume that the full downward effect on Netflix's prices would have materialized by no later than May 19, 2005, the start date

[56] Id. *See also* "Blockbuster Online Kicks Off Super Bowl Sunday With National Advertising Campaign," February 6, 2005, P-01041.

[57] Blockbuster Online P&L Statement, BLOCKBUSTER 0000002.

[58] "Netflix Announces Q1 2010 Financial Results," April 21, 2010, http://netflix.mediaroom.com/index.php?s=43&item=355&printable

[59] Beyer Report, at ¶¶ 9(c) and 12(a). *See also* Id. at ¶ 10(c).

of the putative class period.[60] Dr. Beyer concludes that Plaintiffs can demonstrate class-wide impact using proof common to the purported class because all Netflix subscribers, in his view, would have paid lower rental prices by no later than the start of the alleged class period.[61]

B. Dr. Beyer's Opinion on Class-wide Impact Depends upon Several Key Assumptions

46. Dr. Beyer's opinion with respect to class-wide impact hinges on several critical assumptions. In the remainder of this section, I identify these critical assumptions and highlight why they are important to his conclusion. In the next section, I demonstrate that each assumption is refuted given the observed dynamics of competition in the online DVD rental marketplace.

47. *Service providers compete primarily on price.* Dr. Beyer assumes that the online DVD rental marketplace is characterized by homogeneous products and that suppliers compete primarily on price.[62] Dr. Beyer relies on this assumption to conclude that competition among suppliers of online DVD rentals is expected to drive prices towards marginal costs.[63] In contrast, in differentiated product markets suppliers compete along dimensions other than price, such as quality, reputation, or service. Moreover, it is standard economics that in such markets prices will not converge to marginal costs. Instead, firms will earn margins over their costs which help to defray fixed costs of operations and (if possible) generate profits.

48. *Wal-Mart was a major competitor in the online DVD rental marketplace.* Dr. Beyer describes Wal-Mart as a "competitor with deep resources that was committed to, and

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[60] Id. at ¶ 9(c).

[61] Id. at ¶ 12.

[62] Id. at ¶ 60.

[63] Id. Marginal cost is defined as an additional cost of producing an additional unit of output. Dr. Beyer does not make clear whether the relevant marginal cost is the additional cost of sending a DVD or servicing the rental needs of an additional representative subscriber for a month, for example.

focused on, being a low-price seller in this market."[64] Based on this assumption, Dr. Beyer concludes that in the but-for world Wal-Mart would have exerted significant competitive pressure on Netflix's pricing. On the other hand, if Wal-Mart's competitive position were relatively weak and its service poor, it would not have constrained Netflix's pricing to the degree claimed by Dr. Beyer, if at all.

49. *The third firm transforms the marketplace from one characterized by tacit collusion to one characterized by perfect competition.* Dr. Beyer contends that the marketplace "appears susceptible to tacit collusion when there are only two firms," but with three firms, "competition would have inevitably driven prices down to the cost of supplying the market," whatever that might be in this case.[65] Dr. Beyer therefore assumes that three firms is the minimum number of firms required for effectively competitive outcomes. This is, of course, not the case: there is no general rule in *industrial organization economics* which states that with two firms a market is collusive (tacitly or otherwise) and that with three firms it is so "competitive" as to drive prices to costs.[66] The extent to which the entry or exit of a firm impacts competition can only be gauged reliably with an assessment of the marketplace and the firms participating therein.

50. *Different subscription plans are close substitutes over the relevant range of prices.* Dr. Beyer claims that "Online DVD rental subscription plans are close substitutes for one another."[67] He further asserts that "Netflix's subscription plans must maintain their relative pricing in relation to each other, or suffer cannibalization from consumers switching plans."[68] This assumption is crucial for Dr. Beyer's opinion because Wal-Mart

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[64] Id. at ¶ 12(d).

[65] Id. at ¶ 62.

[66] I have come across no such rule during my nearly thirty years of teaching courses in industrial organization economics.

[67] Beyer Report at ¶ 29.

[68] Id. at ¶ 12(a).

only offered three plans rather than the full array of Netflix plans to which putative class members subscribed. In other words, demonstration of class-wide impact requires – at a minimum – that a change in the price of one plan triggers a similar qualitative adjustment in prices across the entire menu of subscription plans.[69] The evidence indicates that such very tight link does not exist.

V. Dr. Beyer's Assumptions are Deeply Flawed

51. Dr. Beyer's key assumptions are directly refuted by the evidence. As a result he provides no sound economic basis upon which to conclude that Netflix's pricing across all of its plans, but-for the alleged market allocation agreement, would have been lower throughout the entire proposed class period. That is, he fails to show that all (or virtually all) putative class members sustained antitrust injury as a result of the alleged agreement.

(1) Online DVD rental service providers compete primarily on price

52. Dr. Beyer claims that online DVD rental services are substantially homogeneous or commodity-like, and consequently, competition is mainly on price.[70] In support of this assertion, Dr. Beyer notes that suppliers deliver the same DVDs in the same manner to consumers, and also claims that suppliers have similar cost structures.[71] He acknowledges that service attributes such as delivery times and the breadth of a supplier's library of DVD titles may serve to differentiate one supplier's service from

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[69] That is, if a price of Plan A goes up by one dollar, say, prices of all other plans have to increase, although not necessarily by the same amount.

[70] *See, e.g.*, Id. at ¶ 40 ("[T]he online DVD rental market is typical of other commodity products, and, as such, competes primarily on price.")

[71] Id. at ¶ 37. In making this claim, Dr. Beyer references a Netflix quarterly business review from January 2005. Specifically, Dr. Beyer calls attention to a slide that indicates Netflix and Blockbuster "have the same DVDs, from the same studios, and use the same U.S. mail." (Quarterly Business Review, January 5th, 2005, NETFLIX_CORPORATE_00006689-755 at 699.) Notably, he omits any discussion of the numerous slides that identify features and attributes of Netflix's service that set it apart from other online DVD rental offerings, including faster delivery times, a recommendation engine, family profiles, more content, and exclusive content. (Quarterly Business Review, January 5, 2005, NETFLIX_CORPORATE_00006689-755 at 700.)

the rival, but then proceeds to dismiss, without any supporting analysis, such service differentiators as likely not significant and generally non-durable (*i.e.*, temporary).[72]

53. As an empirical matter, and from the standpoint of sound economic analysis, Dr. Beyer's view is unfounded. Over the course of Wal-Mart's nearly two years of operation in the marketplace, Wal-Mart consistently charged lower prices relative to Netflix and yet garnered a subscriber base that was trivial as compared to Netflix's. Simply stated, were DVD rental services substantially homogeneous, as Dr. Beyer asserts, it is implausible that Netflix would be able to charge higher prices and, at the same time, enjoy a subscriber base nearly 60 times the size of Wal-Mart's (as of the time of its exit). Chart A-1 illustrates this point: despite the lower prices charged by Wal-Mart, the number of new Wal-Mart subscribers was consistently just a small fraction of the number of new subscribers that Netflix was adding month after month.

54. Moreover, not only was Wal-Mart struggling to add customers, its subscriber cancellation rates illustrate the company's poor performance relative to Netflix in terms subscriber retention (*see* Chart A-2), which reflects customers' satisfaction with the service. Clearly, Wal-Mart's low prices were not enough to either attract or retain subscribers. This evidence flatly contradicts Dr. Beyer's conclusion that online DVD rental services are substantially homogenous.

55. The lackluster performance of Wal-Mart's DVD rental service shows that the quality of its offering compared poorly to Netflix's. First, the evidence indicates that Wal-Mart subscribers had to endure long wait times to receive movies that they had requested. A September 2003 internal Wal-Mart email noted a New York Times article that discussed Wal-Mart wait times of two weeks to more than a month for films that were available immediately on Netflix.[73] Similarly, a July 2004 analyst report from Citigroup, under the heading "Wal-Mart Unlikely to Pose Serious

[72] Id. at ¶ 38.

[73] WMHOe-001421-002-00002417.

Challenge to Netflix," reported on its experience with Wal-Mart's service relative to Netflix's service. Of the top 50 new release titles, all 50 were available for immediate shipment from Netflix. By comparison, less than one-half of the titles were immediately available from Wal-Mart, 28% required wait times of two to four weeks, and roughly 18% were not available at all.[74]

56. Second, Wal-Mart operated a network of distribution centers that provided one-day delivery to only a small fraction of its subscriber base. According to Wal-Mart's internal email from February 2004, only 10% of its subscribers were receiving one-day delivery.[75] In the same email string, a Wal-Mart employee identified customer attrition as one of two factors preventing Wal-Mart's DVD service from achieving profitability, and further noted that "the attrition variable appears [to] center primarily on delivery time, so building more DCs [distribution centers] (to be able to compete with Netflix) is critical."[76] In another Wal-Mart email, the author reports that the company has been reluctant to reduce its free trial period from 30 to 14 days because the slow delivery times would not provide a free trial customer with "enough time to try the service in 14 days."[77]

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[74] "Netflix, Inc.; A Rising Star in a Blockbuster Market," Citigroup, July 1, 2004, NETFLIX_IR_00001435-518 at 489-490.

[75] WMHOe-100768-002-00001437-1438. Recall that as of year-end 2003, Netflix offered one-day delivery to roughly 80% of its customers. *See also* "Netflix, Inc.; A Rising Star in a Blockbuster Market," Citigroup, July 1, 2004, NETFLIX_IR_00001435-518 at 490 (Reporting four to five day turnaround for Wal-Mart versus two to three days for Netflix.).

[76] WMHOe-100768-002-00001437-1438. *See also* WMHOe-100768-002-00001285 (A Wal-Mart email from June 2004 that highlights the substantial disparity between the percentages of Wal-Mart and Netflix subscribers who receive one-delivery.).

[77] WMHOe-100768-002-00000152-154. It is my understanding that delivery times are a function of several variables, namely the scope of the distribution network, the breadth and depth of the content library, and the software that manages the flow of DVD inventory across shipping centers. In other words, delivery times depend upon the proximity of a shipping center to the subscriber's mailing address, the size of a supplier's DVD library (number of titles and copies of each title), and the software that manages the availability of titles at a given shipping center location to account for demand for a given title among subscribers served by each shipping center location. The evidence suggests that Wal-Mart's online DVD rental service fared poorly with respect to each of these variables.

57. The importance of delivery times to service quality and customer satisfaction should not be underestimated, or disregarded, as does Dr. Beyer. In a Wal-Mart survey of customers who had recently cancelled their online DVD rental agreement with the company, it was reported that "delivery problems and long turnaround times are the biggest customer pain points."[78] More than 35% of respondents reported that these issues were the most important factor driving the cancellation decision, and 65% of respondents indicated that DVD turnaround took six or more days.[79] Moreover, in open-ended comments, "many customers said that Netflix has much faster turnaround/delivery times."[80]

58. Similarly, an August 2004 summary of comments and messages received from customers ranked "Service too slow" as the number one reason for cancellations; "Changing service to Net Flix [sic]" was ranked second.[81] Under the category of complaints and general inquiries, ranked first was "Service is too slow (comparison to Net Flix [sic] and how their service is faster (1 day versus 4-5 days))."[82] Despite the foregoing, in October 2004, a Wal-Mart email reported an *increase* in the volume of customer complaints related to delivery times, as well as problems associated with customers receiving DVDs out of order stated in their queues.[83]

59. Chart A-3 tracks the fraction of Wal-Mart and Netflix subscribers who cancelled their subscriptions within six months following initiation of service. Consistent with the

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[78] "DVD Rentals Survey Results," April 23, 2004, WMHOe-100779-003-00003584-593 at 586. *See also* "DVDR Summit," March 10, 2004, WMHOe-770047-002-00037442-481, at 448 ("Delivery times" identified as number one reason for subscriber attrition.).

[79] "DVD Rentals Survey Results," April 23, 2004, WMHOe-100779-003-00003584-593 at 586.

[80] Id.

[81] DVD Rentals Overview, August 3, 2004, WMHOe-100768-002-00001635.

[82] Id.

[83] WMHOe-100768-002-00001698. *See also* WMHOe-100768-002-00001829 ("Every day we're receiving quite a few customer complaints about the DVD rental service." Issues noted include delivery times and DVDs sent out of order relative to a customer's queue.).

customers complaints noted above, a large fraction of Wal-Mart's customers cancelled their subscriptions within a short period of time after joining the service. For example, the chart shows that over 50% of Wal-Mart's subscribers cancelled their subscriptions within three months after joining and almost 70% cancelled their subscriptions within six months after joining – not including customers who opted out at the end of their free trials.

60. Although Wal-Mart appeared well aware of the adverse effects of long delivery times on customer satisfaction levels, the company was unable to resolve the issue. An internal company email from December 2004 identifies "delivery turnaround times" as the reason driving customer cancellations.[84] The author goes on to explain that "Customers state they would rather pay the $1 to $2 more a month with Netflix and get the guaranteed 1 to 2 day delivery turnaround."[85]

61. Given that Wal-Mart already operated a large network of distribution centers, it is important to explain why the company was unable to develop the ability to deliver DVDs in a timely manner. According to Ari Sussman, the Wal-Mart business manager responsible for the online DVD rental business, the online DVD rental operation posed "complex challenges in the area of distribution that are unique to what the rest of the business deals with."[86] In particular, Mr. Sussman explained that a larger network of distribution centers served to increase the amount of catalog inventory required in each center and to thereby lessen "the chance that that DC will have the discs that customers in that area will want to rent."[87] A Wal-Mart employee in April 2004 articulated his belief that the company did not "have the appropriate

[84] WMHOe-100768-002-00004580-582 at 580.

[85] Id.

[86] WMHOe-100768-002-00001231-232.

[87] Id.

skillset internally to solve how to forecast inventory supply and demand for DVD rentals."[88]

62. A third area where Wal-Mart failed to match Netflix is with respect to marketing its DVD subscription service. It appears that Wal-Mart committed paltry sums to support marketing of its online DVD rental service. In March 2004, Wal-Mart reported internally that one reason for a requested marketing budget increase was to build visibility for businesses with which Wal-Mart customers were not familiar, including "DVD Rentals."[89] A Wal-Mart email from April 2004, referencing a recent contraction in the number of subscribers, indicated that the DVD rental business urgently required marketing support.[90] Similarly, Ari Sussman, at his deposition, noted Wal-Mart's difficulties in acquiring subscribers and explained that the "lack of marketing support" was "discouraging."[91] He went on to indicate that the marketing support needed to acquire subscribers in significant numbers was greater than what he had anticipated during the planning stages of the business, and that the required amounts were never provided.[92] Finally, the deposition testimony of the named plaintiffs themselves is consistent with the proposition that Wal-Mart's DVD rental business had limited visibility among consumers. For the named plaintiffs who became Netflix subscribers prior to Wal-Mart's exit, none of them even knew that Wal-Mart offered an online DVD rental service at the time they signed up for Netflix.[93]

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[88] Id.

[89] WMHOe-001421-002-00000527-528.

[90] WMHOe-100772-001-00003835-836.

[91] Deposition of Ari Sussman (rough transcript), May 24, 2010 (Sussman Deposition), at p. 102.

[92] Id. at pp. 103-105.

[93] Deposition of Michael Orozco, March 10, 2010 (Orozco Deposition), at p. 53; Deposition of Andrea Resnick, March 18, 2010 (Resnick Deposition), at pp. 30, 82; Deposition of Michael Wiener, April 7, 2010 (Wiener Deposition), at pp. 23-24.

63. Wal-Mart recognized the shortcomings of its service relative to Netflix, and also understood that to cure these shortcomings would require substantial resources and operating losses. A Wal-Mart email from mid-year 2004 identified as competitive advantages for Netflix its website, network of distribution centers, and marketing strategy, and explained that Wal-Mart (or any other supplier) would "have a hard time replicating those three assets while generating a decent ROI."[94]

64. More generally, it appears that the profitability objectives of Walmart.com and Wal-Mart's (the parent company) limited appetite for risk-taking, severely constricted the funding that was made available to the online DVD rental service. In a January 2005 email, Ari Sussman summarized the strategic reasons underlying the online DVD rental business's inability to secure the capital required to establish traction in the marketplace.[95] Mr. Sussman explained that the DVD rental business was starved of funding because the expected returns on DVD rental subscriber acquisition did not compare favorably to other businesses operated by Walmart.com.[96] He elaborated that other lines of business operated on Walmart.com, including electronics and jewelry, positioned the site as an Internet extension of Wal-Mart stores, and that Walmart.com customers in these segments tended to shop across multiple categories of products. Customers of the DVD rental service, on the other hand, tended not to purchase outside of the DVD rental segment.[97] In concluding his email, Mr. Sussman writes:

> "If we were an internet wing with more financial mobility and were allowed to take broader risks we may be able to justify spending huge

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[94] WMHOe-100768-002-00000531.

[95] WMHOe-100768-002-00006470.

[96] Id. ("If we felt that acquiring these subscribers in this fast growing market was important for us as a company then we would view acquiring them as an investment but right now the payback for this investment versus other investments the company can make is not as compelling.")

[97] Id. *See also* Walmart.com & Netflix Promotional Agreement: (Key Messages/One-Page Summary), WMHOe-100779-004-00000015 (Primary focus of Walmart.com is on integration with Wal-Mart stores and complementary online categories.); Walmart.com 2005 Shareholders Q&A, WMHOe-100779-002-00000015-019 at 015 ("Whether our customers are shopping in our stores or online, we want to provide an integrated shopping experience ...").

> capital on acquiring customers because we can try to do something with those customers in the future. However, given WM.com's current profitability goals and WMT's apprehension at taking risks like this we have a very slim chance of being able to sell them on such a hyper-competitive business that they currently don't have a huge stake in."[98]

65. Analysts covering Netflix hypothesized that Wal-Mart's seeming reluctance to throw its resources behind its online DVD rental service was due, in part, to a concern that stronger performance in DVD rentals would cannibalize the company's new DVD sales, which were seen as an important driver of sales for other Wal-Mart lines of business. In a June 2004 report, WM Hambrecht & Co. noted that, "We don't see Wal-Mart embracing a service that offers a compelling alternative to purchasing their traffic-driving DVDs."[99] Similarly, a Citigroup report from July 2004 based its conclusion that Wal-Mart was "unlikely to a significant challenge to Netflix" on several factors, including a belief that "Wal-Mart relies on DVD sales to drive customers into its stores in the hopes of selling them additional merchandise during those store visits. Moving customers towards an online DVD delivery service could put those additional sales at risk."[100] A Lehman Brothers report from January 2005 reached roughly the same conclusion: "we do not believe that Wal-Mart has the intention of cannibalizing its in-store sell-through DVD business, as Wal-Mart is the number one retailer of DVD units in the U.S."[101]

66. To summarize, whether or not online DVD rental services can be provided by "homogenous" firms is beside the point for the purposes of claiming common impact. What is important is that Netflix and Wal-Mart were very far apart in the product

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[98] WMHOe-100768-002-00006470.

[99] "NFLX: Happy Customers + Suppliers = Big Opportunity; Upside Throughout 2004 to Spook Shorts; Buy Rating and $40 Target, WR Hambrecht & Co., June 29, 2004, NETFLIX_IR_00001402-1415 at 402. *See also* Id. at 403 ("Wal-Mart aggressively prices new DVDs to drive store traffic and will be reluctant to let DVD rental cannibalize DVD sales.").

[100] "Netflix, Inc.; A Rising Star in a Blockbuster Market," Citigroup Smith Barney, July 1, 2004, NETFLIX_IR_00001435-518 at 488.

[101] "Netflix Inc. Initiation of Coverage," Lehman Brothers, January 11, 2005, NETFLIX_IR_00002308-327 at 310.

space – hardly homogenous firms – and that Wal-Mart did not have a credible strategy to grow share prior to its exit. Wal-Mart's feeble performance relative to Netflix, despite offering lower prices, is inconsistent with the claim that the services of these firms were homogeneous. Rather, the large gap between their performances can be attributed to the fact that Wal-Mart's service was substantially inferior to Netflix's across several key dimensions, and that Wal-Mart, while it understood the importance of its service's shortcomings, never devoted the resources needed to cure them in any meaningful way.

(2) Wal-Mart was a major competitor in the online DVD rental marketplace

67. A second key assumption underlying Dr. Beyer's opinions on class-wide impact is that Wal-Mart was, during its operation, a potent competitor in the online DVD rental marketplace,[102] and thus acted as a significant constraint on Netflix's pricing. Without this assumption, Dr. Beyer has no basis to claim that the continued operation of Wal-Mart's online DVD rental business would have forced Netflix to charge materially lower prices than it actually did. However, despite its importance to his overall conclusion, Dr. Beyer offers no credible economic analysis to demonstrate that Wal-Mart did discipline Netflix's pricing at any point prior to its exit,. Rather, he draws his conclusions from the general assumptions regarding Wal-Mart's competitive position as a retailer.

68. Much of the evidence already discussed in this section, such as Wal-Mart's small subscriber base, the poor quality of its service, its problems with customer attrition, and its relative lack of funding, effectively refutes Dr. Beyer's assertion with respect to Wal-Mart's competitive role. While Dr. Beyer mentions some of this evidence, he provides no economic analysis that would justify his assessment why Wal-Mart, despite its poor performance, should nevertheless be considered Netflix's "major

[102] *See, e.g.*, Beyer Report at ¶ 10(a) (Referring to Wal-Mart as a "major competitor in the online DVD rental market."); ¶ 12(c) (Characterizing Wal-Mart as a "major competitor."); ¶ 73 (Characterizing Wal-Mart as a "primary" competitor and a "formidable" company.)

competitor" that had visible influence on Netflix's pricing decisions. Moreover, he fails to examine the evidence from Wal-Mart's internal documents that question the company's commitment to the online DVD rental business and more generally lament its inability to make any meaningful headway in terms of building a subscriber base.[103]

69. Similarly, Dr. Beyer does not address the competitive assessments of Wal-Mart's service found in Netflix internal documents. Contrary to Dr. Beyer's assertion regarding Wal-Mart's competitive viability, Netflix's internal assessments consistently downplay, or in some cases disregard entirely, Wal-Mart's importance as a rival supplier of online DVD rentals. In January 2003, during the test phase of Wal-Mart's service, a presentation from a Netflix Board of Directors meeting reported that the company had "no effective online competition."[104] Several months following the launch of Wal-Mart's service, Reed Hastings, Netflix's CEO, reported at a Board of Directors meeting that "Wal-Mart appeared to have very little traction in the DVD rental space, primarily due to their inferior service and lack of word-of-mouth."[105] A presentation from the same Board meeting noted that an expansion of Wal-Mart's "competitive effort" in June 2003, had not, and likely would not, impact Netflix.[106]

70. Materials from Netflix Board meetings in 2004 are notable not for what they say about Wal-Mart, but rather because of the near total absence of any mention of Wal-Mart. While Blockbuster's online service was discussed at Netflix Board meetings

[103] At his deposition, Dr. Beyer appeared to downplay the importance of Wal-Mart's actual performance, indicating that contemporaneous assessments of Wal-Mart, rather than those undertaken with hindsight, properly inform his views regarding Wal-Mart's significance as a competitor. (Beyer Deposition at p. 219.) In other words, Dr. Beyer's position appears to be that Wal-Mart's actual performance is not as important as how other online DVD rental suppliers perceived Wal-Mart's performance. As I demonstrate in this section, Netflix, Amazon, and analysts covering the online DVD rental marketplace, consistently assessed Wal-Mart as having minimal or no competitive impact on Netflix.

[104] "Netflix, Inc.; A Rising Star in a Blockbuster Market," Citigroup Smith Barney, July 1, 2004, NETFLIX_IR_00001435-518 at 488.

[105] "Minutes of a Meeting of the Board of Directors of Netflix, Inc.," September 3, 2003, NETFLIX_CORPORATE_00000049 – 059 at 049.

[106] "Board of Directors Meeting," September 3, 2003, NETFLIX_CORPORATE_00002919 – 3028 at 2929.

during 2004,[107] as was the perceived potential entry of Amazon,[108] Wal-Mart was mentioned only once.[109]

71. Quarterly business reviews prepared by Netflix similarly demonstrate the company's view of Wal-Mart as not being a competitive factor. A slide from the April 2004 review, nearly one year after the introduction of Wal-Mart's service, notes Blockbuster's imminent entry and declares "Competition, Finally!"[110] Wal-Mart is noted in the October 2004 presentation in a series of slides dealing with competition, but unlike Blockbuster and Amazon is not assessed in any depth.[111]

72. The review from January 2005 examines in some depth competition from Blockbuster and the potential entry of Amazon, but contains no similar assessment of Wal-Mart's service.[112] The same review also contains a slide that compares the availability of titles at Netflix, Blockbuster, and Wal-Mart. For a group of 41 new releases, Netflix is reported as having 29 available "Now" and 12 with a "Short Wait." Wal-Mart, by contrast, is reported as having five available "Now," one with a "Short Wait," four with a "Long Wait," 16 with a "Very Long Wait," and 15 as "Not Available."[113] Finally, the January 2005 review contains a slide that breaks down the

[107] *See, e.g.,* "Minutes of a Meeting of the Board of Directors of Netflix, Inc.," August 4, 2004, NETFLIX_CORPORATE_00000100 – 101 at 100; "Minutes of a Meeting of the Board of Directors of Netflix, Inc.," September 2, 2004, NETFLIX_CORPORATE_00000102 – 104 at 102.

[108] *See, e.g.*, "Board of Director's Meeting," December 9, 2004, NETFLIX_MINTZ_00054131 – 220.

[109] Id. at 167 (Wal-Mart appears with Blockbuster and Amazon under the heading "DVD rental online competition." Of the three, Blockbuster and Amazon are presented in bold-faced type.).

[110] "Quarterly Business Review," April 1, 2004, NETFLIX_CORPORATE_00006579-630, at 582.

[111] "Quarterly Business Review," October 6, 2004, NETFLIX_CORPORATE_00006653-6688, at 655-657.

[112] "Quarterly Business Review," January 5, 2005, NETFLIX_CORPORATE_00006689-755.

[113] Id. at NETFLIX_CORPORATE_00006734. It appears that poor title availability plagued Wal-Mart's service even during its test phase. *See* "Wal-Mart Unveils Online DVD Rental Site; First Major Competition for Pioneer Netflix," *San Jose Mercury News*, October 16, 2002 (In a test of Wal-Mart's service conducted by an analyst from Merrill Lynch, he was unable to add to his wish list four of the five new releases he selected. By comparison, all five titles were available from Netflix.).

reasons for why customers leave Netflix. According to the slide, 20% of customer departures are attributable to "Competition" from Blockbuster.com and Blockbuster's Freedom Pass service. Wal-Mart's online DVD rental service is not identified as a destination for customers who elected to give up their Netflix service.[114]

73. Assessments of Wal-Mart's online DVD rental service and its impact on Netflix, as well as Netflix's views on the key requirements for success as an online provider of DVD rental subscriptions, are also found in the transcripts of Netflix's quarterly earnings conference calls with institutional investor analysts. These transcripts confirm and clearly articulate Netflix's view of Wal-Mart's service as a substantially inferior offering and one that did not pose a viable competitive threat. The transcripts also make clear that absent a substantial financial commitment on the part of any competing online service provider, Netflix would not consider that provider's service to be a legitimate challenger to Netflix's competitive position. In Appendix A, I summarize relevant portions from the earnings calls from the third quarter of 2002 through the first quarter of 2005.

74. [redacted][115] [redacted][117]

[114] "Quarterly Business Review," January 5, 2005, NETFLIX_CORPORATE_00006689-755, at 741.

[115] AMZ 00592-594.

[116] AMZ 00991-1001 at 993.

[117] AMZ 00716-718 at 716. [redacted] (Id. at 717.)

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[redacted][118] [redacted]

> [redacted][119]

76. Analysts covering Netflix during the period of Wal-Mart's operation consistently reported that Wal-Mart's service did not represent a serious challenge to Netflix. Consider the following excerpts, presented in chronological order:

a. "This morning Wal-Mart announced the 'formal' launch of its online DVD service that competes with Netflix's plan. This service has been around since the middle of last year and has had no impact so far on Netflix."[120]

b. "The competition from Wal-Mart or Blockbuster apparently is not having any impact on Netflix's growth."[121]

c. "The threats from Wal-Mart or Blockbuster do not appear to have any impact on Netflix's sub growth, …"[122]

d. "Competition in the movie subscription business has not been significant to-date. The launch of an Internet service by Wal-Mart and the creation of an in-store

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[118] Deposition of Jorritt Van der Meulen, May 12, 2010 (Van der Meulen Deposition), at p. 214.

[119] Id. at pp. 232-233.

[120] "Nothing New in Wal-Mart Plan—Overreaction Likely; Buying Opportunity," U.S. Bancorp Piper Jaffray, June 10, 2003, NETFLIX_IR_00000676-679 at 676.

[121] "Solid Quarter, Again; Well Ahead Of The Competition," U.S. Bancorp Piper Jaffray, July 18, 2003, NETFLIX_IR_00000738-743 at 738. Note that references in 2003 analyst reports to Blockbuster appear to relate to the company's in-store subscription service.

[122] "Subscriber Growth Ahead Of Estimates Again; Raising Price Target," U.S. Bancorp Piper Jaffray, October 2, 2003, NETFLIX_IR_00000831-835 at 831.

subscription service by Blockbuster have not impacted Netflix's subscriber growth or churn."[123]

e. "Competition has yet to impact the Company's [Netflix] growth trajectory. [W]hile the risk from Wal-Mart and Blockbuster will not immediately disappear, the barriers to entry grow higher as [Netflix] expands its brand name and scales its business model."[124]

f. "The entry of Wal-Mart in mid-2003 into the online rental business has had no impact on Netflix. Wal-Mart has not made significant investments in marketing or its movie library, and we estimate that it has a market share of less than 5% of the online rental market."[125]

g. "Walmart.com … has been offering a 3-out online service at $18.76 plus tax for several quarters with little obvious impact."[126]

h. "Walmart.com … seems to have had little success (approx. 40,000 subs) at a lower price point ($18.76)"[127]

i. "At this point, we do not believe that Wal-Mart poses a viable threat to Netflix."[128]

j. "To date, neither Blockbuster nor Wal-Mart has been particularly aggressive or successful in challenging Netflix, and the company's subscriber growth and financial progress has been uninterrupted by these issues thus far."[129]

77. The reactions from analysts following the announcement of the Netflix-Wal-Mart agreement also indicate that Wal-Mart was not a significant competitor.[130] Piper

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[123] "NFLX: Initiating Coverage With A Buy," WR Hambrecht & Co., November 21, 2003, NETFLIX_IR_00000880-894 at 880. *See also* Id. at 882.

[124] "Revises Q4 Guidance; Catalysts Will Likely Spur Further Appreciation," U.S. Bancorp Piper Jaffray, December 18, 2003, NETFLIX_IR_00000928-931 at 928.

[125] "Online Movie Rentals: A Mass Market Product," SG Cowen & Co., May 26, 2004, NETFLIX_IR_00001244-267 at 246.

[126] "BBI's Aggressive Online Pricing Likely To Pressure Shares; Maintain Estimates and Over Weight Rating," Pacific Growth Equities, July 19, 2004, NETFLIX_IR_00001758-767 at 759.

[127] "Blockbuster Beta Live," Credit Suisse First Boston, July 20, 2004, NETFLIX_IR_00001750-757 at 750.

[128] "Online DVD Rental Survey A Positive For NFLX; Blockbuster Threat Overestimated," Piper Jaffray, September 20, 2004, NETFLIX_IR_00001837-843 at 839.

[129] "NFLX: Price Cut Wipes Out 2005 Profit Outlook," Lowering Rating, Citigroup Smith Barney, October 14, 2004, NETFLIX_IR_00002027-034 at 030.

[130] Trade press reports of Wal-Mart's exit also concluded that there would be little impact on competition in the online DVD rental marketplace. *See, e.g.*, "Netflix 1, Wal-Mart 0," Business Week, May 20, 2005 ("… the benefit from the

(footnote continued …)

Jaffray noted that the agreement led to the exit of a competitor, "albeit a minor and inconsequential one."[131] JP Morgan wrote that, "The agreement between NFLX and WMT effectively eliminates WMT from the DVD rental competitive landscape. However, we believe WMT was a relatively small player in terms of subscriber base and DVD rental revenues. As such, we think the competitive landscape remains mostly unchanged."[132]

78. In sum, Dr. Beyer's opinion on class-wide impact is inextricably linked to his claim that Wal-Mart's exit from the marketplace substantially relaxed the competitive constraints on Netflix and thereby allowed the company to charge higher prices (relative to the but-for prices) to its subscribers. This claim is based upon two key assumptions, namely that online DVD rental services are substantially homogeneous and that Wal-Mart was a major competitor. These assumptions are directly refuted by empirical evidence.

(3) Three-firm competition results in competitive pricing while two-firm competition leads to relatively stable and elevated prices.

79. As demonstrated above, Wal-Mart's full-scale entry into the marketplace in June 2003 did not elicit any competitive response from Netflix. In contrast, Netflix implemented significant price reductions not long after Blockbuster's full-scale entry in August 2004. Dr. Beyer assumes that Netflix reduced prices after Blockbuster's entry but not after Wal-Mart's entry simply because Blockbuster was the third competitor to enter the market while Wal-Mart was the second. He is wrong. His claim rests on an unstated assumption that all that matters for competition is the

(... footnote continued)

Wal-Mart deal won't extend much beyond the elimination of what has proved to be a minor competitor."); "Truce in DVD-rental wars," SFGate.com, May 20, 2005 ("... the deal gives Wal-Mart a way to shed a service that barely made a dent in the online DVD-rental market.").

[131] "NFLX-Wal-Mart: A Major Marketing Coup; Limited Impact," Piper Jaffray & Co., May 19, 2005, NETFLIX_IR_00002731-734 at 731.

[132] "JPMorgan Tech Conference Summary," JPMorgan, May 20, 2005, NETFLIX_IR_00002727-730 at 728.

number of firms and not their capabilities. However, given the very different investments and market success that Blockbuster had compared to Wal-Mart, it is not appropriate to equate the impact from Blockbuster's entry to the (reverse) impact from Wal-Mart's exit. As I have already described – and will not repeat it here – these two firms were materially different along key competitive dimensions and their respective market successes confirm this finding. There is no empirical basis for Dr. Beyer to rely on the effects of Blockbuster's entry as the third firm in the marketplace as a predictor of the effects of Wal-Mart's exit from the marketplace.

80. Dr. Beyer maintains that the online DVD rental marketplace is best characterized by Bertrand competition.[133] He totally misapprehends the theoretical model of Bertrand competition. Contrary to Dr. Beyer's characterization of the marketplace, the Bertrand model of competition does not predict that the marketplace is "susceptible to tacit collusion when there are only two firms." Indeed, the model predicts that with two firms selling identical products price will fall to the level of marginal cost of the more expensive firm, which is as close to perfect competition as one can get with two firms. On the other hand, if the products are not identical, the presence of a third firm will not "inevitably" force prices down to the cost of supplying the market.[134] In fact, no matter what the number of firms in the market, all prices will exceed marginal costs of supply, as long as products are differentiated in the eyes of the consumers.

81. Dr. Beyer's flawed reliance on the Bertrand model of competition appears to be an attempt to rationalize the evidence regarding the lack of downward price change after

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[133] The classic Bertrand model assumes that competition occurs only on the basis of price. In the Bertrand model each firm selects a profit-maximizing price *given* the prices of its rivals. Firms are assumed to set prices simultaneously, and as a result, under the further assumptions of product homogeneity and equal marginal costs, prices are competed down to marginal cost. If products are not differentiated but one firm has a lower cost than its rivals, the price will rest at the level of the second-lowest marginal cost. In this case, the mark-up will be equal to difference in marginal costs between the two most efficient firms. The Bertrand model is generally employed when analyzing competition in markets with product differentiation. With differentiated products, profit-maximizing equilibrium prices exceed marginal costs, no matter what the number of firms. For more on the Bertrand model of competition see, for example, *Modern Industrial Organization (Third Edition)*, Dennis W. Carlton and Jeffrey M. Perloff, Boston: Addison Wesley, 2005, pp. 166-7, 196-201.

[134] Beyer Report at ¶ 62.

Wal-Mart's entry and a significant downward price change after Blockbuster's entry, as the third competitor, on prices. The evidence forces Dr. Beyer to claim that there is something special in terms of the impact on price from entry of the third firm which, in turn, allows him (or so he thinks) to claim that he can show impact to the members of the putative class based on common evidence – *i.e.*, based on Wal-Mart's exit. This will not do. First, based on no evidence at all, he is suggesting that Netflix and Wal-Mart tacitly colluded on price and that Blockbuster's entry broke the possibility of tacit collusion, forcing prices down. He then concludes, again based on no evidence at all, that once Wal-Mart departs, Netflix and Blockbuster will restore the collusive outcome and harm subscribers. There is absolutely no basis in economics for these conclusions and, much more importantly, there is absolutely no empirical basis for his claims.

82. Theoretical models of the effects of entry on prices generally predict that such effects depend on the size of the entrant (or entrants) and other relevant characteristics (such as the quality of its product, marketing, service, etc.) that consumers value. Indeed, as I have argued earlier, a weak entrant (such as Wal-Mart was at the time of entry) may have a zero or *de minimis* impact on prices since it makes no sense for the incumbent to slash prices to all of its customers in order to try to retain a few of its customers who otherwise might migrate to the new entrant. On the other hand, an entrant who makes a substantial commitment to the market may provoke a very potent response from the incumbent firm.

83. The evidence in this case is consistent with the proposition from economics that entry responses depend (in part) on the nature of the entrant. It contradicts Dr. Beyer's inferences from misstated theoretical models of competition and thus denies him the support for his conclusion that common impact on Netflix subscribers can be established using common evidence. In particular, when Wal-Mart entered the online DVD rental marketplace in June 2003 as a second competitor, Netflix did not respond by lowering prices. Indeed, Netflix held its prices steady for a year before implementing a price *increase* for most of its plans. It was not until 2004, when Blockbuster entered the marketplace and Amazon was considering entering as

well,[135] that Netflix lowered the prices of most of its plans.[136] In contrast, Wal-Mart's entry as the second supplier of online DVD rental service (apart from niche/regional providers), did not pose a sufficient threat to Netflix to cause its prices to drop. The fact that Netflix lowered prices after Blockbuster's entry has nothing to do with the fact that Blockbuster was the third competitor in the market, as claimed by Dr. Beyer.

84. Chart A-4, which depicts Netflix's success in attracting and retaining subscribers following Wal-Mart's entry and exit from the online DVD rental marketplace, provides further compelling evidence of Wal-Mart's lack of competitive significance as a rival to Netflix during the period after its launch and prior to its exit. The chart demonstrates that Wal-Mart's entry and exit had no impact on Netflix subscriber growth.

85. To summarize, it is well understood among economists that an incumbent's responses to an entry event vary depending on any number of potentially relevant market factors.[137] This observation is borne out in the online DVD rental marketplace, where Netflix did not respond to the entry of Wal-Mart, but did change its prices following the entry of Blockbuster (and before the expected entry of Amazon). A reasonable conclusion to draw from the differences in Netflix's responses is that Wal-Mart's service did not offer sufficiently powerful competition to affect Netflix. The finding that Wal-Mart's exit had no meaningful impact on Netflix's pricing is entirely consistent with this conclusion.

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[135] Amazon's anticipated entry is identified by Netflix as a factor that drove its decision to lower prices. See, e.g., "NFLX – Q3 2004 Netflix.com Earnings Conference Call," Thomson StreetEvents, October 14, 2004, NETFLIX_MINTZ_00048128–143, at 133; "Minutes of a Meeting of the Board of Directors of Netflix, Inc.," October 11, 2004, NETFLIX_CORPORATE_00000105-106, at 106.

[136] The fact that Netflix did not respond aggressively to the first entrant is entirely consistent with the proposition advanced in my declaration that what matters competitively is not only the number of firms but also their competitive prowess (or at least the prospect of such).

[137] For example, the incumbent's market share post-entry, and its expectation regarding the competitive significance of the entrant going forward, can strongly influence pricing and other strategic responses. As the newly released Horizontal Merger Guidelines explain, an incumbent with a large market share may determine that it is not the best strategy to lower its prices in response to a smaller rival's price cut. (Horizontal Merger Guidelines, Release for public comment on April 20, 2010, at p. 15.)

(4) Netflix Must Maintain a Reasonably Rigid Relationship of Prices across Its Menu of Plans

86. Dr. Beyer asserts that Netflix's online DVD rental plans are sufficiently close substitutes for one another so that if Netflix lowers (or raises) the price on one of its plans, it must reduce (or increase) prices on all of its plan in order to avoid "cannibalization," i.e., customers' switching across plans.[138] An examination of Netflix's actual pricing practices, as well as the response of Netflix's subscribers to price changes, effectively undermines Dr. Beyer's theoretical claim. First, it is simply not the case that Netflix (and Wal-Mart and Blockbuster) maintained a set relationship among prices in different service plans. Second, in instances where Netflix did change its relative prices, the actual switching behavior of Netflix subscribers does not support Dr. Beyer's assumption regarding the importance of cannibalization. And third, subscribers to different plans exhibit materially different rental behavior, which suggests that Dr. Beyer overstates the strength of substitution across plans.

87. Empirical evidence contradicts Dr. Beyer's assertion that "Netflix's subscription plans must maintain their relative pricing in relation to each other, or suffer cannibalization from consumers switching plans."[139] Simply put, Netflix – as well as Blockbuster and Wal-Mart – has *not* maintained such relationships in the sense that price adjustments (up or down) to some plans did not trigger price changes (up or down) to all plans. The major price changes implemented by Netflix, Wal-Mart, and Blockbuster are summarized in table B-1.

88. Netflix undertook three major price changes during the period 2002-2009. In June 2004 Netflix raised the prices of five of its six available plans by amounts ranging from \$1 to \$10. Measured in terms of percentages, plan price changes also exhibited substantial variation: from 0% for the 4U plan to 25% for the 8U plan. Similarly, in

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[138] Beyer Report at ¶ 12(a).

[139] Id. Of course, it is true that Netflix must maintain relative pricing in the sense that plans become more expensive as disc limits are increased, *e.g.*, the 2U is more expensive than the 1U, the 3U is more expensive than the 2U, and so on.

October-November 2004 Netflix reduced its prices non-uniformly. For example, while the price of the 6U plan was reduced by $6 (14%) and the price of the 3U plan was reduced by $4 (20%), the price of the 8U plan was reduced by only $2 (4%) and the price of the 4U plan did not change at all. A third sequence of price changes occurred in February-August 2007. During this period, Netflix reduced by $1 the prices of all plans for which Blockbuster had a directly analogous offering – 1C, 1U, 2U, and 3U. At the same time, Netflix did not change the prices of the six plans for which Blockbuster did not have a directly analogous offering, namely the 2C, 4U, 5U, 6U, 7U, and 8U plans. This most recent episode is notable because it directly contradicts Dr. Beyer's claim that competitive pressures that compelled Netflix to reduce prices on a subset of its plans necessarily would compel Netflix to lower prices on all plans. This plainly did not happen.

89. Dr. Beyer's contention regarding relative pricing is further undermined by Wal-Mart's pricing behavior. In November 2004 Wal-Mart reduced the price of its 3U plan by $1.40 (7%). Two months later Wal-Mart reduced the price of its 2U plan much more dramatically, by $2.60 (17%). The price of Wal-Mart's 4U plan was not changed at all. These price changes show that the price premium for Wal-Mart's 4U plan relative to its 2U plan was 41% until January 2005 and then 69% thereafter.

90. Blockbuster's pricing behavior is even more inconsistent with Dr. Beyer's hypothesis: Blockbuster did not change its plan prices in a manner that maintained constant relative prices, and in fact it implemented price changes in *opposite* directions. In June-July 2007 Blockbuster reduced the prices of its 1U and 3U plans by $1, increased the price of its 1C Total Access by $2, and did not change the prices of its remaining plans. Similarly, in December 2007 Blockbuster increased the prices of seven of its plans (by non-uniform dollar amounts), reduced the prices of two other plans, and did not change the prices of its two remaining plans.

91. The actual switching behavior of Netflix subscribers further contradicts the proposition that potential switching across plans forces Netflix to maintain stability in relative prices. As discussed, in July-August 2007 Netflix reduced the prices of its 1U, 2U, and 3U plans without changing other plan prices. Chart B-3 plots the percent

of customers who switched to the 1U, 2U, and 3U plans from higher-volume plans (4U - 8U). As the chart shows, the reduction in the relative prices of the 1U, 2U, and 3U plans did not cause a significant change in the rate of switching to these plans relative to the normal cross-plan switching.[140] Stated differently, the frequency of switching to the 1U, 2U, and 3U plans from other Netflix plans was similar before and after the price changes that rendered the 1U, 2U, and 3U plans relatively less expensive.

92. Finally, an examination of the conduct of Netflix subscribers confirms that subscribers to different plans exhibit materially different usage patterns.[141] Table B-2 summarizes differences across subscribers along several dimensions. For example, on average subscribers to higher-volume plans utilize the Netflix service more intensively, even after taking account of higher disc limits. [redacted] Dr. Beyer fails to examine observed differences in usage patterns across subscribers, and more

[140] The uptick in switching immediately following the price reductions that is shown on Chart B-3 should not be read as corroborating Dr. Beyer's hypothesis that Netflix must maintain tight control over relative price spreads in order to avoid significant cannibalization. A similar spike is observed a year earlier, suggesting that factors other than changes in relative price spreads lead to temporary increases in switching across plans. Moreover, the price reductions implemented by Netflix in mid-2007 did not induce a substantial increase in the magnitude of switching. Nor was the increase permanent.

[141] Netflix's pricing scheme is an example of second-degree price discrimination, which refers to a situation in which a seller offers the same menu of options to all buyers and allows each to self select his or her most preferred option in the menu. (*See, e.g.*, Tirole, J., The Theory of Industrial Organization, The MIT Press (1994), at pp. 142-143.) Here, Netflix offers a menu of rental plans and each consumer selects a plan that best matches his or her preferences, as measured by willingness to pay for watching DVDs on television given relative prices and income. Dr. Beyer's argument seems to be that Netflix must maintain a certain relationship between rental prices so that if the price of one plan falls, all other plans must have their prices adjusted as well.

specifically fails to explain how his assertion regarding the importance of cannibalization remains valid given these differences.

93. To conclude, the evidence demonstrates that Netflix (and Wal-Mart and Blockbuster) has not maintained constant relative prices across plans. The evidence also establishes that observed changes in the relative prices across Netflix plans did not induce material changes in subscriber switching across plans, *i.e.*, there is no evidence of the significant cannibalization effect that Dr. Beyer posits would arise unless relative prices across plans were held steady. The absence of non-trivial shifts in subscriber switching is consistent with the intensive utilization of subscribers to higher-volume versus lower-volume plans.

VI. Lack of Class-wide Impact

A. Wal-Mart's Impact on Netflix Pricing Would Have Occurred, If Ever, at Some Point after the Start of the Proposed Class Period

94. Dr. Beyer's conclusion regarding class-wide impact boils down to the claim that absent the purported market allocation agreement, continued competition from Wal-Mart would have compelled Netflix to charge lower prices for all of its plans, to the benefit of all Netflix subscribers. Dr. Beyer claims that such beneficial effects would start no later than the beginning of the putative class period. Again, for purposes of my analysis, I am accepting as true the allegation that Wal-Mart and Netflix entered into the market allocation agreement as described in the Complaint.[142] However, Dr.

[142] It is important to note, however, that there is evidence suggesting Wal-Mart's unilateral consideration of exiting the online DVD rental business. For example, a June 2004 Wal-Mart email identified several competitive advantages enjoyed by Netflix and concluded that it would be difficult for Wal-Mart to replicate those advantages and simultaneously earn a "decent" return on investment. (WMHOe-100768-002-00000531.) According to Ari Sussman, exiting the online DVD rental business had been discussed internally at Wal-Mart by October 2004. (Sussman Deposition at pp. 101-102.) A December 2004 Wal-Mart email states that if current pricing in the online DVD rental marketplace were to hold steady indefinitely, Wal-Mart "would have to seriously consider exiting the business." (WMHOe-100768-002-00003192-194, at 192.) The same email also indicates that Wal-Mart is going to see how marketplace conditions unfold over the next few months before "making more drastic strategic decisions like exiting, etc." (Id. at 193.) In January 2005, a Wal-Mart regional vice-president expressed his desire to put investments in Wal-Mart's distribution network on hold until he saw sales volumes and forecasts that would support the investments. (WMHOe-100768-002-00003563-564, at 563.) Another email from January 2005 refers to Wal-Mart's "current thinking

(footnote continued ...)

Beyer's finding of class-wide impact depends upon more than the alleged agreement – his opinion also depends upon the assumptions that Wal-Mart would have continued to operate in the market absent the agreement, that Wal-Mart would have become a significant competitor in the market, and that all Netflix plan prices would have been lower but-for Wal-Mart's exit. There is no empirical basis for these assumptions, irrespective of their theoretical validity.

95. As to the first point, I have already discussed evidence regarding Wal-Mart's weak commitment to its online DVD rental business and its poor fit with the overall objectives of Walmart.com which were to develop online businesses that effectively were extensions of the products and services offered through Wal-Mart's store-based operations.[143] In addition, evidence suggests Walmart.com and its parent Wal-Mart had little appetite for developing and maintaining lines of business that were not expected to reach profitability over a relatively short time horizon.[144] Moreover, some industry analysts believed that Wal-Mart's commitment to online DVD rentals was tempered by concerns relating to potential cannibalization of its DVD sales.[145]

(… footnote continued)

as it relates to staying in the [online DVD rental] business." (WMHOe-100768-002-00006470). At the beginning of February 2005, it appears that Wal-Mart set up a loss reserve associated with discontinuing its DVD rental service. (WMHOe-000732-001-00000001-008.)

[143] *See, e.g.*, WMHOe-100779-004-00000015 (Walmart.com's "primary focus is further integration with Wal-Mart stores and expanded online assortments to complement our stores merchandise, which ultimately provide a complete solution for customers."); WMHOe-100779-002-00000015-019, at 015 ("Whether our customers are shopping in our stores or online, we want to provide an integrated shopping experience… ."); "Netflix, Inc. Initiating Coverage," SG Cowen & Co., May 26, 2004, NETFLIX_IR_00001244-1267 at 1256 (Analyst does not anticipate that Wal-Mart will compete aggressively in online DVD rentals, in part because "online movie rentals do not overlap with Wal-Mart's core business nor do they increase store traffic.").

[144] *See, e.g.*, "Netflix (NFLX --$40.15); Subscriber Growth Unabated, But Valuation Prompts Pause Raising Price Target, Downgrading Rating to Neutral Based on Valuation," Roth Capital Partners, LLC, October 6, 2003, NETFLIX_IR_00000836-840 at 837 ("But at the subscriber estimate above [10K], Walmart.com's DVD-By-Mail would be losing money each quarter, causing us to question how long management will fund it. If this venture is successful at driving traffic to Wal-Mart.com, the company may find DVD-By-Mail a valuable loss-leader, just as DVD sales are for Wal-Mart stores. But so far any incremental increase in website visitors appears to be slight.").

[145] *See, e.g.*, "NFLX: Happy Customers + Suppliers = Big Opportunity; Upside Throughout 2004 To Spook Shorts; Buy Rating and $40 Target," WR Hambrecht & Co., June 29, 2004, NETFLIX_IR_00001402-415 at 402 ("We don't see Wal-Mart embracing a service that offers a compelling alternative to purchasing their traffic-driving DVDs."); "Netflix,

(footnote continued …)

96. Despite the evidence that calls into question Wal-Mart's willingness to remain active in the online DVD rental marketplace, Dr. Beyer simply assumes that Wal-Mart would not have exited but-for the agreement. While I find this assumption, at a minimum, questionable, in the remainder of this section I accept it as valid.

97. Even accepting this assumption, it is nonetheless essential to examine Wal-Mart's likely future competitive strength of its online DVD rental business. Dr. Beyer never considers the question of whether Wal-Mart's online DVD rental service would have become much stronger over time or, alternatively, withered away due to the competitive pressures from Netflix and Blockbuster. This, in my view, is a critical omission which vitiates his claims of common impact from day one of the proposed class period through today. Given that Wal-Mart, because of its weak performance and observable lack of commitment, did not constrain Netflix's pricing behavior at any point prior to the start of the putative class period, it is reasonable to ask at what point going forward, assuming Wal-Mart's continued operation, would Wal-Mart's service evolve into a full-fledged competitor constraining Netflix's pricing for on-line DVD rentals.

98. Based upon my analysis of the record in this case, it is my conclusion that at least as of May 2005, Wal-Mart's service was *not* on the way to becoming a potent participant in the provision of on-line DVD rentals. In fact, Wal-Mart's online DVD rental service – despite Wal-Mart's prominence as a retailer – showed no sign of competitive strength or long-run viability.

99. First, during the twelve months before its exit in June 2005, Wal-Mart attracted, on net, a little more than 12,000 subscribers to its online DVD rental service. During roughly the same period, Netflix grew its subscriber base by 1.5 million, or more than

(... footnote continued)

Inc.; A Rising Star in a Blockbuster Market," Citigroup Smith Barney, July 1, 2004, NETFLIX_IR_00001435-518 at 488 (Wal-Mart unlikely to pose a serious challenge to Netflix in part because a stronger DVD rental business would put a "core retail business" for Wal-Mart – DVD sales – at risk.).

100 times Wal-Mart's total.[146] This indicates that there was an unserved segment of the population that could have – in principle – been attracted to Wal-Mart's low cost plans, but in fact were not. Even if one were to assume that in the but-for world, at some point after 2005, Wal-Mart would have begun to add subscribers at a substantially faster rate, an assumption for which there is no clear evidentiary support, Wal-Mart would have remained a marginal supplier for quite some time, or at least until such time that Wal-Mart would have "pulled the plug."[147]

100. Earlier in this report, I presented Charts A-1, A-2, and A-3, which show graphically the competitive weakness of Wal-Mart's service relative to Netflix. Chart A-1 shows that Wal-Mart was only able to attract a very small fraction of the subscribers that Netflix was able to attract. Chart A-2 highlights the fact that even the few subscribers that Wal-Mart was able to add were much more likely to cancel their subscriptions relative to consumers who signed up for service with Netflix. Finally, Chart A-3 tracks the fraction of subscribers who cancelled their subscriptions within a six month period following initiation. Here, Wal-Mart's poor performance is striking – as mentioned earlier, the chart shows that over 50% of Wal-Mart's subscribers cancelled their subscriptions within three months after joining and almost 70% cancelled their subscriptions within six months after joining – not including customers who opted out at the end of their free trials.

101. Second, Wal-Mart's online DVD rental service received only limited funding, and there is no indication that greater resources would have been made available going forward. As already discussed, in order to become a meaningful competitor against Netflix – a successful first mover – required substantial investments, and absent those investments, Wal-Mart's service was not going to transmogrify into a viable

[146] Insofar as one might attribute Wal-Mart's anemic growth to its relatively recent entry, it is important to recall the rapid pace at which Blockbuster Online added subscribers immediately following the full-scale launch of its service. (See Section III(D) *supra.*)

[147] For example, by the end of 2005, Netflix's subscriber population stood at nearly 4.2 million. Even if Wal-Mart had been able to more than double its subscriber base to 100,000 by year-end 2005 (again, an assumption that lacks evidentiary support), it still would have been more than 40 times smaller than Netflix.

competitor, despite the retailing strength of the parent company. At best, it likely would have continued to limp along or decline into further irrelevancy. This is especially the case once Blockbuster entered the online DVD rental marketplace and quickly gained visible market presence (perhaps based on the strength of its brick-and-mortar DVD rental business). Thus, after Blockbuster's entry in 2004, Wal-Mart would have to survive a competitive race against two firms whose core businesses were renting DVDs.

102. Third, the evidence indicates that Wal-Mart, even before its exit, was considering scaling back rather than expanding its service. For example, a Wal-Mart email from the end of 2004 advises that serious consideration should be given to eliminating the company's three and four disc plans because of their lack of profitability.[148] According to Ari Sussman, beginning around the end of 2004, Wal-Mart allowed new customers to sign up only for its 2U plan.[149]

103. One might claim that if Wal-Mart had *any* significance as a competitor, this would be enough to force Netflix to lower its prices – even if by a very small amount. It is theoretically possible for Netflix to "slash" price from, say, 16.99 to 16.89 or even 16.79. However, such response would be at odds with the observed patterns in Netflix's pricing.[150] In particular, since the beginning of the class period, Netflix has always charged prices in the form $X.99, and has always changed prices in whole dollar increments. Accordingly, it is not credible to argue that any amount of competitive influence from Wal-Mart, no matter how trivial, would have induced Netflix to adjust its prices downward by dollar on each extant plan.

[148] WMHOe-100768-001-00019563-564, at 563. See also WMHOe-100768-001-00019565-566, at 566 (Suggesting that Wal-Mart will want to evaluate moving its entire subscriber base to the company's two disc offering.).

[149] Sussman Deposition at pp. 158-159.

[150] For more discussion on price rigidity see, for example, *Modern Industrial Organization (Third Edition),* Dennis W. Carlton and Jeffrey M. Perloff, Boston: Addison Wesley, 2005, pp. 546-552.

104. Dr. Beyer also fails to consider the evolution of the marketplace over the putative class period in terms of the channels through which consumers can obtain film and other content for purposes of home viewing. For example, over the putative class period, video on demand offerings from cable and satellite operators have continued to expand their breadth of programming,[151] streaming services like those from Apple[152] and Amazon[153] have developed, and video kiosks operated by Redbox[154] and others[155] have proliferated. To demonstrate antitrust impact over the entire class period, Dr. Beyer must show that the incremental effect of Wal-Mart's exit was to permit Netflix to charge higher prices. Wal-Mart's incremental impact on pricing, if any, would depend in part upon the presence of competing services. Insofar as various services for delivery of video content to homes, other than online DVD rental, were increasingly operating in the marketplace, Dr. Beyer should have accounted for their presence in assessing the incremental impact from Wal-Mart's hypothesized continued operation in the but-for world.

105. Given that competition from Wal-Mart during its period of operation was insufficient to impact Netflix's pricing, any reliable determination of common (class-wide) impact must include some analysis of the likely date on which Wal-Mart would begin exerting a sufficient pressure to force Netflix into cutting prices (since it has not done so till the day the putative class period starts). Dr. Beyer's gets around this problem by assuming that, inexplicably, Wal-Mart's exit had an immediate upward effect on

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[151] *See, e.g.*, "Comcast Increases On Demand Movie Lineup By 450 Percent Bringing 11,000+ Movie Choices To Customers," May 11, 2010, http://www.comcast.com/About/PressRelease/PressReleaseDetail.ashx?PRID=990 (The expanded movie offerings brings the total number of content choices available on Comcast On Demand to more than 25,000.).

[152] http://www.apple.com/itunes/whats-on/.

[153] http://www.roku.com/amazon-partner ("Amazon Video On Demand – Instantly Watch Over 45,000 Movies and TV Shows").

[154] "Redbox Fact Sheet," http://redboxpressroom.com/factsheets/RedboxFactSheet.pdf (Redbox service is currently available at nearly 25,000 kiosks throughout the U.S.).

[155] *See, e.g.*, http://www.blockbusterexpress.com/company-info/about-us (Blockbuster Express planning to have as many as 10,000 kiosks operating in the U.S. by the end of 2010.).

Netflix's pricing. Because the underlying assumption is demonstrably unfounded, the conclusion itself is without merit. As a result, the proposed class, as currently constituted, includes at a minimum some percentage of Netflix subscribers who sustained no antitrust injury as a result of the alleged market allocation agreement. This percentage is larger the later is the date by which Wal-Mart reasonably could have emerged as a material competitive constraint on Netflix.

106. Chart A-5 illustrates the percentage of proposed class members who sustained no antitrust injury as a result of Wal-Mart's exit, based upon different assumptions about the time it would have taken for Wal-Mart to evolve into a sufficiently effective rival to constrain Netflix's (and Blockbuster's) pricing. For example, the chart shows that roughly 30% of the putative class members cancelled their memberships by mid-2008 and did not rejoin Netflix at a later point in time. This implies that if Wal-Mart would have become a sufficiently viable rival no sooner than mid-2008, roughly 30% of putative class members did not suffer antitrust impact because they only subscribed to Netflix during the period when Wal-Mart was not constraining pricing.

B. In a But-for World, Competition from Wal-Mart Would Not Necessarily Constrain Prices of All Netflix Plans

107. Wal-Mart offered three plans over most of the period of its operation: 2U, 3U, and 4U. At the end of 2004, Wal-Mart allowed new customers to enroll only in its 2U plan. In contrast, when Wal-Mart was active, Netflix offered between six and nine different plans, and today offers 10 different plans: 1C and 2C plans as well as 1U through 8U plans.

108. There is no indication (and Dr. Beyer does not claim) that had Wal-Mart remained in the marketplace, it would have offered all the plans available from Netflix.[156] Indeed, as explained earlier, evidence suggests that Wal-Mart was considering streamlining its menu of plans down to a single offering – the 2U plan.

[156] It is worth noting that Blockbuster has never offered a plan that allows subscribers to have more than three discs out at a time.

109. Despite the fact that many of the Netflix plans were never offered by Wal-Mart, Dr. Beyer nonetheless claims that Wal-Mart's presence in the marketplace would have forced Netflix to lower prices on all of its plans, to the benefit of all putative class members. Specifically, Dr. Beyer claims that if Netflix were forced to lower the prices of the plans directly comparable to Wal-Mart's plans, it would have been compelled to lower the prices of its remaining plans as well. This conclusion is based on the unsubstantiated assumption that different plans are sufficiently close substitutes for a large number of Netflix subscribers such that price adjustment in some plans would necessarily force Netflix to adjust prices across all its plans because not doing so would risk substantial migration of subscribers to the plans whose relative prices have fallen *vis-à-vis* the remaining plans.[157]

110. As shown earlier, Dr. Beyer's conclusion is at odds with the evidence. First, price changes implemented by Netflix, Wal-Mart, and Blockbuster did not preserve relative price spreads across plans. Specifically, on several occasions the three suppliers changed a subset of their prices without changing the others prices at all. For example, in mid-2007 Netflix reduced the prices of its plans for which Blockbuster had directly comparable offerings but did not – contrary to Dr. Beyer's hypothesis – change the prices of its remaining plans. Second, comparing the periods before and after price changes, the rate of switching to plans that became relatively less expensive did not change materially as compared to typical patterns of cross-plan movements. For example, the price reduction of the 1U, 2U, and 3U plans by Netflix in mid-2007 did not lead to an increase in the frequency of switching to these plans from other Netflix plans (as compared to the frequency of switching before the change in prices). Finally, subscribers to different Netflix plans exhibit different usage patterns along several dimensions. This suggests that different subscription plans offered by Netflix are not necessarily such close substitutes that small changes

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[157] This assumes that it would be profit-maximizing to reduce prices across all plans in order to retain the subscribers who might migrate in response to lower price for some plan(s) that are not directly comparable to the plans whose prices were lowered rather than preserve the prices and shed some subscribers.

in relative prices will induce a substantial share of the subscribers to migrate across plans. In particular, subscribers to higher-volume plans utilize their subscriptions disproportionately more intensively than subscribers to lower-volume plans.

111. It is also important to recall that Netflix has, over the putative class period, always changed its prices by whole dollar increments. To see why this matters, suppose that Netflix lowered the price of its 2U plan by one dollar. According to Dr. Beyer, such a reduction would induce some subscribers to higher-volume plans to consider switching to the 2U plan. Insofar as the incremental switching caused by the 2U plan price reduction is modest, a possible outcome might be for Netflix to lower the price of the 5U plan, but only by a few pennies. However, given Netflix's pricing practices since the launch of the service, it would be unlikely to respond with a price cut of just a few pennies, and more plausibly would maintain the 5U pricing. Consequently, if Netflix's theoretically optimal response is to lower the price of higher-volume plans by an amount well under one dollar, it might elect not to adjust higher-volume plan prices. In sum, Dr. Beyer has failed to demonstrate that the cross-elasticity across Netflix's plans is substantial enough to induce price reductions across all plans in response to a reduction in other firm's prices on some selected plans, especially if the rival firm is not likely to attract many subscribers from plans that are not directly comparable.[158]

112. These flaws in Dr. Beyer's analysis undermine his conclusions regarding class-wide impact inasmuch as Wal-Mart never offered plans directly comparable to Netflix plans that have accounted for a significant percentage of Netflix's subscribers over the putative class period. Charts B-4 and B-5 show the fraction of new subscribers that joined each of Netflix's and Wal-Mart's plans, respectively. As is clear from Chart B-4, during the class period a substantial fraction of Netflix's new subscribers

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[158] More generally, the well-known phenomenon of price stickiness has been a popular research topic in economics. *See, e.g.*, Zbaracki, Mark, Ritson, Mark, Levy, Daniel, Dutta, Shantanu and Bergen, Mark E., Managerial and Customer Costs of Price Adjustment: Direct Evidence from Industrial Markets. *Review of Economics and Statistics*, Vol. 86, No. 2, pp. 514-533, May 2004.

selected plans that were never offered by Wal-Mart. For example, starting in late 2006 more than 40% of Netflix's new subscribers selected plans for which Wal-Mart had no directly comparable offerings, *i.e.*, plans other than the 2U, 3U, and 4U. Similarly, as of 2008 Netflix's most popular plan among new subscribers was the 1U; Wal-Mart never offered a 1U plan.[159]

113. Thus, even if Dr. Beyer could demonstrate that Wal-Mart would grow into a more potent competitor to Netflix (and subsequently to Blockbuster as well), this would be insufficient to support a finding of class-wide impact. He would also need to demonstrate that head-to-head competition from Wal-Mart's directly analogous plans would be sufficiently potent to compel Netflix to charge lower prices across its entire menu of plans. Dr. Beyer offers no sound basis upon which to conclude that subscribers to Netflix plans with no directly comparable offering from Wal-Mart (*i.e.*, all subscribers to plans other than the 2U, 3U, and 4U) sustained antitrust impact as a result of the alleged market allocation agreement.

114. The fraction of class members that sustained no antitrust injury is potentially far greater than the foregoing discussion indicates. As noted earlier, Wal-Mart considered the elimination of its 3U and 4U plans, and in any case the vast majority of its subscribers utilized the 2U plan. Chart B-5 shows that Wal-Mart's 2U plan accounted for more than 70% of Wal-Mart's subscriber additions in every single month during the service's operation. Therefore, any constraining effect on Netflix's pricing would have been felt principally, if anywhere, on Netflix's 2U plan price. [redacted] Consequently, Dr. Beyer's analysis does not support his conclusion regarding class-wide impact.

[159] Of course, it is possible that Wal-Mart could have developed and introduced a 1U plan, assuming its continued operation. Dr Beyer offers no analysis to inform this question, or more generally the issue of how Wal-Mart's service would have evolved (if at all) in the but-for world.

C. Dr. Beyer's But-For World Poses a Serious Risk of Conflict among Class Members

115. The only but-for world outcome posited by Dr. Beyer is one in which competition from Wal-Mart forces Netflix to maintain its services, albeit at lower prices.[160] Critical to this outcome is Dr. Beyer's assumption that online DVD rental services are essentially homogeneous, which results in primarily price-based competition. As discussed earlier in Section V, the evidentiary record highlights several dimensions on which the services of Wal-Mart and Netflix were, in fact, highly differentiated, and more specifically several dimensions on which Wal-Mart's service was of substantially inferior quality relative to Netflix. As emphasized already, the mere fact that Wal-Mart captured a trivial share of subscribers while charging lower prices relative to Netflix demonstrates that competition occurs on dimensions other than price.

116. The differentiated nature of the Netflix and Wal-Mart services gives rise to plausible but-for worlds that are not considered by Dr. Beyer. First, Dr. Beyer contends that in the but-for world intense competition from Wal-Mart would have squeezed Netflix's margins and caused a significant loss in subscriber volumes. If this were true, then Netflix's incentives to invest in high-quality services (such as streaming, one-day delivery, and its recommendation engine) could be weakened. In other words, prices would be lower, but so too would the quality of Netflix's service. Alternatively, Netflix could respond to Wal-Mart's entry by focusing its service on subscribers who place relatively more value on the quality of service and less so on price. That is, Netflix might shed price-elastic subscribers and try to retain quality-oriented subscribers with a high willingness to pay, (*i.e.*, the less price-sensitive subscribers). This strategy plausibly could lead Netflix to increase its prices to reflect the average higher willingness to pay of its remaining subscribers. Below, I describe these possible responses from Netflix and explain how such responses would lead to conflicts across putative class members.

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[160] Beyer Report at ¶ 9(c).

117. To start, it is clear that when it was operating, Wal-Mart's online DVD service reasonably can be characterized as a low-priced and low-quality offering. In particular, Wal-Mart charged lower prices relative to Netflix for comparable plans and offered a lower quality service. From my review of the evidence, I have seen no indication that Wal-Mart had plans to re-position its service at a relatively higher price point, *e.g.*, at parity with Netflix. Nor have I seen any evidence indicating that Wal-Mart was intending to plow substantial resources into its online DVD rental service and match Netflix's quality.

118. Wal-Mart's service thus appealed mostly to consumers who were relatively price-sensitive and/or who placed relatively little value on service quality. With respect to service quality, observed differences in Netflix subscriber behavior – in terms of how they use the Netflix service and how cancellation rates compare with usage intensity – are consistent with the proposition that these subscribers assign different values to the quality-related aspects of Netflix's service. Charts C-1 and C-2 show that Netflix subscribers with low turn rates are more likely to cancel their Netflix service as compared to subscribers with higher turn rates. Charts C-3 and C-4 show lower rates of cancellation for Netflix subscribers who make greater use of the streaming service or who rate larger numbers of titles, respectively.[161]

119. In Dr. Beyer's unsupported but-for world, where competition from Wal-Mart would compress Netflix's margins and divert subscribers from Netflix, it is at least plausible that Netflix would have invested less in services such as streaming, faster DVD shipments, and its recommendation engine. One reason for such lessened investments follows from the fact that lower per-subscriber gross margins imply, *ceteris paribus*, lower returns on investments and therefore weaker incentives to invest in the first place. Stated differently, Netflix would have weaker incentives to invest in services

[161] In all cases, higher usage of a given service feature is consistent with a higher valuation of that feature. Insofar as certain Netflix subscribers make greater use of a given feature, they would be less likely to switch to a lower-priced competing service that did not offer the same feature.

that attract new customers or preserve existing ones if margins – and therefore the returns on such investments – were reduced.[162]

120. A second possible reason for Netflix to scale back on its investments under such a scenario is that lower prices (and thus margins) might reduce Netflix's ability to fund such investments. In Dr. Beyer's but-for world, Netflix's margins are compressed as a result of lower prices and, as well, Netflix presumably loses some subscriber business to Wal-Mart. A plausible outcome is that Netflix scales back on its investments in service quality and features due to an inability to recover the fixed costs required by these investments.[163] Indeed, Netflix documents support the notion that at least to some extent, Netflix tied its investments in new and existing services to its gross margins.[164]

121. The possibility that Netflix would eliminate (or reduce the quality of) some of its services in response to the greater competition from Wal-Mart that Dr. Beyer unrealistically assumes creates a serious risk of conflict across putative class members. While some class members may derive greater value from price reductions relative to the loss in value attached to the reduction or elimination of quality attributes, *e.g.*, streaming or immediate availability of titles, the calculus may tip in the other direction for other putative class members. This latter group is worse off in a but-for world with lower Netflix prices and quality because they lose more value from the decline in quality than they gain from the reduction in price. Within this

[162] That this was not the case in the actual world does not diminish the point; rather, it underscores the weakness of Dr. Beyer's assumptions at the outset.

[163] To give this argument some context, consider that Dr. Beyer is positing a two dollar reduction in Netflix's 3U price as of the time of Wal-Mart's exit. At the end of calendar year 2005, Netflix had nearly 4.2 million subscribers, the majority of whom were enrolled in the 3U plan. If one assumes that the average reduction in monthly price across all plans would be two dollars, this implies an approximately $100 million reduction in Netflix profits. A reduction of such magnitude quite likely would curtail to some extent Netflix's investments in service quality and features.

[164] *See, e.g.*, "Q2 09 Earnings Recap," July 29, 2009, NETFLIX_SWASEY_00011725-740 at 734 (Netflix funding investments in streaming content, the digital platform, and customer acquisition with earnings above a 10% operating margin.); "Quarterly Review Offsite," April 7, 2003, NETFLIX_HUNT_00165081-122 at 087 (Cost savings used to fund service improvements.).

group of subscribers are those for whom the quality of Netflix service was a sufficiently important consideration such that reduced quality would have led them not to subscribe to Netflix. The important takeaway is that a conflict among class members exists. Subscribers who would have foregone joining Netflix because of diminished quality are worse off in a lower-price/lower-quality but-for world, as are subscribers more generally who experience lower utility as a result of lower prices coupled with lower quality. Their interests do not align with those class members whose utility gain from a lower price would have outweighed the utility loss due to a reduction in service quality and/or features.

122. Importantly, the potential class conflict noted above, and the but-for world in which it arises, should not be dismissed as mere speculation. Netflix did, in fact, invest substantially in the introduction and enhancement of service quality attributes and features. It is also beyond dispute that Netflix subscribership has increased dramatically over the years, from less than one million at year-end 2002 to nearly 14 million as of March 31, 2010.[165] There is every reason to believe that the company's investments in service quality and enhanced features played an important role in this growth, and that some non-trivial number of subscribers would not have joined Netflix had the service been poorer or less feature-rich.[166]

123. To gauge the importance of streaming in terms of stimulating subscriber additions, I analyzed the streaming behavior of subscribers that joined Netflix in January 2007 (when the streaming service first became available) or later. I also compared their streaming behavior to that of subscribers that signed up for Netflix service prior to January 2007. The results of my analysis are presented in Chart C-5. [redacted]

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[165] "Netflix Announces Q1 2010 Financial Results," April 21, 2010, http://netflix.mediaroom.com/index.php?s=43&item=355&printable.

[166] *See, e.g.*, "Netflix, Inc.," Cowen and Company, January 9, 2009, NETFLIX_BECKER_00244641-649, at 642 ("We believe an increase in Watch Instantly press coverage and promotion by consumer electronics companies resulted in an acceleration in sign ups …"); NFLX – Q2 2009 Netflix Earnings Conference Call, July 23, 2009, NETFLIX_IR_00000350-364, at 351 ("We believe that the inclusion of streaming in our service has broadened the appeal of Netflix and is driving growth.").

[redacted]

124. A second possible response to Wal-Mart's entry could be for Netflix to increase the prices of some of its plans. Because Netflix cannot engage in first-degree price discrimination,[167] one of the downsides of reducing prices is that Netflix would be required to offer lower prices to all subscribers of any given plan, including those with relatively high willingness to pay who derive greater value from the high-quality aspects of Netflix's service.

125. The high costs of reducing prices to all subscribers might lead Netflix to cede to Wal-Mart customers with lower willingness to pay for the Netflix service. That is, rather than offer a lower price to all subscribers to a given plan, Netflix would refrain from implementing a price reduction and accept the fact that some fraction of plan subscribers – specifically, subscribers who are price sensitive and who do not place much value on service quality – would depart for Wal-Mart. If Netflix elected not to reduce its price, the resulting defection of some subscribers to Wal-Mart would have the effect of increasing the willingness to pay of the average remaining Netflix subscriber. Moreover, the average cost of serving these customers would increase because of their overall more intensive use of the service, *e.g.*, more streaming, more

[167] First-degree price discrimination refers to a situation in which a seller's price to a given buyer reflects information about that buyer's willingness to pay. In the extreme, perfect first-degree price discrimination occurs when the seller charges a set of prices according to each buyer's willingness to pay that permits the extraction of all consumer surplus.

disc rentals. Faced with a subset of subscribers who are on average (i) willing to pay more for the Netflix service, and (ii) more costly to serve, it is possible that Netflix would find it profitable to actually *raise* some prices in response to but-for world competition from Wal-Mart.

126. Indeed, economic theory is ambiguous as to how an incumbent would respond (if at all) to the entry of a smaller rival. The economic literature shows that there are conditions under which an incumbent would choose to respond to entry by lowering its prices and service quality. Under some other circumstance, an incumbent would choose to re-position its service and offer a higher-price, higher-quality service in response to entry.[168]

127. A credible formulation of the but-for world should consider the range of possible strategic responses that Netflix might have implemented had Wal-Mart remained in the marketplace *and grown to become a viable competitor*. Dr. Beyer only considers the possibility that Netflix would have responded to but-for world competition from Wal-Mart by lowering its prices. However, given the specific competitive dynamics of the online DVD rental marketplace outlined above, such strategic response is not necessarily optimal. Having failed to consider the possibilities that Netflix would have reduced its investments in new and existing services or would have raised its prices in response to but-for world competition from Wal-Mart, Dr. Beyer's formulation of the but-for world lacks proper support.

[168] Johnson, Justin P., David P Myatt, "Multiproduct Quality Competition: Fighting Brands and Product-Line Pricing," American Economic Review, Vol. 93, No. 3 (June, 2003): 748-774.

VII. Dr. Beyer's Approaches to Estimating Class-wide Damages Are Flawed

A. Overview

128. Dr. Beyer proposes to estimate damages on a classwide basis by "[m]ultiplying the estimated overcharge percentage by the dollar value of purchases,"[169] where he defines the overcharge percentage as "the extent to which actual prices per unit with the alleged anticompetitive conduct are higher than the prices estimated to have prevailed absent the anticompetitive conduct (*i.e.*, but-for prices)."[170]

129. Dr. Beyer puts forward two alternative methods for estimating Netflix's but-for prices as inputs into damages calculations. Dr. Beyer's first approach is based upon a comparison of Netflix's price-cost margins before and after the alleged market allocation agreement.[171] His second approach employs a "but-for price benchmark."[172] Dr. Beyer offers no economic framework or analysis for calculating reasonable estimates of but-for prices. Rather, he selects a 3U plan price of $15.99[173] based upon nothing more than the fact that Netflix "tested and considered" this price prior to the purported agreement with Wal-Mart.[174] Dr. Beyer also asserts that the 3U price benchmark could be used to determine damages for the entire putative class based on the alleged "cost and price differences normally maintained between the plans."[175]

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[169] Beyer Report at ¶ 67.

[170] Beyer Report at ¶ 65.

[171] Beyer Report at ¶ 69.

[172] Beyer Report at ¶ 75.

[173] Netflix charged $17.99 per month for its 3U plan at the time of Wal-Mart's exit, and charges $16.99 today.

[174] Beyer Report at ¶ 75.

[175] Beyer Report at ¶ 75.

130. Below, I discuss Dr. Beyer's two approaches and demonstrate that neither represents a reasonable formulaic approach or methodology for estimating damages on a class-wide basis.

B. The Price-Cost Margin Approach

131. Dr. Beyer asserts that "[c]omparing price-cost margins in the period during which three firms competed and after the alleged Market Allocation Agreement would yield a percentage overcharge that can be used to determine Class-wide damages suffered by the Class as a result of the alleged Market Allocation Agreement"[176] He appears to consider Netflix's gross profit margins as the relevant metric for his proposed analysis.[177] Although Dr. Beyer describes his approach as "economically sound,"[178] he offers no sound economic analysis to support the proposition that Netflix's margins prior to the alleged agreement provide a reasonable estimate of the margins it would have earned in the absence of the alleged agreement throughout the class period. In fact, for several reasons his approach is flawed.

132. First, Dr. Beyer proposes to use as a benchmark Netflix's gross margins over a five month period – from August 2004, when Blockbuster entered the marketplace,[179] undercut Netflix and launched an aggressive marketing campaign designed to rapidly acquire subscribers,[180] to January 2005, when Wal-Mart and Netflix supposedly began negotiations that led to the putative market allocation agreement. Netflix responded to Blockbuster's competitive threat (as well as to the potential entry by Amazon) by cutting prices, effective November 1, 2004, and it is this price reduction

176 Beyer Report at ¶ 69.

177 Beyer Report at ¶ 70. Dr. Beyer does not explain how he would apply a but-for world company-wide gross margin for Netflix to each of Netflix's numerous plans in order to obtain plan-specific but-for prices.

178 Beyer Report at ¶ 70.

179 Prior to August 2004, Blockbuster operated its online DVD rental service on a test basis.

180 *See, e.g.*, "Board of Director's Meeting," December 9, 2004, NETFLIX_MINTZ_00054131-220, at 132 (Estimating $60 million in advertising expenditures by Blockbuster Online in the second half of 2004.)

that principally drives the observed declines in Netflix's gross margins.[181] Dr. Beyer offers no analysis that links Netflix's price reduction, and hence the bulk of the decline in its gross margins, to competitive pressure from Wal-Mart, and I am aware of no evidence that would substantiate such a claim. Because Dr. Beyer fails to connect the decline in Netflix's gross margins to competition from Wal-Mart, he has no basis to assume that the later increase in Netflix's gross margin was linked in any way to Wal-Mart's exit. In short, Dr. Beyer's gross margin benchmark is not based on the theory of antitrust injury advanced by Plaintiffs, namely that Wal-Mart's exit materially attenuated the competitive constraints on Netflix's pricing.

133. Dr. Beyer has not shown that Wal-Mart's exit led Blockbuster to relax its competitive efforts and lessened the need for Netflix to implement further price reductions.[182] Additionally, Dr. Beyer has not demonstrated that Blockbuster's early operating strategy, with its aggressive pricing and ambitious marketing spending, was sustainable over the long-term. Indeed, evidence in the record suggests it was not. For example, in August 2005 Blockbuster's Chairman and CEO, John Antioco, explained that the company's $14.99 monthly price for its 3-out plan was "not sustainable" and that the company's plans all along had been to increase price once it had acquired one million subscribers.[183] Netflix considered Blockbuster's entry strategy "unsustainable,"[184] in part because the operating losses sustained by

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[181] It appears that Netflix gross margins declined as well because of, among other reasons, increased disc usage, on average, across its subscriber base. By making one-day delivery available to a greater percentage of its subscriber base, the Netflix service became more attractive to subscribers, but also more costly to operate insofar as subscribers were able to rent more DVDs per month.

[182] Dr. Beyer seems to advance such a hypothesis in his report (Beyer Report at ¶ 10(c)).

[183] "Blockbuster falls to second-quarter loss," *Associated Press Newswires*, August 9, 2005.

[184] Netflix Board of Director's Meeting, December 9, 2004, NETFLIX_MINTZ_00054131-220 at 157. Blockbuster's John Antioco, who served as the Chairman and Chief Executive, also pointed out that the $14.99 price "was not sustainable." (*See* "Blockbuster falls to second-quarter loss," *Associated Press Newswires*, August 9, 2005.)

Blockbuster placed in jeopardy its ability to satisfy its loan covenants.[185] Thus, there is reason to believe that Blockbuster's move to pricing parity with Netflix in August 2005 was not linked to Wal-Mart's exit.[186]

134. Dr. Beyer's gross margin benchmark for calculating damages is also flawed because it assumes that Netflix's gross margins would have remained constant or decreased over time. In particular, Netflix's costs were declining in the year or so after its agreement with Wal-Mart, a trend which explains, in part, the observed improvement in Netflix's gross margin. Dr. Beyer's approach implicitly assumes that competition from Blockbuster and Wal-Mart would have pressured Netflix to fully pass on in lower prices this decline in its costs. However, there is no economic basis for such an assumption. On the contrary, many models of competition predict that if a single firm's costs decline, its gross margins will rise. Consequently, Dr. Beyer cannot gauge damages using a model that assumes constant mark-up by Netflix on its DVD rental plans without explaining why such a model is applicable to the facts of the case.

135. Moreover, the mere fact that Netflix's gross margins increased after Wal-Mart exited the marketplace does not demonstrate that the increase can be linked to Wal-Mart's exit. To establish a causal link, Dr. Beyer would have to disentangle the effect of Wal-Mart's exit on Netflix's gross margins from the effects of Netflix's declining costs and other marketplace factors that also could be expected to affect gross margins. Dr. Beyer does not present such an analysis, nor does he provide a framework with which to perform such an analysis. His price-cost margin approach therefore does not represent a reasonable methodology for estimating Netflix's but-for gross margins.

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[185] "Blockbuster falls to second-quarter loss," Associated Press, August 9, 2005; NFLX – Netflix Fourth Quarter and Fiscal Year 2004 Earnings Conference Call, Thomson StreetEvents, January 24, 2005, NETFLIX_IR_00000053-066, at 057.

[186] It also appears that Wal-Mart was prepared to increase its own prices once Blockbuster increased its prices. (WMHOe-100768-002-00003192-194, at 193 ("We would obviously reprice upwards as soon as BB and NFLX come back up.").)

136. Finally, even if one were to assume, *arguendo,* that Dr. Beyer's price-cost margin approach could provide a reasonable estimate of Netflix's but-for gross margin over the proposed class period, his approach still would not provide reasonable estimates of damages across all members of the proposed class. This follows because the final step in Dr. Beyer's approach is to apply the alleged *average* percentage overcharge to all of Netflix's revenues.[187] However, even if one assumes that Wal-Mart's exit did result in an increase in Netflix's gross margins, economic theory would predict that the effect would be greater on the plans that were closer substitutes to the plans offered by Wal-Mart (the 2U, 3U, and 4U plans) and specifically the Wal-Mart plan that was the least unsuccessful (the 2U plan).[188] Such variation in gross margins across plans, coupled with the observation that the shares of various Netflix plans varied substantially over time (*see* Chart B-4), imply that Netflix's average gross margin would not be expected to remain constant over time. By ignoring the likely differences in the effects across plans, Dr. Beyer fails to provide a reasonable methodology for estimating the damages allegedly suffered by individual members of the putative class.

C. The Price Benchmark Approach

137. Alternatively, Dr. Beyer proposes to estimate damages using a but-for "price benchmark." As a general principle, estimating but-for prices and comparing them to actual prices is an accepted approach to estimating antitrust damages. However, Dr. Beyer provides no useful framework to estimate even a single but-for price, let alone the full set of but-for prices that would apply to Netflix's various plan offerings. Thus, his price benchmark approach amounts to little more than an assurance that but-for prices can be estimated on a class-wide basis.

[187] Beyer Report at ¶ 72.

[188] As discussed in Section VI above, the evidence strongly contradicts Dr. Beyer's assumption that Netflix maintained a fixed pricing structure across its various plans. This variation in relative prices supports the view that Wal-Mart would not have had a uniform impact on the gross margins across all of Netflix's plans.

138. Without advancing such framework, Dr. Beyer merely asserts that $15.99 might be a reasonable benchmark for the but-for price of Netflix's 3U plan. Dr. Beyer does not provide price benchmarks corresponding to Netflix's other nine plans. Instead, he proposes to estimate the but-for prices for these plans using "a formula based upon the cost and price differences normally maintained between the [3U and other] plans."[189] However, as already discussed, an analysis of Netflix's pricing behavior demonstrates that Netflix has not maintained a uniform relationship across plan prices. Thus, his suggested method of extrapolation is based upon a premise that is demonstrably false.

139. The only basis Dr. Beyer provides for selecting $15.99 as the but-for price benchmark is that Netflix "considered and tested" this price prior to the company's supposed market allocation agreement with Wal-Mart. Dr. Beyer is correct that Netflix briefly tested a price of $15.99 in October 2004. However, the mere fact that Netflix considered a price is not a sufficient basis for establishing that it would have implemented that price had Wal-Mart continued to operate its online DVD rental business. This is particularly the case because Netflix decided, prior to the supposed negotiations that led to the alleged agreement with Wal-Mart, that it would not be profitable to decrease its 3U plan price to $15.99. In other words, Netflix decided against implementing $15.99 price during what Dr. Beyer refers to as the period of three-firm competition. He nevertheless claims that Netflix would have adopted the $15.99 price had Wal-Mart not exited from the marketplace.

140. As of October 2004, Netflix's 3U plan was priced at $21.99 and Netflix was evaluating a number of possible reductions. During a one-week period, Netflix tested six different adjustments to its $21.99 3U plan: $19.99 (unlimited), $17.99 (cap of 10 DVDs per month), $17.99 (cap of 16 DVDs per month), $17.99 (unlimited), and $15.99 (unlimited).[190] Shortly thereafter, Netflix announced that it would reduce the price of its 3U plan to $17.99. That is, of the five prices tested for the plan, plus

[189] Beyer Report at ¶ 75.

[190] NFLX0037_00021940.

Netflix's existing 3U price of $21.99, Netflix elected to lower the price to $17.99 with no limits on the number of DVDs per month. Nothing about this sequence of events suggests that Netflix would have lowered its prices to $15.99 (unlimited) had Wal-Mart remained in the marketplace.

141. Contemporaneous Netflix business documents indicate that the company rejected adoption of the $15.99 price for legitimate business reasons. For example, a December 9, 2004 presentation to Netflix's Board of Directors indicates that a price of $15.99 for the 3U plan would prevent the company from fully funding its projected marketing budget and would require the company to cease offering customers a free trial at sign-up.[191] The same presentation indicated that no change in Netflix's pricing was expected in 2005.[192] Thus, there was no indication as of December 2004, during the period that three firms were renting DVDs online, that Netflix planned to reduce the price of its 3U plan to $15.99 and thus no basis for Dr. Beyer to assume that it would have done so absent the alleged agreement with Wal-Mart.

142. Even if in the but-for world Netflix would have at some later date reduced the price of its 3U plan to $15.99, it cannot be assumed that it also would have lowered the prices of its other plans by the same amount, a proportional amount, or at all. As discussed in Section VI above, Dr. Beyer's assumption that the prices for all of Netflix's plans would have moved in tandem is directly contradicted by the evidence, including the fact that Netflix has at times changed the price of some plans but not others, and that Blockbuster has even simultaneously lowered its prices for some plans while raising its prices for others. A proper analysis of the but-for world would need to consider

[191] Netflix Board of Director's Meeting, December 9, 2004, NETFLIX_MINTZ_00054131-220 at 186.

[192] Id. at 00054189. See also "Netflix, Inc.," Cowen & Co., January 11, 2005, NETFLIX_IR_00002284-296, at 284 (In January 2005, Netflix communicated publicly the company's intention to maintain its premium pricing, i.e., to leave intact 3U plan pricing at $17.99 per month.); "Netflix, Inc.," Cowen & Co., March 8, 2005, NETFLIX_IR_00002489-499, at 490 (Discusses Netflix shifting the focus of its marketing and promotion from its 3U plan to its lower-priced 2C plan. The Cowen analyst believes that the shift was triggered by Blockbuster Online lowering the price of its 3U plan to $14.99. In other words, Netflix responded to Blockbuster's price reduction for its 3U plan not by lowering the price of its analogous plan but rather by re-orienting its promotional efforts to focus on a lower-priced plan.).

separately the competitive forces influencing Netflix's plans as well as how those forces were affected, if at all, by Wal-Mart's exit. Dr. Beyer presents no such analysis, and as a result his but-for price benchmark approach does not offer a reasonable basis for estimating the damages allegedly suffered by all members of the putative class.

143. Finally, Dr. Beyer omits from his report any analysis of the prices that Wal-Mart would have needed to charge in order to induce Netflix to lower its 3U plan price to $15.99. Given the substantially inferior quality of Wal-Mart's service, it is implausible that Netflix would lower its 3U plan price to $15.99 as a result of competition from Wal-Mart unless Wal-Mart's price were substantially below $15.99. Dr. Beyer does not demonstrate that such a price would be profitable for Wal-Mart, and in fact the evidence indicates that even a price of $15.99, let alone a lower price, would not have covered the company's variable costs.[193] Of course, Wal-Mart, in theory, might have been willing to incur losses in the short-term if it anticipated longer-run profitability. However, evidence discussed earlier suggests that Wal-Mart had a limited tolerance for negative earnings, which raises doubts as to the company's willingness to set price at a level that failed to recoup its variable costs.

J A Ordover

Janusz A. Ordover

May 28, 2010

Date

[193] According to a Wal-Mart email from June 2004, the monthly variable cost associated with the company's 3U plan was $17.35. (WMHOe-100768-002-00000265-266, at 265).

CHART A-1

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CHART A-2

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CHART A-3

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CHART A-4

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CHART A-5

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B-1: Variation in Relative Prices of Different Plans

NETFLIX PRICE CHANGES		Range	1C	2C	1U	2U	3U	4U	5U	6U	7U	8U
June 04	$	[$0, $10]		$1			$2	$0	$4	$7		$10
	%	[0%, 25%]		7%			10%	0%	13%	20%		25%
Oct 04 - Nov 04	$	[-$6, $0]		-$3			-$4	$0	-$4	-$6		-$2
	%	[-20%, 0%]		-20%			-18%	0%	-12%	-14%		-4%
Feb 07 - Aug 07	$	[-$1, $0]	-$1	$0	-$1	-$1	-$1	$0	$0	$0	$0	$0
	%	[-17%, 0%]	-17%	0%	-10%	-7%	-6%	0%	0%	0%	0%	0%

WALMART PRICE CHANGES		Range	2U	3U	4U
Nov 04 - Jan 05	$	[-$2.6, $0]	-$2.6	-$1.4	$0
	%	[-17%, 0%]	-17%	-7%	0%

BLOCKBUSTER PRICE CHANGES		Range	1C	1U	2U	3U	1C TA	1U TA	2U TA	3U TA	1U TAP	2U TAP	3U TAP
Jun 07 - Jul 07	$	[-$1, $2]	$0	-$1	$0	-$1	$2	$0	$0	$0	$0	$0	$0
	%	[-6%, 33%]	0%	-10%	0%	-6%	33%	0%	0%	0%	0%	0%	0%
Dec 07	$	[-$1, $10]	-$1	$0	$0	-$1	$2	$2	$2	$2	$5	$8	$10
	%	[-20%, 40%]	-20%	0%	0%	-6%	25%	20%	13%	11%	29%	36%	40%

Source: Netflix, Walmart, Blockbuster pricing tables

CHART B-2

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CHART B-3

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CHART B-4

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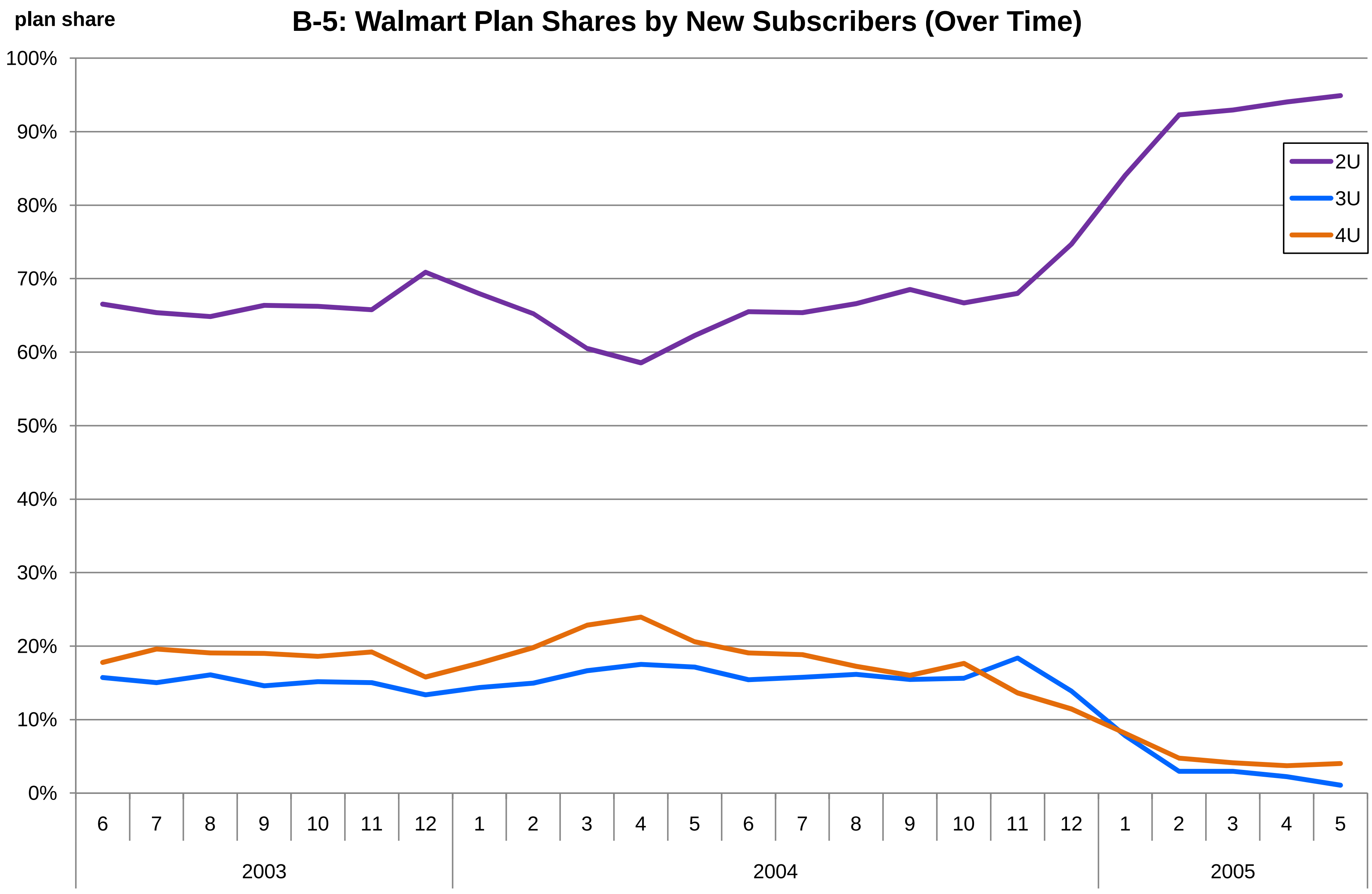

Source: Walmart subscriber data
Note: (1) Free trial subscriptions were excluded from the analysis.

CHART C-1

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CHART C-2

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CHART C-3

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CHART C-4

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CHART C-5

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APPENDIX 1

May 2010

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EDUCATION

1968-1973	Columbia University, New York, New York Graduate Department of Economics and European Institute of the School of International Affairs Doctoral Dissertation: Three Essays on Economic Theory (May 1973). Ph.D 1973.
1967-1968	McGill University, Montreal, Canada Departments of Economics and Political Science
1963-1966	Warsaw University, Warsaw, Poland Department of Political Economy. B.A. (equiv.), 1966.

HONORS

1973	Columbia University: Highest distinction for the doctoral dissertation
1971-1972	Columbia University: Honorary President's Fellow
1969-1971	Columbia University: President's Fellow
1967-1968	McGill University: Honors Student
1964, 1965	Warsaw University: Award for Academic Achievement, Department of Political Economy
	Who's Who in the World Who's Who in America Who's Who in the East

PROFESSIONAL EXPERIENCE

June 1982 - present	Professor of Economics Department of Economics, New York University, New York, New York
Sept. 1996 -	Director of Masters in Economics Program

Aug. 2001	Department of Economics, New York University, New York, New York
Summer 1996-2000	Lecturer International Program on Privatization and Reform Institute for International Development, Harvard University, Cambridge, Massachusetts
Aug. 1991 - Oct. 1992	Deputy Assistant Attorney General for Economics Antitrust Division United States Department of Justice, Washington, D.C.
Sept. 1989 - July 1990	Visiting Professor of Economics School of Management, Yale University, New Haven, Connecticut Lecturer in Law Yale Law School
Mar. 1984 - June 1988	Visiting Professor of Economics Universita Commerciale "Luigi Bocconi", Milan, Italy
June 1982 - Feb. 1985	Director of Graduate Studies Department of Economics, New York University
Sept. 1982 - June 1986	Adjunct Professor of Law (part-time) Columbia University Law School, New York, New York
Feb. 1982 - June 1982	Acting Director of Graduate Studies Department of Economics, New York University
June 1978 - June 1982	Associate Professor of Economics Department of Economics, New York University
Sept. 1979 - May 1990	Lecturer in Economics and Antitrust New York University Law School
Sept. 1977 - June 1978	Member, Technical Staff Bell Laboratories, Holmdel, New Jersey Associate Professor of Economics Columbia University Visiting Research Scholar Center for Law and Economics, University of Miami, Miami, Florida
Sept. 1973 - Aug. 1977	Assistant Professor of Economics New York University
Summer 1976	Fellow, Legal Institute for Economists, Center for Law and Economics, University of Miami
Summer 1976	Visiting Researcher Bell Laboratories, Holmdel, New Jersey

OTHER PROFESSIONAL ACTIVITIES

2006 - present	Special Consultant, Compass Lexecon (formerly Compass)/FTI Company, Washington, D.C.
2003 - 2006	Director, Competition Policy Associates, Inc. ("Compass"), Washington, D.C.
1997 – 1999	Consultant, Inter-American Development Bank, Washington, D.C.
1997 – present	Board of Editors, *Antitrust Report*
1995 – 2001	Consultant, The World Bank, Washington, D.C.
1998 – 2004	Senior Consultant Applied Economic Solutions, Inc., San Francisco, California
1995 - 2000	Senior Affiliate Cornerstone Research, Inc., Palo Alto, California
various	Testimony at Hearings of the Federal Trade Commission
1994 - 1996	Senior Affiliate Law and Economics Consulting Group, Emoryville, California
1994 - 2000	Senior Affiliate Consultants in Industry Economics, LLC, Princeton, New Jersey
1993 - 1994	Director Consultants in Industry Economics, Inc., Princeton, New Jersey
1992 - 1993	Vice-Chair (*pro tempore*) Economics Committee, American Bar Association, Chicago, Illinois
1990 - 1991 1992 - 1995	Senior Consultant Organization for Economic Cooperation and Development, Paris, France
1991	Member *Ad hoc* Working Group on Bulgaria's Draft Antitrust Law The Central and East European Law Initiative American Bar Association
1990 - 1991	Advisor Polish Ministry of Finance and Anti-Monopoly Office Warsaw, Poland
1990 - 1991	Member Special Committee on Antitrust Section of Antitrust Law, American Bar Association
1990 - 1991	Director and Senior Advisor Putnam, Hayes & Bartlett, Inc., Washington, D.C.

1990 - 1996	Member Predatory Pricing Monograph Task Force Section of Antitrust Law, American Bar Association
1989	Hearings on Competitive Issues in the Cable TV Industry Subcommittee on Monopolies and Business Rights of the Senate Judiciary Committee Washington, D.C.
1989	Member EEC Merger Control Task Force, American Bar Association
1988 - present	Associate Member American Bar Association
1987 - 1989	Adjunct Member Antitrust and Trade Regulation Committee, The Association of the Bar of the City of New York
1984	Speaker, "Industrial and Intellectual Property: The Antitrust Interface" National Institutes, American Bar Association, Philadelphia, Pennsylvania
1983 - 1990	Director Consultants in Industry Economics, Inc
1982	Member Organizing Committee Tenth Annual Telecommunications Policy Research Conference, Annapolis, Maryland
1981	Member Section 7 Clayton Act Committee, Project on Revising Merger Guidelines American Bar Association
1980	Organizer Invited Session on Law and Economics American Economic Association Meetings, Denver, Colorado
1978 - 1979	Member Department of Commerce Technical Advisory Board Scientific and Technical Information Economics and Pricing Subgroup
1978 – present	Referee for numerous scholarly journals, publishers, and the National Science Foundation

MEMBERSHIPS IN PROFESSIONAL SOCIETIES

American Economic Association
American Bar Association

PUBLICATIONS

A. Journal Articles

"Coordinated Effects in Merger Analysis: An Introduction, " *Columbia Bus. Law Review*, No. 2, 2007, 411-36.

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B. Books and Monographs

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C. Book Chapters

"Coordinated Effects," chap. 27, in *Issues in Competition Law and Policy*, vol. 2, American Bar Association, 2008, 1359-1384.

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"Predation, Monopolization, and Antitrust," with G. Saloner, in R. Schmalensee and R.D. Willig (eds.), *Handbook of Industrial Organization*, vol. 1, North Holland, 1989, 538-596.

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Regulation of Economic Activity Program, National Science Foundation, Microeconomic Analysis of Antitrust Policy, Principal Investigator, April 1, 1983 - March 31, 1984.

Economics Division of the National Science Foundation, "Political Economy of Taxation," Principal Investigator, Summer 1982.

Sloan Workshop in Applied Microeconomics (coordinator), with W.J. Baumol (Principal Coordinator), September 1977 - August 1982.

Economics Division of the National Science Foundation, "Collaborative Research on the Theory of Optimal Taxation and Tax Reform," July 1979 to September 1980, with E.S. Phelps.

Division of Science Information of the National Science Foundation for Research on "Scale Economies and Public Goods Properties of Information," W.J. Baumol, Y.M. Braunstein, M.I. Nadiri, Fall 1974 to Fall 1977.

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APPENDIX 2

May 2010

Expert Testimony Provided by
Dr. Janusz A. Ordover 2003 – 2010

In Re: Gemstar Development Corporation Patent Litigation, MDL-1274-WBH (N.D. Ga.) (deposition testimony)

College Loan Corporation v. SLM Corporation, Sallie Mae, Inc., and Sallie Mae Servicing L.P., Civil Action No. 02-1377A (E.D. Va.) (deposition testimony)

Aventis Environmental Science et al., v. Scotts Company and Monsanto Co., 99 Civ. 4015 (LAP) (S.D. NY) (deposition testimony)

The Citizenship of DHL Airways, Inc. under 49 USC 40102 (a) (15), U.S. Department of Transportation Docket 13089 (trial testimony)

United States of America, et al., v. First Data Corporation and Concord EFS, Inc., 1:03CV02169 (RMC) (pre-trial testimony, deposition testimony)

Carolyn Fears, et al., v. Wilhelmina Model Agency, Inc., et al., U.S. Dist. Court, S.D.N.Y., Case No. 02-CV-4911 (HB)(HBP) (deposition testimony)

CSC Holdings, Inc. v. Yankee Entertainment and Sports Network, LLC.,American Arbitration Assoc. (February 2004) (deposition testimony)

Masimo Corporation v. Tyco Health Care Group L.P. and Mallinckrodt, Incorporated, No. CV 02-4440 MRP, (C.D. Ca.), (deposition testimony and trial testimony in 2005, deposition and trial testimony in 2006, trial testimony in 2007)

Qantas Airways Ltd. and Air New Zealand Ltd. v. ACCC, (The Australian Competition Tribunal, Sydney, Australia) (tribunal testimony)

GE v. Commission, (Case T-210/01) (The Court of First Instance, Luxembourg) (Testimony for the Commission of the European Communities) (Testimony at the Hearing for UTC In re GE/Honeywell Merger, European Commission, Brussels, Belgium)

Sony/BMG Joint Venture (Case No. Comp/M3333) (Oral hearing testimony at the EC, Brussels, Belgium)

In Re: Remeron Direct Purchaser Antitrust Litigation, Master Docket No.03-CV-85 (FSH)(New Jersey) (deposition testimony)

Qantas Airways Ltd. and Air New Zealand Ltd. v. NZ Commerce Commission (High Court of New Zealand, Auckland Registry Case CIV 2003 404 6590, Auckland, New Zealand) (Appeal hearing testimony)

Reading International, Inc., et al., v. Oaktree Capital Management, et al., No. 03 Civ. 1895, (S.D. NY), (deposition testimony)

Natural Gas Anti-Trust Cases I, II, III, & IV (J.C.C.P. Nos. 4221 through 00000), Superior Court of the State of California, County of San Diego (deposition testimony)

In Re: NCAA I-A Walk-On Football Players Litigation, U.S. Dist. Court, Western District of Washington at Seattle, Master File No. C-04-1254-C (deposition testimony in 2005 and 2006)

Canadian Lumber Trade Alliance, et al. v. United States, et al. and Coalition for Fair Lumber Imports Executive Committee, et al. Consolidated Court No. 05-00324 (U.S. Court of International Trade) (deposition and trial testimony)

Jame Fine Chemicals, Inc. v. Hi-Tech Pharma Co., Inc., v. Medpointe Inc., U.S. Dist. Court, Dist. of New Jersey, Civ. Action No. 00-3545 (AEI) (deposition testimony)

Jason White, et al. v. NCAA, U.S. Dist. Court, Central District of California, No. CV06-0999 RKG (MANx) (deposition testimony)

In Re: Hydrogen Peroxide Antitrust Litigation, U.S. Dist. Court, Eastern District of Pennsylvania, Civ. Action No. 05-DV-666 (MDL No.:1682) (deposition testimony)

Rochester Medical Corp. v. C.R. Bard International et al., U.S. Dist. Court, E.D. of Texas (Texarkana Div.), No. 504-CV-060 (deposition testimony)

Natchitoches Parish Hospital et al. v. Tyco International, Ltd. et al., U.S. Dist. Court, District of Massachusetts, Civ. Action No. 05-12024 PBS (deposition testimony twice, court hearing, jury trial testimony)

In the Matter of Adjustment of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, Docket No. 20006-1 CRB DSTRA, Copyright Royalty Board, Library of Congress, Washington, D.C. (deposition testimony, hearing testimony)

Allied Orthopedic Appliances, Inc. v. Tyco Health Care Group L.P. et al., U.S. Dist. Court, Central District of California (Western Div.), CV-05-6419 MRP (AJWx) (deposition testimony twice)

Delco LLC and Edward Decker v. Giant of Maryland LLC, Wakefern Food Corp., and Stop & Shop Supermarket Company LLC, U.S. Dist. Court, District of New Jersey (Camden Vicinage), No. 07-CV-03522 (JBS-AMD) (deposition and PI hearing testimony)

Woolworths Ltd. and The Warehouse Group v. The Commerce Commission, High Court of New Zealand, Wellington Registry, CIV 2007-485-1255 (hearing on the appeal from the determination of the NZ Commerce Commission)

IGT v. Alliance Gaming et al., U.S. Dist. Court, Dist. of Nevada, No. CV-S-04 (1676-RCJ-(RJJ)) (deposition testimony)

In Re: New Motor Vehicle Canadian Export Antitrust Litigation, MDL Docket No. 03-md-1532-P-H (All Cases) (deposition testimony)

The European Commission Case Comp. 39.188 Bananas, European Commission, Brussels, Belgium (Oral Hearing testimony)

The European Commission Case Comp. 37.990 Intel, European Commission, Brussels, Belgium (Oral Hearing testimony)

Appeal No. 25: PCCW versus Telecommunications Authority, In the Telecommunications (Competition Provisions) Appeal Board, Hong Kong (Testimony)

Michael Siegel et al., v. Shell Oil Co., et al., U.S. District Court, Northern District of Illinois, Eastern Div., No. 06 C 0035 (deposition testimony)

The Commerce Commission v. Telecom Corp. of New Zealand Ltd., High Court of New Zealand, Auckland Registry, Civ. 2004-404-1333 ("hot tub" testimony)

Daniels Shapsmart Inc., Plaintiff, v. Tyco International, (US) Inc., and Tyco Healthcare Group, L.P., Defendants, U.S. District Court, Eastern District of Texas, Texarkana Division, No. 5:05-CV-169 (deposition testimony)

FTC v. CCC Holdings, Inc., et al, U.S. District Court for the District of Columbia, CA 08-2043 (deposition and trial testimony)

Rambus Inc. v. Micron Technology, Inc. et al., Superior Court of the State of California, County of San Francisco, Case No. 04-431105 (deposition testimony)

*In The Matter of Herring Broadcasting, Inc. d/b/a Wealth TV vs. Bright House Networks, LLC and Cox Communications, Inc.,*Federal Communications Commission, Washington, DC, File Nos. CSR-7709-P, 7822-P, 7829-P, 7907-P. (deposition testimony, FCC hearing testimony)

In the matter of Rubber Chemicals Antitrust Litigation: Bridgestone Americas Holdings, Inc., et al v. Chemtura Corp., et al, U.S. District Court, Northern District of California, Individual Case No. C 06-5700-MJJ (testimony in an arbitration hearing)

International Business Machines v. *T3 Technologies, Inc.,* U.S. District Court, Southern District of New York, Civ. Action No. 06-cv-13565-LAK (deposition testimony)

In the matter of BP America Production Company v. Repsol YPF, S.A., Arbitration under the Uncitral Arbitration Rules (testimony in an arbitration hearing)

Tessera Technologies, Inc. v. Hynix Semiconductor, Inc., Case No. 106CV-07668, Sup. Ct. of the State of California, County of Santa Clara (deposition testimony)

In Re: TFT-LCD (Flat Panel) Antitrust Litigation, U.S. Dist. Court, N.D. of California, No. M 07-1827 SI, MDL No. 1827

Enron Coal Services Ltd. And English Welsh and Scottish Railway Ltd., In the Competition Appeal Tribunal (London, U.K.), Case No. 1106/5/7/08 (testimony in the Hearing)

Geoffrey Pecover, et al v. *Electronic Arts,* Case No. C08-02820VRW, US Dist. Court, N.D. of CA, San Francisco Div. (deposition testimony)

Darren Berry, et al v. *Volkswagen of America, Inc.,* Case No. 0516-CV01171-01, Cir. Court of Jackson County, Missouri at Independence (deposition testimony)

Ekaterini Kotaras, et al v. *Whole Foods Market,* U.S. Dist. Court, Dist. of Columbia, 1:08-cv-01832 - PLF

APPENDIX 3

List of Materials Considered by Professor Janusz A. Ordover
Online DVD Rental Antitrust Litigation

Depositions and Exhibits

Netflix

Leslie J. Kilgore	March 3, 2010

Wal-Mart

Ari Sussman (rough transcript)	May 24, 2010

Amazon

Jorrit Van der Meulen	May 12, 2010

Named Plaintiffs

Bryan D. Eastman	April 14, 2010
Amy Leigh Latham	March 30, 2010
Stan Magee	March 17, 2010
Michael Orozco	March 10, 2010
Andrea Resnick	March 18, 2010
Melanie Salvi	April 16, 2010
Liza Sivek	March 23, 2010
Michael Wiener	April 7, 2010

Other

John C. Beyer, Ph.D.	May 11, 2010

Expert Materials

Expert Report and Backup of John C. Beyer, Ph.D.

Legal Filings

Consolidated Amended Class Action Complaint	May 27, 2009
Notice of Motion and Plaintiffs' Motion for Class Certification; Memorandum in Support Thereof	March 19, 2010
Declaration of Peter A. Barile III in Support of Plaintiffs' Motion for Class Certification (and Exhibits)	March 19, 2010
Defendants' Notice of Motion and Motion to Dismiss the Blockbuster Subscribers' Second Amended Class Action Complaint; Memorandum of Points and Authorities	March 31, 2010

Articles/Publications/Studies

"Wal-Mart Unveils Online DVD Rental Site; First Major Competition for Pioneer Netflix," *San Jose Mercury News*	October 16, 2002

"Amazon DVD rentals? Rivals start worrying; Speculation has led to lowered prices," *International Herald Tribune*	October 28, 2004
"Netflix 1, Wal-Mart 0," *Business Week*	May 20, 2005
"Truce in DVD-rental wars," *SFGate.com*	May 20, 2005
"Blockbuster falls to second-quarter loss," *Associated Press Newswires*	August 9, 2005

Economic Articles and Textbooks

Zbaracki, Mark, Ritson, Mark, Levy, Daniel, Dutta, Shantanu and Bergen, Mark E., "Managerial and Customer Costs of Price Adjustment: Direct Evidence from Industrial Markets." *Review of Economics and Statistics, Vol. 86, No. 2*	
Tirole, J., "The Theory of Industrial Organization," *The MIT Press*	1994
Johnson, J., D. Myatt, "Multiproduct Quality Competition: Fighting Brands and Product-Line Pricing," *American Economic Review, 93: 748-774*	2003
Carlton, Dennis W., Jeffrey M. Perloff, "Modern Industrial Organization (Third Edition)," *Boston: Addison Wesley*	2005

Government Publications

Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines; For Public Comment	April 20, 2010

Public Websites

"Amazon Video On Demand – Instantly Watch Over 45,000 Movies and TV Shows," available at <http://www.roku.com/amazon-partner>	
"Blockbuster Express planning to have as many as 10,000 kiosks operating in the U.S. by the end of 2010," available at <http://www.blockbusterexpress.com/company-info/about-us>	
"iTunes," available at <http://www.apple.com/itunes/whats-on/>	
"Netflix Corporate Fact Sheet," available at <http://files.shareholder.com/downloads/NFLX/882057732x0x295021/422b46fb-ca67-47a6-be19-36879cf977fe/IR_Fact_Sheet.pdf>	
"Redbox Fact Sheet," available at <http://redboxpressroom.com/factsheets/RedboxFactSheet.pdf>	
"Wal-Mart Tests Online DVD Rental Service," *The Write News*, available at <http://www.writenews.com/2002/102502_walmart_dvdrentals.htm>	October 25, 2002
"Wal-Mart Starts Full-Time Online DVD Rental Business," *AllBusiness*, available at <http://www.allbusiness.com/retail-trade/food-stores/4479102-1.html>	June 11, 2003
"Netflix Announces Q1 2010 Financial Results," available at <http://netflix.mediaroom.com/index.php?s=43&item=355&printable>	April 21, 2010
"Comcast Increases On Demand Movie Lineup By 450 Percent Bringing 11,000+ Movie Choices To Customers," available at <http://www.comcast.com/About/PressRelease/PressReleaseDetail.ashx?PRI	May 11, 2010

D=990>

SEC Fillings

Netflix, Inc. Form 10-K for the fiscal year ended December 31, 2002	March 31, 2003
Netflix, Inc. Form 10-Q for the quarterly period ended June 30, 2003	July 23, 2003
Netflix, Inc. Form 10-Q for the quarterly period ended September 30, 2003	October 22, 2003
Netflix, Inc. Form 10-K for the fiscal year ended December 31, 2003	February 27, 2004
Netflix, Inc. Form 10-K for the period ending fiscal year December 31, 2004	March 15, 2005
Netflix, Inc. Form 10-Q for the quarterly period ended March 31, 2004	April 19, 2004
Netflix, Inc. Form 10-Q for the quarterly period ended June 30, 2004	July 19, 2004
Netflix, Inc. Form 10-Q for the quarterly period ended September 30, 2004	October 20, 2004
Netflix, Inc. Form 10-K for the period ending December 31, 2005	March 16, 2006
Netflix, Inc. Form 10-K for period ending December 31, 2006	February 28, 2007
Netflix, Inc. Form 10-Q for the quarterly period ended March 31, 2005	May 4, 2005
Netflix, Inc. Form 10-K for the period ending December 31, 2007	February 28, 2008
Netflix, Inc. Form 10-K for the period ending December 31, 2008	February 25, 2009
Netflix, Inc. Form 10-K for the period ending December 31, 2009	February 22, 2010

Netflix Production Documents

NETFLIX_BECKER_00244641-649
NETFLIX_CORPORATE_00000049-059
NETFLIX_CORPORATE_00000100-101
NETFLIX_CORPORATE_00000102-104
NETFLIX_CORPORATE_00000105-106
NETFLIX_CORPORATE_00002740-819
NETFLIX_CORPORATE_00002919-3029
NETFLIX_CORPORATE_00003029-118
NETFLIX_CORPORATE_00006579-630
NETFLIX_CORPORATE_00006653-688
NETFLIX_CORPORATE_00006689-741
NETFLIX_HUNT_00165081-122
NETFLIX_HYMAN_00000012-024
NETFLIX_HYMAN_00000025-038
NETFLIX_HYMAN_00000039-050
NETFLIX_IR_00000053-066
NETFLIX_IR_00000350-364
NETFLIX_IR_00000397-427
NETFLIX_IR_00000441-456
NETFLIX_IR_00000457-468
NETFLIX_IR_00000469-478
NETFLIX_IR_00000831-835
NETFLIX_IR_00000836-840
NETFLIX_IR_00000880-894
NETFLIX_IR_00000928-931
NETFLIX_IR_00001244-267
NETFLIX_IR_00001402-415
NETFLIX_IR_00001435-518
NETFLIX_IR_00001750-757
NETFLIX_IR_00001758-767
NETFLIX_IR_00001837-843
NETFLIX_IR_00002027-034
NETFLIX_IR_00002284-269
NETFLIX_IR_00002308-327
NETFLIX_IR_00002489-499
NETFLIX_IR_00002727730
NETFLIX_IR_00002731-734
NETFLIX_MINTZ_00048128-143
NETFLIX_MINTZ_00054131-220
NETFLIX_SAVAGE_00080354-367
NETFLIX_SAVAGE_00080356
NETFLIX_SAVAGE_00401756-769

NETFLIX_IR_00000479-487
NETFLIX_IR_00000676-679
NETFLIX_IR_00000738-743
NETFLIX_IR_00000744-762
NETFLIX_SAVAGE_00401760
NETFLIX_SWASEY_00011725-740
NFLX0037_00021940
NETFLIX_SAVAGE_00401760

Wal-Mart Production Documents

WMHOe-000732-001-00000001-008
WMHOe-001421-002-00000527-528
WMHOe-001421-002-00002417
WMHOe-100768-001-00015459-481
WMHOe-100768-001-00019563-564
WMHOe-100768-001-00019565-566
WMHOe-100768-002-00000152-154
WMHOe-100768-002-00000531
WMHOe-100768-002-00000265-266
WMHOe-100768-002-00001231-232
WMHOe-100768-002-00001285
WMHOe-100768-002-00001291
WMHOe-100768-002-00001437-438
WMHOe-100768-002-00001635
WMHOe-100768-002-00001698
WMHOe-100768-002-00001829
WMHOe-100768-002-00003192-193
WMHOe-100768-002-00004580-581
WMHOe-100768-002-00006470
WMHOe-100772-001-00003835-836
WMHOe-100779-002-00000015-019
WMHOe-100779-003-00002059
WMHOe-100779-003-00003581-582
WMHOe-100779-003-00003584-593
WMHOe-100779-004-00000015
WMHOn-100768-002-00004474
WMHOe-770047-002-00037442-481

Amazon Production Documents

AMZ 00592-594
AMZ 00716-718
AMZ 00991-1001

Blockbuster Production Documents

BLOCKBUSTER 0000002

Plaintiff Production Documents

P-01041
P-00981-994

Data

Netflix_Data_001
Netflix_Data_002
Netflix_Data_003
Wal-Mart data

APPENDIX 4

Excerpts from Netflix Earnings Calls

Third Quarter 2002[1]

In his opening remarks, Reed Hastings notes the launch of Wal-Mart's service and the fact that with the exception of the Atlanta area, Wal-Mart subscribers are required to wait up to five days for DVD delivery. On that point, Mr. Hastings explains that, "Until Wal-Mart supports their rental service with a few dozen metro warehouses, they will not be a serious competitive threat."[2] Mr. Hastings also questions Wal-Mart's ability to execute successfully a subscription-based business, using as an example the company's recent roll-out of Internet service. According to Mr. Hastings, Wal-Mart achieved little success in attracting subscribers, despite offering its service at a 60% discount relative to AOL. In short, Mr. Hastings concludes that "Wal-Mart is just not a subscription marketing machine."

In the question and answer session with analysts, Mr. Hastings provides further commentary on Wal-Mart's service. He characterizes Wal-Mart's entry as "almost like a half launch" because of the company's lack of metropolitan area shipping centers, and indicates that until Wal-Mart creates a nationwide network of distribution centers, their service is "really not a serious threat." Still on the subject of Wal-Mart's thin distribution network and long delivery times, Mr. Hastings is asked at what level of discount Wal-Mart's service would have any impact on Netflix's business. In response, Mr. Hastings again notes that Wal-Mart's entry as an ISP was largely unsuccessful even at a price 60% below AOL's, and further explains that price likely is not among the top three or four factors that would turn Wal-Mart's service into a material competitive threat.

Finally, one analyst on the call points out that while Wal-Mart advertises a library of 12,000 DVD titles, he found many DVDs subject to long wait times. In

[1] "Conference Call Transcript; NFLX – Q3 2002 NetFlix.com Earnings Conference Call," Thomson StreetEvents, October 17, 2002, NETFLIX_IR_00000457-468.

[2] More generally, Mr. Hastings stated that, "Any company that wishes to be a credible on-line threat to Netflix must also open several dozen metro shipping centers, just to be competitive."

response, Mr. Hastings explains that a large inventory of DVDs, by itself, is insufficient to avoid unacceptable wait times. According to Mr. Hastings, critical to an effective inventory management system is software that requires hundreds of engineer-years to develop. Mr. Hastings identifies the management of DVD inventory as “another example of where I think walmart.com will find that the online rental business is categorically different and harder than anything they’ve done before.”

Fourth Quarter 2002[3]

In the transcript for the 4Q2002 call, Wal-Mart’s online service is not discussed specifically. However, Mr. Hastings reports that Netflix has not felt direct competition from online providers of DVD rentals. He also explains that “Our online competition, which shows no signs of opening their own metropolitan shipping centers, is a clearly inferior consumer choice” because of their long delivery times relative to Netflix.

First Quarter 2003[4]

In his opening remarks, Mr. Hastings identifies Wal-Mart and Blockbuster as Netflix’s two online competitors, but notes that neither has gained traction or slowed Netflix’s growth.[5] In the subsequent question and answer session with analysts, Mr. Hastings appears to have some difficulty responding to a question about the actions taken by Wal-Mart and Blockbuster because, in his view, “they’re not doing a lot.”

[3] “Conference Call Transcript; NFLX – Q4 2002 NetFlix.com Earnings Conference Call,” Thomson StreetEvents, January 15, 2003, NETFLIX_IR_00000479-487.

[4] Netflix Earnings Call Transcript for 1Q2003, April 17, 2003, NETFLIX_IR_00000397-427.

[5] At this point, both Blockbuster and Wal-Mart were conducting tests of their online DVD rental services; neither service had launched on a full-scale basis.

Second Quarter 2003[6]

During the call, Mr. Hastings reports that as was the case in prior quarters, competition from Blockbuster and Wal-Mart did not slow Netflix's growth. In response to a question about a potential price war between Netflix and Wal-Mart, Mr. Hastings indicates that Netflix is unlikely to react to lower prices from Wal-Mart. He points to Wal-Mart's lack of success as an ISP in spite of charging prices 60% below those of MSN and AOL, a fact which, in his view, demonstrates "the futility of simply doing those lower prices without the brand marketing." Later in the call, Mr. Hastings references a PC Magazine study of online DVD rental services that awarded three stars to Wal-Mart and five stars to Netflix. According to Mr. Hastings, one of the key factors driving Netflix's higher rating was "the consistency of the overnight delivery that we offer."

Third Quarter 2003[7]

Reed Hastings offers the following synopsis of Wal-Mart in his opening statement:

> "On the competitive front it was another quarter of steady growth for Netflix and lack of traction for our competitors. Wal-Mart's online service was launched one year ago and continues to make little progress. Of course, Wal-Mart is a great company and a trusted retail brand, but Netflix has 1.3 million subscribers telling their friends how great Netflix's subscription rental is. Wal-Mart, on the other hand, has only a few thousand online rental subscribers telling their friends how the Wal-Mart subscription service is adequate at best. That difference in evangelist power is a nearly insurmountable barrier to entry as we are seeing in Wal-Mart's failed entry attempt."

[6] "Conference Call Transcript; NFLX – Q2 2003 NetFlix.com Earnings Conference Call," Thomson StreetEvents, July 17, 2003, NETFLIX_IR_00000441-456.

[7] "Conference Call Transcript; NFLX – Q3 2003 NetFlix.com Earnings Conference Call," Thomson StreetEvents, October 15, 2003, NETFLIX_IR_00000469-478.

Fourth Quarter 2003[8]

At the outset of the call, Mr. Hastings states that, "Very large companies have tried to gain a foothold in our market and have not succeeded after 15 months of effort." Mr. Hastings goes on to explain that the superiority of Netflix's service, the difficulty a rival would have in duplicating its service, and the high satisfaction levels of the company's 1.5 million subscribers, all provide Netflix with "great momentum."

First Quarter 2004[9]

During the call Mr. Hastings is asked whether he has noticed any effect on Netflix's customer acquisition and growth due to Wal-Mart's online DVD rental business. He responds that Wal-Mart is "not very active" in the marketplace and that Netflix has felt no impact from Wal-Mart's operation, even in areas where Wal-Mart operates shipping centers and presumably provides faster DVD turnaround times relative to the delivery times for its DVD rental service more generally. In concluding his answer, Mr. Hastings expresses his belief that the DVD subscription business is "a fairly minor initiative" for Wal-Mart.

Second Quarter 2004[10]

In his initial remarks, Mr. Hastings devotes some attention to competition from Blockbuster's store-based subscription service and its anticipated launch of an online service. He does not mention Wal-Mart. In the later question and answer session, Mr. Hastings stresses the substantial capital needed to compete effectively as an online DVD rental provider, in terms of DVD acquisition, customer acquisition, and software development. He states that, "When you're doing all three simultaneously, it is quite expensive."

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[8] "Conference Call Transcript; NFLX – Q4 2003 NetFlix.com Earnings Conference Call," Thomson StreetEvents, January 21, 2004, NETFLIX_HYMAN_00000039-050.

[9] "Conference Call Transcript; NFLX – Q1 2004 NetFlix.com Earnings Conference Call," Thomson StreetEvents, April 15, 2004, NETFLIX_HYMAN_00000025-038.

[10] "Conference Call Transcript; NFLX – Q2 2004 NetFlix.com Earnings Conference Call," Thomson StreetEvents, July 15, 2004, NETFLIX_HYMAN_00000012-024.

Third Quarter 2004[11]

In terms of rival suppliers of online DVD rentals, most all of the discussion during the 3Q2004 earnings call deals with Blockbuster and the anticipated entry of Amazon. A single question is asked with respect to what actions Netflix expects Wal-Mart to undertake in the future. In response, Mr. Hastings responds that Netflix has competed successfully with Wal-Mart since the launch of its service in 2002, and he does not anticipate any significant change to how Wal-Mart approaches the business.

Fourth Quarter 2004[12]

In the final earnings call covering Netflix's 2004 performance, the discussion of competition in the online DVD rental marketplace again focuses on Blockbuster initiatives and the anticipated entry of Amazon. For example, in describing the advent of a "challenging competitive environment," Mr. Hastings makes reference to the "aggressive entry" of Blockbuster and the "likely entry" of Amazon.[13] Wal-Mart is mentioned a single time during the entire course of the earnings call, where it is generically described as a continuing source of competition for Netflix. As in past calls, Mr. Hastings highlights the competitive significance of a large network of distribution centers, stating that "dozens of Metropolitan warehouses … [i]s now the minimum cost of serious entry."

At one point during the question and answer session, Mr. Hastings is asked what developments in the marketplace might prompt Netflix to lower its price. In his response, he identifies substantial advertising on the part of Blockbuster, Amazon entry at a relatively low price, or further price reductions on the part of Blockbuster. Missing from Mr. Hastings comments is any scenario involving competitive pressure from Wal-Mart.

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[11] "Conference Call Transcript; NFLX – Q3 2004 Netflix.com Earnings Conference Call," Thomson StreetEvents, October 14, 2004, NETFLIX_MINTZ_00048128 –143.

[12] "Final Transcript; NFLX –Netflix Fourth Quarter and Fiscal Year 2004 Earnings Conference Call," Thomson StreetEvents, January 24, 2005, NETFLIX_SAVAGE_00401756–769.

[13] Similarly, Mr. Hastings refers to 2004 as a "brutal year" because of competition from Blockbuster, anticipated competition from Amazon, and the consequent price reductions.

First Quarter 2005[14]

During the final earnings call that transpired prior to Wal-Mart's exit, Mr. Hastings discusses the greater intensity of competition in the online DVD rental marketplace that would occur if customers could choose from among four major competitors – Netflix, Blockbuster, Amazon, and Wal-Mart – rather than just Netflix and Blockbuster. Dr. Beyer seizes upon this statement to support his conclusion that Wal-Mart's exit materially attenuated the competitive pressure on Netflix's pricing.[15] A full reading of the earnings call transcript demonstrates that Dr. Beyer's reliance on this one statement is misplaced, in particular with regard to his assertion that Wal-Mart was a significant competitor that impacted Netflix's pricing behavior.

First, the statement by Mr. Hastings is posed as a hypothetical, *i.e.*, **if** Wal-Mart and Amazon are major competitors, and empirically it is clear that neither firm ever achieved such status. Second, Mr. Hastings points to Blockbuster's entry as the first instance of Netflix confronting "a major player in online rental," which indicates that he did not consider Wal-Mart to represent a viable competitive threat.[16] Third, Mr. Hastings speaks of the entry of a third major competitor in terms of a hypothetical – "If there is a third major entrant" – further suggesting that he did not view Wal-Mart as a substantial rival. And finally, Mr. Hastings states that there are two "primary competitors" currently operating in the marketplace, "Netflix and the other guy (Blockbuster)."

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[14] "Conference Call Transcript; NFLX – Q1 2005 Netflix.com Earnings Conference Call," Thomson StreetEvents, April 21, 2005, NETFLIX_SAVAGE_00080354–367.

[15] Beyer Report at ¶ 63.

[16] *See also* 30(b)(6) Deposition of Netflix, Inc., Leslie J. Kilgore, March 3, 2010 (Kilgore Deposition), at p. 94 (Noting that prior to Blockbuster's entry Netflix faced "no meaningful competition" in the online DVD rental marketplace.); p. 99 (Prior to Blockbuster's entry Netflix "had not faced any material or significant competition" in the online DVD rental marketplace.); and pp. 174-175 (Wal-Mart was a "completely inconsequential player in the space because [it] never gained any traction with consumers.").

List of Materials Considered by Professor Janusz A. Ordover
Online DVD Rental Antitrust Litigation

Depositions and Exhibits

Netflix

Leslie J. Kilgore	March 3, 2010

Wal-Mart

Ari Sussman (rough transcript)	May 24, 2010

Amazon

Jorrit Van der Meulen	May 12, 2010

Named Plaintiffs

Bryan D. Eastman	April 14, 2010
Amy Leigh Latham	March 30, 2010
Stan Magee	March 17, 2010
Michael Orozco	March 10, 2010
Andrea Resnick	March 18, 2010
Melanie Salvi	April 16, 2010
Liza Sivek	March 23, 2010
Michael Wiener	April 7, 2010

Other

John C. Beyer, Ph.D.	May 11, 2010

Expert Materials

Expert Report and Backup of John C. Beyer, Ph.D.

Legal Filings

Consolidated Amended Class Action Complaint	May 27, 2009
Notice of Motion and Plaintiffs' Motion for Class Certification; Memorandum in Support Thereof	March 19, 2010
Declaration of Peter A. Barile III in Support of Plaintiffs' Motion for Class Certification (and Exhibits)	March 19, 2010
Defendants' Notice of Motion and Motion to Dismiss the Blockbuster Subscribers' Second Amended Class Action Complaint; Memorandum of Points and Authorities	March 31, 2010

Articles/Publications/Studies

"Wal-Mart Unveils Online DVD Rental Site; First Major Competition for Pioneer Netflix," *San Jose Mercury News*	October 16, 2002

"Amazon DVD rentals? Rivals start worrying; Speculation has led to lowered prices," *International Herald Tribune*	October 28, 2004
"Netflix 1, Wal-Mart 0," *Business Week*	May 20, 2005
"Truce in DVD-rental wars," *SFGate.com*	May 20, 2005
"Blockbuster falls to second-quarter loss," *Associated Press Newswires*	August 9, 2005

Economic Articles and Textbooks

Zbaracki, Mark, Ritson, Mark, Levy, Daniel, Dutta, Shantanu and Bergen, Mark E., "Managerial and Customer Costs of Price Adjustment: Direct Evidence from Industrial Markets." *Review of Economics and Statistics, Vol. 86, No. 2*	
Tirole, J., "The Theory of Industrial Organization," *The MIT Press*	1994
Johnson, J., D. Myatt, "Multiproduct Quality Competition: Fighting Brands and Product-Line Pricing," *American Economic Review, 93: 748-774*	2003
Carlton, Dennis W., Jeffrey M. Perloff, "Modern Industrial Organization (Third Edition)," *Boston: Addison Wesley*	2005

Government Publications

Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines; For Public Comment	April 20, 2010

Public Websites

"Amazon Video On Demand – Instantly Watch Over 45,000 Movies and TV Shows," available at <http://www.roku.com/amazon-partner>	
"Blockbuster Express planning to have as many as 10,000 kiosks operating in the U.S. by the end of 2010," available at <http://www.blockbusterexpress.com/company-info/about-us>	
"iTunes," available at <http://www.apple.com/itunes/whats-on/>	
"Netflix Corporate Fact Sheet," available at <http://files.shareholder.com/downloads/NFLX/882057732x0x295021/422b46fb-ca67-47a6-be19-36879cf977fe/IR_Fact_Sheet.pdf>	
"Redbox Fact Sheet," available at <http://redboxpressroom.com/factsheets/RedboxFactSheet.pdf>	
"Wal-Mart Tests Online DVD Rental Service," *The Write News*, available at <http://www.writenews.com/2002/102502_walmart_dvdrentals.htm>	October 25, 2002
"Wal-Mart Starts Full-Time Online DVD Rental Business," *AllBusiness*, available at <http://www.allbusiness.com/retail-trade/food-stores/4479102-1.html>	June 11, 2003
"Netflix Announces Q1 2010 Financial Results," available at <http://netflix.mediaroom.com/index.php?s=43&item=355&printable>	April 21, 2010
"Comcast Increases On Demand Movie Lineup By 450 Percent Bringing 11,000+ Movie Choices To Customers," available at <http://www.comcast.com/About/PressRelease/PressReleaseDetail.ashx?PRI	May 11, 2010

D=990>

SEC Fillings

Netflix, Inc. Form 10-K for the fiscal year ended December 31, 2002	March 31, 2003
Netflix, Inc. Form 10-Q for the quarterly period ended June 30, 2003	July 23, 2003
Netflix, Inc. Form 10-Q for the quarterly period ended September 30, 2003	October 22, 2003
Netflix, Inc. Form 10-K for the fiscal year ended December 31, 2003	February 27, 2004
Netflix, Inc. Form 10-K for the period ending fiscal year December 31, 2004	March 15, 2005
Netflix, Inc. Form 10-Q for the quarterly period ended March 31, 2004	April 19, 2004
Netflix, Inc. Form 10-Q for the quarterly period ended June 30, 2004	July 19, 2004
Netflix, Inc. Form 10-Q for the quarterly period ended September 30, 2004	October 20, 2004
Netflix, Inc. Form 10-K for the period ending December 31, 2005	March 16, 2006
Netflix, Inc. Form 10-K for period ending December 31, 2006	February 28, 2007
Netflix, Inc. Form 10-Q for the quarterly period ended March 31, 2005	May 4, 2005
Netflix, Inc. Form 10-K for the period ending December 31, 2007	February 28, 2008
Netflix, Inc. Form 10-K for the period ending December 31, 2008	February 25, 2009
Netflix, Inc. Form 10-K for the period ending December 31, 2009	February 22, 2010

Netflix Production Documents

NETFLIX_BECKER_00244641-649
NETFLIX_CORPORATE_00000049-059
NETFLIX_CORPORATE_00000100-101
NETFLIX_CORPORATE_00000102-104
NETFLIX_CORPORATE_00000105-106
NETFLIX_CORPORATE_00002740-819
NETFLIX_CORPORATE_00002919-3029
NETFLIX_CORPORATE_00003029-118
NETFLIX_CORPORATE_00006579-630
NETFLIX_CORPORATE_00006653-688
NETFLIX_CORPORATE_00006689-741
NETFLIX_HUNT_00165081-122
NETFLIX_HYMAN_00000012-024
NETFLIX_HYMAN_00000025-038
NETFLIX_HYMAN_00000039-050
NETFLIX_IR_00000053-066
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NETFLIX_IR_00000738-743
NETFLIX_IR_00000744-762
NETFLIX_SAVAGE_00401760
NETFLIX_SWASEY_00011725-740
NFLX0037_00021940
NETFLIX_SAVAGE_00401760

Wal-Mart Production Documents

WMHOe-000732-001-00000001-008
WMHOe-001421-002-00000527-528
WMHOe-001421-002-00002417
WMHOe-100768-001-00015459-481
WMHOe-100768-001-00019563-564
WMHOe-100768-001-00019565-566
WMHOe-100768-002-00000152-154
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WMHOe-100768-002-00001291
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WMHOe-100768-002-00001635
WMHOe-100768-002-00001698
WMHOe-100768-002-00001829
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WMHOe-100768-002-00006470
WMHOe-100772-001-00003835-836
WMHOe-100779-002-00000015-019
WMHOe-100779-003-00002059
WMHOe-100779-003-00003581-582
WMHOe-100779-003-00003584-593
WMHOe-100779-004-00000015
WMHOn-100768-002-00004474
WMHOe-770047-002-00037442-481

Amazon Production Documents

AMZ 00592-594
AMZ 00716-718
AMZ 00991-1001

Blockbuster Production Documents

BLOCKBUSTER 0000002

Plaintiff Production Documents

P-01041
P-00981-994

Data

Netflix_Data_001
Netflix_Data_002
Netflix_Data_003
Wal-Mart data

APPENDIX 4

CHART C-4

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