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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

The Apple iPod iTunes Antitrust Litigation NO. C 05-00037 JW

**ORDER GRANTING DEFENDANT’S
MOTION FOR JUDGMENT ON THE
PLEADINGS AS TO THE FIRST CAUSE
OF ACTION FOR VIOLATIONS OF
SECTION 1 OF THE SHERMAN ACT
AND THE FIFTH CAUSE OF ACTION
FOR VIOLATIONS OF THE
CARTWRIGHT ACT**

I. INTRODUCTION

In this class action, Plaintiffs¹ allege that iTunes and iPods are two products that are sold separately by Apple Inc. (“Defendant”), but that Apple nevertheless violates the prohibitions of Section 1 of the Sherman Act against unlawful tying by forcing purchasers of iTunes to buy iPods because the products are technologically tied to one another. The issue before the Court is whether these allegations state a cognizable claim under the rule of reason theory of antitrust. In this Order, the Court finds that Plaintiffs do not state a claim for violation of Section 1 and accordingly, the Court grants judgment on the pleadings in favor of Apple.

II. BACKGROUND

Plaintiffs are prosecuting this class action against Apple alleging that the technological compatibility created by Apple between digital music files sold by its iTunes Music Store (“iTMS”)

¹ Named Plaintiffs are Melanie Tucker, Mariana Rosen, and Somtai Troy Charoensak.

1 and iPod digital music players constitutes an unlawful tying arrangement in violation of Section 1 of
 2 the Sherman Act, and violates related state laws.² Originally, Plaintiffs based their Section 1 claims
 3 on two alternative theories: *per se* unlawful tying and the rule of reason.³ In its May 15, 2009
 4 Order,⁴ based on undisputed allegations that iTunes files and iPods are sold separately, the Court
 5 granted judgment on the pleadings in favor of Apple and dismissed *per se* tying as a permissible
 6 basis for Plaintiffs' Section 1 claims. Specifically, the Court found that there must be a tie between
 7 two separate products or services sold in separate markets.⁵ Since the parties had not addressed
 8 whether Plaintiffs should be permitted to proceed on a rule of reason theory, the Court invited
 9 Defendant to file another Rule 12(c) motion to provide the parties with an opportunity to fully brief
 10 the issue.

11 Presently before the Court is Defendant's Motion for Judgment on the Pleadings as to
 12 Plaintiffs' Rule of Reason Tying Claim. (hereafter, "Motion," Docket Item No. 229.) The Court
 13 conducted a hearing on October 5, 2009 and the matter was taken under submission for a decision.

14 **III. DISCUSSION**

15 **A. Examining the Allegations of the First Amended Complaint and the Answer**

16 The standards by which the Court evaluates a Rule 12(c) motion were articulated in its May
 17 15 Order. (See Order at 3.) The Court applies those same standards in evaluate the present Motion.

18 Generally, in ruling on a motion for judgment on the pleadings, the allegations of the
 19 non-moving party must be accepted as true, while the allegations of the moving party which have
 20

21
 22 ² A detailed statement of the factual allegations and procedural history in this case may be
 23 found in the Court's December 20, 2006 Order Denying Defendant's Motion to Dismiss (Docket
 24 Item No. 27) and in the Court's December 22, 2008 Order Granting Plaintiffs' Motion for Class
 Certification as to Counts Two, Three, Four, Five, Six, and Seven Only and Appointing Class
 Counsel; *Sua Sponte* Order Reconsidering Defendant's Motion to Dismiss Count One and Requiring
 Further Briefing (Docket Item No. 196).

25 ³ (Second Amended Complaint ¶ 70, hereafter, "SAC," Docket Item No. 77.)

26 ⁴ (hereafter, "Order," Docket Item No. 213.)

27 ⁵ (Order at 4 (citing Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12 (1984)).)

1 been denied are assumed to be false. Hal Roach Studios, Inc. v. Richard Feiner & Co., Inc., 896
2 F.2d 1542, 1550 (9th Cir. 1990).

3 Here, with respect to the relationship between iTunes and iPods, there are no conflicts
4 between the allegations of the First Amended Complaint and the Answer.

5 Plaintiffs allege:

6 Online music purchased from the iTMS is encoded by Apple with Digital
7 Rights Management (“DRM”) restrictions called “FairPlay.” (SAC ¶ 41.)

8 Use of FairPlay requires iTMS consumers to use Apple’s iPod to transfer the
9 music directly to a Digital Music Player. (SAC ¶ 43.)

10 The tied product is the iPod and the tying product is FairPlay-DRM Online
11 Music purchased from the iTMS. Apple deliberately makes the music files purchased
12 from the iTMS incapable of being played by other Digital Music Players. Thus,
13 consumers who have purchased Online Music from Apple will have no choice but to
14 buy an iPod if they want to play their music directly on a Digital Media Player.
(SAC ¶ 43.)

15 After purchasing Digital Music from the iTMS, consumers are locked into
16 making all future Digital Music Player purchases from Apple, because consumers
17 with libraries of iTMS music could not utilize any of the songs they purchased from
18 the iTMS with any non-iPod Digital Music Player. (SAC ¶ 44.)

19 As a result of this activity, Apple has been able to charge supra-competitive
20 prices to all purchasers of iPods. (SAC ¶ 76.)

21 Defendant alleges:

22 On April 28, 2003, Apple launched the iTunes Music Store that can be
23 accessed by a computer and that allows users to browse listings of digital recordings.⁶

24 Consumers may purchase individual songs from the iTunes Music Store. (Id.)

25 Customers can play music purchased from iTunes Music Store on a computer
26 or CD player or on an iPod. (Id.)

27 Based on the pleadings, it is conceded that iTunes music and iPods are always sold
28 separately and without any requirement that purchasers of one product also purchase the other. It is
further conceded in the pleadings that either product may be used by consumers without the
necessity of purchasing the other. The gravamen of the Complaint is that Apple has created a DRM-
mediated link between iTunes music and iPods which allows iPod owners to play back their iTunes
music purchases with fewer intermediate steps than required for consumers who own a digital music
player manufactured by one of Apple’s competitors, and that Apple refuses to license the DRM

⁶ (Defendant Apple Inc.’s Answer and Defenses to Plaintiffs’ Consolidated Complaint ¶¶ 3-15, hereafter, “Answer,” Docket Item No. 110.)

1 technology to its competitors. Plaintiffs allege that the technological interrelationship between
2 iTunes music files and iPods constitutes unlawful tying under the rule of reason because it is
3 tantamount to forcing consumers to forego their free choice of portable digital media players.

4 **B. The Rule of Reason**

5 Section 1 of the Sherman Act prohibits “every contract, combination . . . , or conspiracy, in
6 restraint of trade or commerce.” 15 U.S.C. § 1. Courts have established two standards for
7 scrutinizing commercial practices under Section 1: *per se* rules of illegality and the rule of reason.
8 *Per se* analysis applies to practices that have such pernicious effect on competition that they are
9 presumed to be unreasonable and therefore illegal without elaborate inquiry into the precise harm
10 the practices have caused. Northern Pac. R. Co. v. United States, 356 U.S. 1, 5 (1958). Under a rule
11 of reason analysis, the factfinder weighs all of the circumstances surrounding a restrictive practice in
12 making a determination whether the practice should be prohibited as imposing an unreasonable
13 restraint on competition. Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918).

14 In general, a “tie” is an arrangement in which a seller conditions the sale of one product on
15 the purchaser’s agreement to purchase a separate product. Eastman Kodak Co. v. Image Technical
16 Services, Inc., 504 U.S. 451 (1992). If a seller is proved to have market power in a tying product
17 and the tying arrangement affects a substantial volume of commerce in the market for a tied product,
18 the tying arrangement is analyzed under the *per se* rule because courts regard such tying as serving
19 little purpose other than the restriction of competition. U.S. Steel Corp. v. Fortner Enters., 394 U.S.
20 495, 503 (1969).

21 Here, the Court has ruled that the technological interrelationship between iTunes music and
22 iPods in the absence of any condition that purchasers of one product also purchase the other does not
23 state a Section 1 tying claim under the *per se* rule and has granted judgment on the pleadings on that
24 ground.⁷ Having been denied a right to proceed on the basis of a *per se* analysis, Plaintiffs are left
25 with allegations that Apple’s conduct violates Section 1 under the rule of reason theory.

26
27 ⁷ The Court also granted Defendant’s Motion with respect to Plaintiffs’ state law claims, to
28 the extent those claims were based on unlawful tying under federal antitrust law.

1 It is well established that “[a] tying arrangement which is not unlawful *per se* ‘may be
2 invalidated under the ‘rule of reason’ if the party challenging the tie demonstrates that it is ‘an
3 unreasonable restraint on competition in the relevant market.’” County of Tuolumne v. Sonora
4 Cnty. Hosp., 236 F.3d 1148, 1157 (9th Cir. 2001) (quoting Beard v. Parkview Hosp., 912 F.2d 138,
5 140 (6th Cir. 1990)). In a *per se* claim, “a showing that the defendant had market power in the tying
6 market leads to a presumption that it is using that power to expand into the tied market.” Brokerage
7 Concepts, Inc. v. U.S. Healthcare, Inc., 140 F.3d 494, 519 (3d Cir. 1998); see also Jefferson Parish,
8 466 U.S. at 26 (finding that an analysis of actual market conditions may only be avoided upon a
9 showing that the arrangement “involves the use of market power to force [consumers] to buy
10 services they would not otherwise purchase”); Foremost Pro Color, Inc. v. Eastman Kodak Co., 703
11 F.2d 534, 540-41 (9th Cir. 1983) (finding that the *per se* tying rule excuses the necessity of
12 demonstrating unreasonable competitive effect because the party imposing the arrangement is
13 benefitting from “the leverage exerted as a result of its economic power in the market for the tying
14 product”).

15 Where a plaintiff cannot demonstrate adequate market power to invalidate a restraint under
16 the *per se* tying rule, they may still succeed in stating a claim under the rule of reason by alleging
17 sufficient facts to demonstrate that the tying arrangement “unreasonably restrained competition.”
18 Jefferson Parish, 466 U.S. at 29. To state a claim under the rule of reason, a plaintiff cannot rely on
19 a presumption of unreasonable anticompetitive effect, but instead must “provide a basis for finding
20 that the [tying arrangement], as it actually operates in the market, has unreasonably restrained
21 competition.” Id.

22 In Jefferson Parish, the Supreme Court examined the validity of a tie between surgical and
23 anesthesiological services at a hospital. 466 U.S. at 4-5. In that case, the hospital (“East Jefferson”)
24 entered into an exclusive contract with a firm of anesthesiologists which required that every patient
25 undergoing surgery at East Jefferson use the services of a member of that firm. Id. After trial, the
26 district court denied relief to a board-certified anesthesiologist who was barred from admission to
27 the medical staff at East Jefferson because of the exclusive contract. Id. at 5. The Supreme Court
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1 affirmed the district court's decision. Id. To determine whether East Jefferson exerted sufficient
2 market power to establish *per se* tying liability, the Court looked at the hospital preferences of local
3 residents and found that seventy percent of those in the area used a hospital other than East
4 Jefferson. Id. at 26. The Court found that "[t]he fact that a substantial majority of the parish's
5 residents elect not to enter East Jefferson means that the geographic data does not establish the kind
6 of dominant market position that obviates the need for further inquiry into actual competitive
7 conditions." Id. at 27. Since East Jefferson did not have sufficient market power to establish *per se*
8 liability, the Court turned to the rule of reason and found insufficient evidence that the arrangement
9 at issue unreasonably restrained competition among anesthesiologists in that particular market. Id.
10 at 29-30.

11 In Town Sound and Custom Tops, Inc., the Third Circuit examined the validity of a tie
12 between cars and car stereo equipment. 959 F.2d 468, 471-73 (3d Cir. 1992). In that case, a group
13 of independent car stereo dealers filed an antitrust action against Chrysler claiming that Chrysler
14 unlawfully restrained commerce by conditioning the sale of their cars on the purchase of Chrysler-
15 supplied sound systems. Id. at 471. The district court granted summary judgment to Chrysler on
16 plaintiffs' *per se* and rule of reason claims. Id. at 474. The Third Circuit affirmed. Id. at 496.
17 When defining the relevant market broadly to include Chrysler cars and cars that are reasonably
18 interchangeable with Chrysler cars, the Third Circuit determined that Chrysler did not wield enough
19 market power to establish *per se* tying liability. Id. at 480-81. The Court found, however, that such
20 a showing of market power was not necessary to succeed on a tying claim under the rule of reason.
21 Id. at 482-85. Ultimately, the plaintiffs' rule of reason claim failed for a reason not directly related
22 to market power: the plaintiffs could not show that Chrysler's conduct caused competitive injury in
23 the car stereo market. Id. at 495.

24 What is less clear from a review of the cases is whether a plaintiff may state a tying claim
25 under the rule of reason where, as here, its *per se* claim has failed on the basis of the absence of a
26 coercive tying relationship. In their Motion, Defendant contends that without a coercive tie, there
27 can be no valid claim under either a *per se* analysis or a rule of reason analysis. (Motion at 4-6.)
28

1 Plaintiffs respond that a rule of reason claim is available even when all of the elements of *per se*
 2 tying cannot be established and that they should be allowed to proceed on that theory because the
 3 technological relationship between iTunes and iPod was intended to harm competition and in fact
 4 caused injury to competition.⁸ In other words, Plaintiffs contend that even though the Court has
 5 found that the technological interrelationship does not constitute tying under the *per se* rule, the
 6 technological relationship is sufficient to constitute an unlawful restraint under the rule of reason.

7 **C. Technological Relationship Between Products Under the Rule of Reason**

8 There have been a number of cases that have considered allegations of antitrust violations
 9 based on a technological relationship between products. Meaningful application of these so-called
 10 “technological tie” cases requires an examination of what type of technological relationship was
 11 involved. The Court examines a couple of cases for illustration.

12 **1. Products that are technologically integrated and sold as one product**

13 Products are characterized as “technologically tied” in cases involving integrated products,
 14 namely, where a plaintiff alleges that unlawful tying takes place because two separate products have
 15 been integrated and sold as one. For example, in United States v. Microsoft, the D.C. Circuit
 16 scrutinized Microsoft’s practice of bundling its web browser, Internet Explorer (“IE”), with its
 17 Windows operating system (“OS”). 253 F.3d 34 (D.C. Cir. 2001). The facts underlying the tying
 18 claim consisted of four allegations:

- 19 (1) Microsoft required licensees of [the OS] to also license IE as a bundle at a single price;
 20 (2) Microsoft refused to allow [original equipment manufacturers] to uninstall or remove IE
 21 from the Windows desktop; (3) Microsoft designed [the OS] in a way that withheld from
 22 consumers the ability to remove IE by use of the Add/Remove Programs utility; and (4)
 23 Microsoft designed [the OS] to override the user’s choice of default web browser in certain
 24 circumstances.

25 Id. at 85-86 (internal citations omitted). After a bench trial, the district court found Microsoft liable
 26 for, *inter alia*, the government’s tying claim. Id. at 48. The D.C. Circuit reversed as to the
 27 government’s tying claim under the *per se* rule, but remanded to the district court for further

28 ⁸ (See Plaintiffs’ Opposition to Defendant’s Motion for Judgment on the Pleadings as to
 Plaintiffs’ Rule of Reason Tying Claim at 5, hereafter, “Opposition,” Docket Item No. 230.)

1 proceedings under a rule of reason analysis. Id. at 89-97. The D.C. Circuit held that where the tying
2 arrangement alleged involves the integration of additional software functionality into a platform for
3 third-party applications, finding a *per se* violation “creates undue risks of error and of deterring
4 welfare-enhancing innovation.” Id. at 90. Instead, the court found that the appropriate mode of
5 analysis was the rule of reason, and remanded the case so that the district court could make the
6 appropriate “inquiry into the actual effect of Microsoft’s conduct on competition in the tied good
7 market.” Id. at 95 (internal quotation omitted); see also Caldera, Inc. v. Microsoft Corp., 72 F.
8 Supp. 2d 1295 (D. Utah 1991).

9 It is clear that these integrated technology cases involve a technological relationship that can
10 fit within the tying paradigm because they involve allegations that, by virtue of technological
11 integration, purchasers are coerced into purchasing two allegedly separate products.

12 2. Products that are technologically interdependent and sold as separate products

13 The phrase “technological tie” has also been used in cases in which technologically
14 interdependent products are being sold separately by the seller. See Foremost, 703 F.2d at 540-41.
15 In Foremost, the Ninth Circuit stated:

16 Although liberally sprinkled with the word ‘required,’ Foremost’s tying allegation
17 basically involves the so-called technological tie. In other words, because the new
18 film could not be processed with the old chemicals, and because the needed new
19 photographic paper similarly could not be processed with the old chemicals, it was
20 necessary to purchase an entire package of film, chemicals and paper.

21 703 F.2d at 542.

22 In this latter group of technologically interdependent cases, there is no coercive tie between
23 two separate products. Although the technological relationship enhances the utility of each product,
24 purchasers are free from any requirement imposed by the seller to purchase one product in order to
25 obtain the other. Consistently, in cases involving only a technological interrelationship, courts have
26 adhered to the proposition that if the buyer is free to take either product by itself, there is no tying:

27 Foremost’s tying claim alleged only the introduction of technologically related
28 components incompatible with existing products offered by the competition. It did
not allege that the dominant purpose motivating Kodak’s design and introduction of
the 110 system was to compel purchase of the entire system as a package, rather than
to achieve the legitimate goal of marketing new, technologically superior products

1 designed to satisfy consumer demand for small, pocket-sized cameras. Therefore, the
2 complaint failed to state a claim for relief predicated on unlawful tying.

3 Foremost, 703 F. 2d at 543.

4 **D. Technological Interrelationship Between iTunes and iPods**

5 In light of the analysis above, the Court finds that Plaintiffs cannot state a claim under the
6 rule of reason by demonstrating that a technological tie unreasonably restrains competition in the
7 relevant market. Without a threshold showing of a “contract, combination in the form of trust or
8 otherwise, or conspiracy” that is actionable under Section 1 of the Sherman Act, Plaintiffs’ antitrust
9 claims under the rule of reason theory is not viable. Here, the only restraint alleged by Plaintiffs is
10 the technological interrelationship between iTunes and iPods.

11 As the Court pointed out in its previous Order, there is “no dispute that iTunes music and
12 iPods are always separately available.” (Order at 7.) Furthermore, “there is no allegation that there
13 was any form of express conditioning in connection with Apple’s sale of either iTunes music or
14 iPods,” nor is there any “allegation of a package pricing policy that could constitute an unlawful
15 tie.” (Order at 8.) While Defendant did develop two products that worked optimally with one
16 another, consumers remained free at all times to purchase one or the other without purchasing both.
17 Although Plaintiffs allege that functionality was impaired when not using the two products together,
18 it is undisputed that songs purchased from iTMS can be played without ever having to purchase an
19 iPod.

20 In stark contrast, consumers in the Microsoft case were forced to purchase the Microsoft OS
21 and the IE together as a bundle. 253 F.3d at 85-86. Microsoft’s direct conditioning of the purchase
22 of one product on that of another presents a much clearer example of the type of anticompetitive
23 conduct that the antitrust laws proscribe than the technological tie at issue here. The consumer’s
24 ability to play music purchased from iTunes is not conditioned on the purchase of an iPod. The
25 increased convenience of using the two products together due to technological compatibility does
26 not constitute anticompetitive conduct under either *per se* or rule of reason analysis. See Foremost,

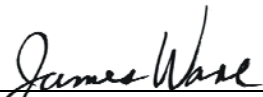
1 703 F.2d at 544 (“[T]he introduction of technologically-related products, even if incompatible with
2 the products offered by competitors, is alone neither a predatory nor anticompetitive act.”)

3 In sum, the Court holds that in order to state a Section 1 tying claim, whether under the *per*
4 *se* rule or the rule of reason, a plaintiff must first meet the threshold requirement of alleging a
5 coercive tying relationship. Plaintiffs’ allegations of a technological interrelationship between
6 iTunes and iPods fail to meet that requirement. Accordingly, the Court GRANTS Defendant’s
7 Motion for Judgment on the Pleadings as to Plaintiffs’ Rule of Reason Tying Claim under 15 U.S.C.
8 §1 and all related state law claims.

9 **IV. CONCLUSION**

10 The Court GRANTS Defendant’s Motion for Judgment on the Pleadings as to Plaintiffs’
11 Rule of Reason Tying Claim under 15 U.S.C. §1 and all related state law claims. Thus, the Court
12 DISMISSES Plaintiffs’ First Cause of Action for violation of the Section 1 of the Sherman Act, 15
13 U.S.C. § 1, and Fifth Cause of Action for violation of the California’s Cartwright Act, Cal. Bus. &
14 Prof. Code §§ 16700 *et seq.*

15
16 Dated: October 30, 2009



JAMES WARE
United States District Judge

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Richard W. Wieking, Clerk

14
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