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Netflix Wins Summary Judgment Dismissal Of Consumer Class Antitrust Claims

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Plaintiff Netflix subscribers alleged that Netflix and Wal-Mart violated Sections 1 and 2 of the Sherman Act by entering into to a horizontal market allocation agreement. *In re: Online DVD Rental Antitrust Litigation*, No. M 09-2029 PJH, Order Granting Motion For Summary Judgment (N.D. Cal. Nov. 22, 2011). Netflix and Walmart entered into a Promotion Agreement under which Netflix would rent but not sell DVDs online, and Walmart would sell but not rent DVDs online. Walmart would promote DVD rentals by Netflix, and Netflix would promote the sale of DVDs by Walmart.

The Promotion Agreement stated that Walmart had previously decided to exit the online rental business, which it did after entering into the Agreement. Netflix paid to acquire Walmart rental customers. Netflix had stopped selling DVDs online prior to the creation of the Agreement. The Agreement also stated that Wal-Mart could reenter the online rental business if it chose to do so.

Plaintiffs claimed that their injury arose from Walmart's exit from the rental business, which allegedly left Netflix free to charge supracompetitive prices to consumers for DVD rentals, which it allegedly did.

After the court certified a plaintiff class of Netflix subscribers and after Walmart had settled out, Netflix sought summary judgment on a number of grounds. The District Court, Phyllis J. Hamilton, J., found against plaintiffs in a 29 page opinion. The court held that plaintiffs could not establish the essential element of fact of injury, and accordingly granted defendant's motion for summary judgment. In the course of its analysis, the court held that the *per se* rule could not be applied to the Promotion

Agreement. *Slip opinion* at 9-16. The court did not make a definitive ruling under the rule of reason because of its holding that plaintiffs could not establish causal injury-in-fact. *Slip op.* at 16-19.

Per Se Rule

In rejecting application of the per se rule, the court held that the Agreement was not one "that facially appears to be one that would always or almost always tend to restrict competition and decrease output." *Slip op.* at 9 *quoting National Society of Prof'l Engineers v. United States*, 435 U.S. 679, 692 (1978) (test for *per se* illegality); *accord State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997). The *per se* rule applies to "'[c]lassic' horizontal market division agreements [which] are ones in which 'competitors at the same level agree to divide up the market for a given product.'" *Slip op.* at 10, *quoting California v. Safeway, Inc.*, 651 F.3d 1118, 1133 (9th Cir. 2011) (citation omitted).

Evidence supported Netflix's contention that Walmart considered its rental business to be a failure and determined on its own to withdraw from that business, rather than withdrawing from the rental market as a quid pro quo in exchange for Netflix's agreement not to sell DVDs in competition with Walmart. The court noted that Walmart had 1.5 percent of the DVD rental business, while Netflix had seventy percent and Blockbuster had the balance. Walmart's minimal market presence made it unlikely that its withdrawal would restrict competition, particularly when Blockbuster would continue to provide competition. *Slip op.* at 15. Netflix adduced credible evidence to show that the Agreement resulted in "increased output in rentals," and to support its contention that "the eventual agreement between the parties reflected Netflix's desire to capitalize on Walmart's independent realization that its online DVD rental service was not profitable, and to profit from such realization by negotiating terms upon which Netflix could acquire Walmart's existing subscriber base and then improve upon this acquisition with cross-promotional efforts." *Slip op.* at 14. There was no legal authority "clearly establishing the manifestly anticompetitive nature of joint promotion agreements such as the one in question." *Id.* at 16. The court refused to treat the Agreement as a "naked" market allocation agreement, and therefore declined to apply the *per se* rule of illegality.

Rule Of Reason

When arguing for liability under the rule of reason, plaintiffs continued to maintain that Walmart's withdrawal from the rental market was a *quid pro quo* for Netflix agreeing not to compete in the DVD sales market. They also adduced evidence that assertedly supported their contention that the online DVD rental market was negatively impacted as a result of the Agreement, as measured by lower output and unresponsiveness to consumer preference. They claimed that "Walmart was poised to rapidly grow its subscriber base via a major deal with Yahoo! and gain traction in the DVD rental market." *Slip op.* at 18. Netflix countered with evidence assertedly showing that it had lowered prices and improved service since entering into the Agreement, together with showing that consumers benefitted from the Agreement and that "Walmart's significance to the market and ability to impact the market was minimal." *Slip op.* at 17.

The court did not reach the issue of whether the Promotion Agreement and the defendants' conduct violated the rule of reason. This was because "plaintiffs have not, and cannot demonstrate, a triable issue as to competitive injury." *Id.* at 18.

Fact Of Injury

Plaintiffs claimed that Netflix would have lowered prices had Walmart remained in the rental market. Netflix argued that Walmart was an insignificant competitor in the rental market, and that neither its exit nor its participation on the market had any impact on Netflix's pricing.

Plaintiffs provided internal Netflix documents reflecting concern that Walmart's presence had prevented Netflix from raising prices. *E.g.*, *Slip op.* at 20 (Netflix memo discussing potential price increase and saying that Netflix "didn't want to risk it while Walmart [was] still lurking"). Internal emails from both "Netflix and Walmart purportedly demonstrate[ed] that both companies viewed Walmart as a significant competitor to Netflix." *Slip op.* at 21. Plaintiffs also adduced expert testimony to show that Walmart exhibited downward pricing pressure on Netflix that would have forced Netflix to reduce prices. *Id.* at 21-22.

Netflix provided evidence to show that, among other things: no one in the online DVD rental business based pricing decisions on what Walmart did; that objective evidence

showed that Walmart failed to exert any pricing pressure on Netflix; that Walmart's share of the online DVD rental business was *de minimus*; that Netflix did not lower its prices when Walmart had entered the market; and that Netflix did not lower prices in the face of a price cut by Blockbuster. *Slip op.* at 22-24. Further, plaintiffs' expert "concedes that no competitors responded competitively to Walmart in online DVD rental in pricing terms." *Id.* at 24.

The court found that Netflix's evidence had proven "market facts" defeating plaintiffs' contention that subscribers would have paid lower prices absent the Promotion Agreement. *Id*. There being no triable issue on fact of injury, the court granted summary judgment as to both plaintiffs' Section 1 and Section 2 claims.