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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

THE APPLE IPOD ITUNES ANTI-TRUST LITIGATION	Lead Case No. C-05-00037-JW(HRL)
	CLASS ACTION
This Document Relates To: ALL ACTIONS.	PLAINTIFFS' MEMORANDUM IN OPPOSITION TO APPLE'S MOTION FOR SUMMARY JUDGMENT
	JUDGE: Hon. James Ware DATE: April 18, 2011 TIME: 9:00 a.m. CTRM; 8, 4th Floor

[REDACTED]

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I. INTRODUCTION

To prevail on its motion for summary judgment, Apple must show that no reasonable jury could fail to accept Apple's explanation for its suppression of the competitive threat posed by RealNetworks' Harmony technology. The problem for Apple is that its exculpatory explanation – that RealNetworks was an unintended collateral victim of Apple's efforts to block genuine hackers – is squarely at odds with the contemporaneous record.

As shown below, there is ample evidence to permit a jury to conclude that Apple used the ***pretext*** of fighting hackers – indeed going so far as to disparage RealNetworks itself as a hacker (a position it no longer seems to endorse) – to shut down a technology that would have dramatically enhanced competition and benefitted consumers by allowing them to play songs legally purchased from Apple's competitors on their iPods. Contrary to Apple's assertion, the record labels did not require Apple to shut down the competition. Rather, the labels ***supported*** Harmony because it provided interoperability while preserving digital rights management ("DRM") protection. Nor was Harmony merely an unintended victim of Apple's fight against "hacks" that stripped DRM protection from iTS songs. The record shows that Apple treated Harmony as a far more serious threat than any hack – as demonstrated by its swift and punishing response to RealNetworks' Harmony announcement – and deliberately re-designed its FairPlay DRM in ways that disabled Harmony but did not improve the software's ability to withstand attacks that stripped DRM encryption from iTunes Music Store (now called "iTunes Store" or " iTS") songs. Finally, Apple has failed to demonstrate that the software updates that disabled Harmony provided any benefit to consumers. Apple's claim that the labels would have stopped supplying music if it had not made the changes it did finds no support in the record. Moreover, Apple's own customer service reports demonstrate that consumers greatly preferred the interoperability provided by Harmony to the dubious "protection" Apple's software updates provided against the "injection of foreign DRM keys."

Neither of the two cases that pervade Apple's motion, *Allied Orthopedic Appliances Inc. v. Tyco Health Care Group*, 592 F.3d 991 (9th Cir. 2010) ("*Tyco*") and *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko LLP*, 540 U.S. 398, 124 S. Ct. 872 (2004) ("*Trinko*"), grant Apple the

broad immunity it claims. To the contrary, the line between exclusionary conduct and legitimate product improvement is a very fine one for a monopolist, requiring close examination by the fact-finder of the unique facts and circumstances of each case.[1] *See, e.g.*, *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 467, 112 S. Ct. 2072 (1992) (affirming reversal of summary judgment on Section 2 claim); *Image Technical Serv., Inc. v. Eastman Kodak Co.*, 903 F.2d 612, 620-21 (9th Cir. 1990) ("*Image Tech. Serv. I*") (reversing summary judgment on Section 2 claim); *see also Foremost Pro Color, Inc. v. Eastman Kodak Co.*, 703 F.2d 534, 545 (9th Cir. 1983) ("We do not, of course, hold that product innovation is immune from antitrust scrutiny and may never provide the requisite conduct element in support of a claim for monopolization or attempted monopolization under section 2 of the Sherman Act.").

Therefore, Apple's admission that its actions "had the effect" of disabling competition from RealNetworks only raise further disputed and genuine issues of material fact: Did Apple engage in exclusionary conduct beyond simply stopping genuine hackers or improving its product? Are Apple's *post hoc* business justifications for its actions against Harmony valid and sufficient? And, do the anticompetitive effects of Apple's exclusionary conduct outweigh any even arguable procompetitive benefits to consumers? Under *Eastman Kodak* and the record presented, the resolution of each of these factual questions remains the prerogative of the jury.

II. APPLICABLE STANDARD FOR SUMMARY JUDGMENT

Apple's motion is based on the purported lack of a genuine dispute for trial as to two distinct issues under Section 2 (though these two issues are frequently conflated in its motion): (1) whether Apple engaged in "exclusionary conduct"; and (2) the validity and sufficiency of Apple's "business justifications" defense. As movant, Apple bears the initial burden of demonstrating the lack of any dispute for trial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S. Ct. 2548 (1986); *Eastman Kodak*, 504 U.S. at 456 (the "respondents' version of any disputed issue of fact is presumed correct"). If Apple carries that burden, Plaintiffs then must come forward with specific facts

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[1] Unless otherwise noted, citations are omitted and emphasis is added.

demonstrating the presence of a genuine dispute for trial. *Celotex*, 477 U.S. at 324. All justifiable inferences are to be drawn in Plaintiffs' favor. *Eastman Kodak*, 504 U.S. at 456 (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 106 S. Ct. 2505 (1986)). Summary judgment is warranted only where the record, taken as a whole, could not lead a rational trier of fact to find for the non-moving party. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586, 106 S. Ct. 1348 (1986).

III. BACKGROUND

The factual record presents a compelling picture of unjustifiable exclusionary conduct by Apple directed squarely against RealNetworks.[2]

When Apple and the record labels negotiated the terms under which Apple could sell digital music files online through its iTS, most of the labels required that the recordings have "content protection to guard against piracy," in order to prevent consumers from making an unlimited number of copies.[3] Ex. 1, Declaration of Howie Singer ("Warner Decl."); Ex. 2, Declaration of Lawrence Kanusher ("Sony Decl."); Ex. 3, Declaration of Amanda Marks ("Universal Decl."); Ex. 4, Declaration of Mark Piibe ("EMI Decl."). [redacted]

Critically, none of the labels required Apple to use a proprietary DRM system that made iTS music incompatible with portable digital media players other than the iPod. Rather, all of the labels would have preferred a system that allowed their music to be played on multiple competing devices,

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[2] Plaintiffs have developed this record despite the unprecedented and unfair "data dump" in the final two weeks of the discovery period. *See* Dkt. No. 486 at 7 n.7. (Plaintiffs' Notice of Motion and Renewed Motion for Class Certification and Appointment of Lead Class Counsel).

[3] Unless otherwise noted, all references to "Ex." and Exs." are to the exhibits attached to the Declaration of Bonny E. Sweeney in Support of Plaintiffs' Opposition to Apple's Motion for Summary Judgment, filed concurrently.

because they had an interest in having their music sold "in the widest manner possible, through as many channels as possible." Ex. 1, Warner Decl.; Ex. 3, Universal Decl.; *see also* Ex. 2, Sony Decl. ("Apple did not accommodate Sony's request for a solution that would both protect the content as well as be interoperable with other devices."); Ex. 4.

[redacted]

Apple thus created a closed system that locked iTS customers into using the iPod for direct playback of their digital audio files. [redacted] As a result, digital audio files purchased from other internet sites (such as Amazon.com or Walmart.com) could not play directly on an iPod. Similarly, songs purchased from the iTS could not play directly on any portable digital media player other than the iPod. This closed system allowed Apple to rapidly leverage its market power in the digital audio file market into the market for portable digital media players. [redacted] With iTS, Apple was able to achieve dominance in the portable digital media player market almost immediately. By mid-2004, Apple had achieved positions of dominance in ***both*** the online audio and portable digital media player markets, with market shares in both markets exceeding [redacted] From that point forward, to compete in the digital audio download market any would-be competitor had to make its music playable on the iPod; by the same token, manufacturers of competing portable digital media players could not effectively compete in that market because their products were not compatible with the digital audio files sold through iTS. [redacted]

[redacted]

RealNetworks launched an online music store that competed directly with iTS in January 2004. [redacted] Ex. 20; *see also* Ex. 1, Warner Decl.; Ex. 2, Sony Decl.; Ex. 3, Universal Decl.; Ex. 4 EMI Decl. From the outset, RealNetworks recognized that in order to compete successfully in the digital audio file market, its music had to be directly playable on the dominant portable digital media player, the iPod.

[redacted]

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[4] *See* Apple's Motion for Summary Judgment ("Mtn.") at 8. [redacted] *See* Declaration of Dr. John P. J. Kelly in Support of Defendants' Renewed Motion for Summary Judgment, dated January 18, 2011 ("Kelly Decl."), ¶5.

[5] *See* Dkt. No. 396 (Apple Inc.'s Motion for Protective Order Preventing the Deposition of Steve Jobs). [redacted]

[redacted] According to RealNetworks, the Harmony technology followed "in a well-established tradition of fully legal, independently developed paths to achieve compatibility. . . . Harmony creates a way to lock content from Real's music store in a way that is compatible with the iPod, Windows Media DRM devices, and Helix DRM devices. Harmony technology does not remove or disable any digital rights management [DRM] system." Ex. 23. [redacted]

RealNetworks' Harmony technology represented the first real threat to Apple's monopoly in the digital audio download market and, because dominance in the digital audio download market enabled Apple to achieve dominance in the market for portable digital media players, that market as well. Moreover, RealNetworks' product was legal and received the full endorsement of the record labels that had licensed content to Apple and RealNetworks. Ex. 24; *see also* Ex. 1 ("WARNER has an interest in having its music sold in the widest manner possible, through as many channels as possible" and entered into an agreement with RealNetworks to sell Warner's sound recordings.);

[redacted] Mr. Glaser has evaded service of Plaintiffs' deposition subpoena. *See* Ex. 27, Affidavit of Reasonable Diligence.

[6] *See* Declaration of David F. Martin in Support of Plaintiffs' Opposition to Apple's Motion for Summary Judgment ("Martin Decl."), filed concurrently.

Ex. 2 ("SONY entered into agreements with other companies, including Real Networks."); Ex. 3 ("Universal has always had an interest in having its music sold in the widest manner possible, through as many channels as possible" and entered into an agreement with RealNetworks to sell Universal's music.); Ex. 4 ("EMI was interested in having its recorded music made widely available though many different channels" and had an agreement with RealNetworks to sell downloads of EMI sound recordings.).

[redacted]

Customers flocked to RealNetworks because it offered better prices than iTS. *Id.* In August 2004, RealNetworks sold its audio downloads for as low as .49 cents per-track – less than half the price of Apple's .99 cent per-track price. *Id.* [redacted]

Apple's response to the RealNetworks threat was swift and punishing. [redacted]

[redacted] Thus, instead of welcoming the interoperability created by RealNetworks, Apple unfairly disparaged its competitor and made clear to any other

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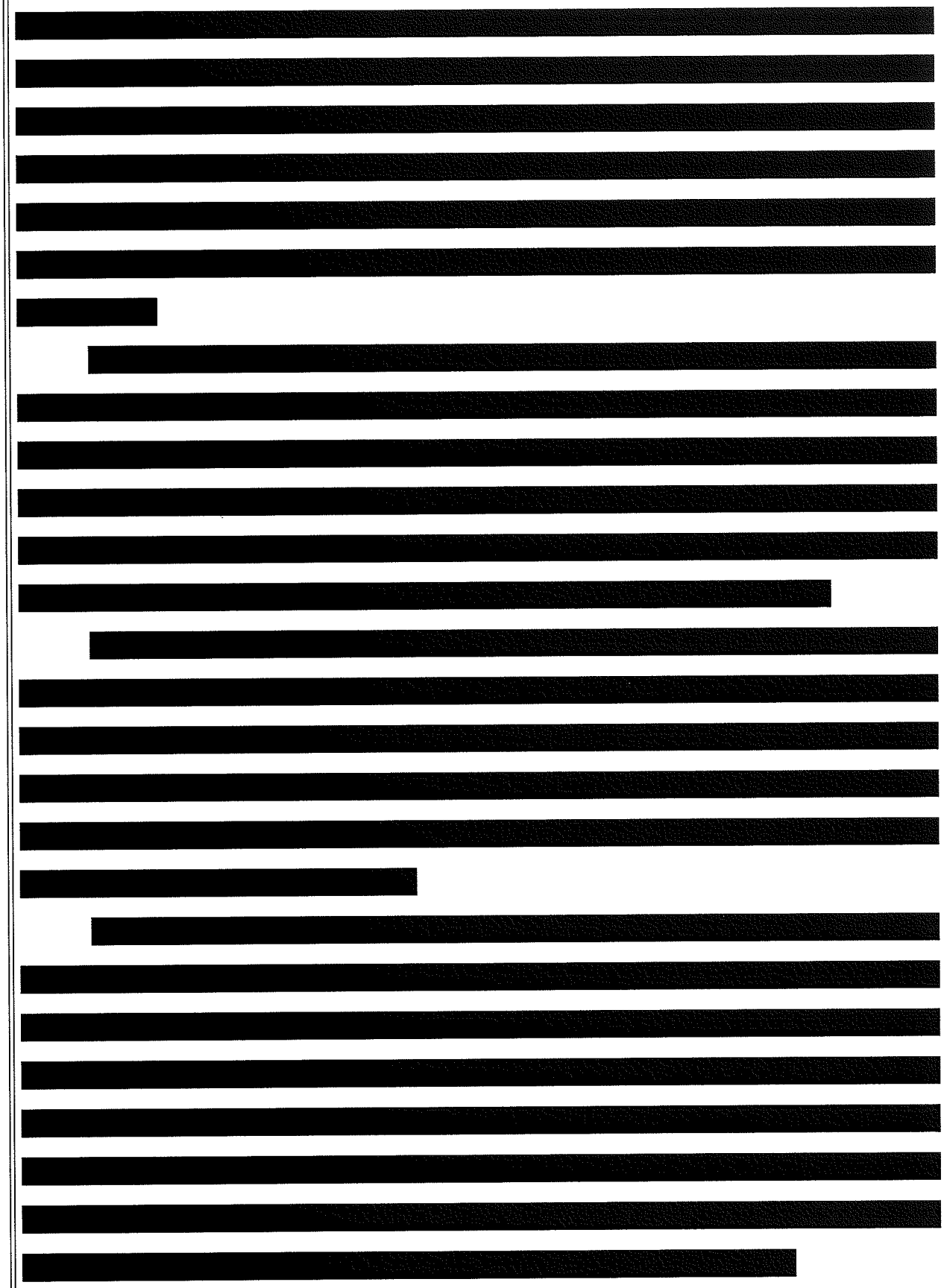
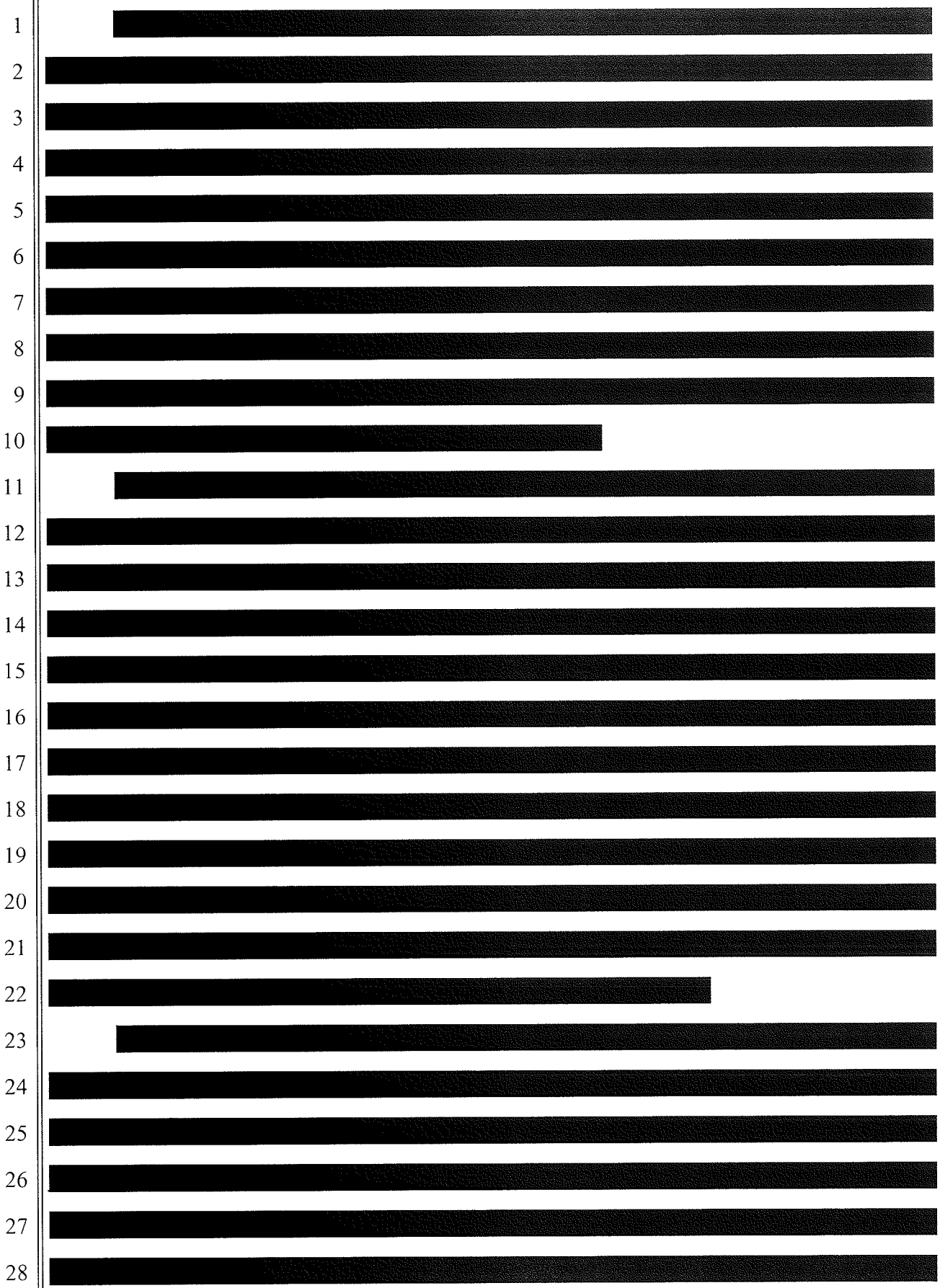
[7] [redacted]

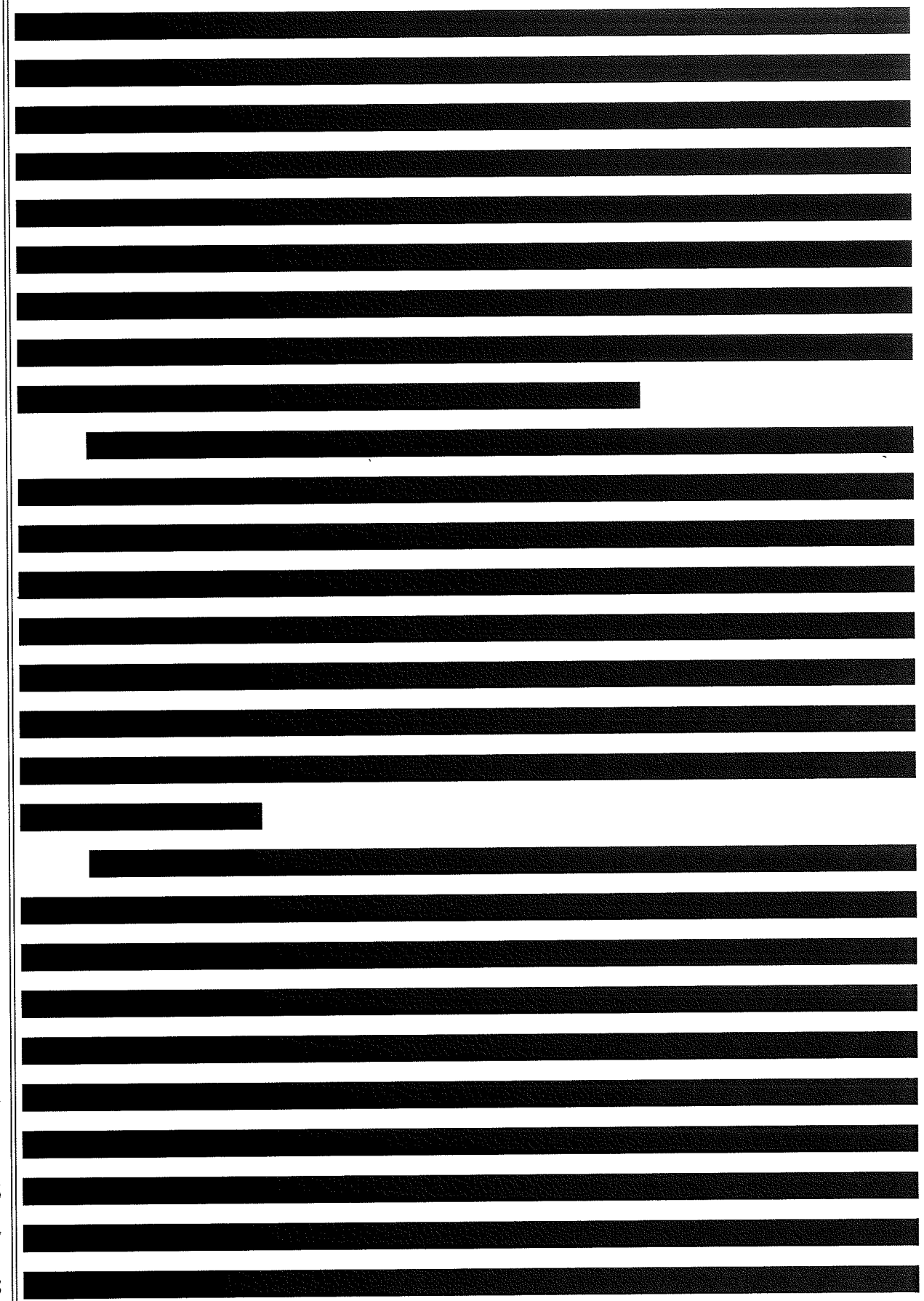
[8] [redacted]

would-be rival that Apple would take all necessary steps to prevent any inroads into its dual monopolies.

[redacted]







[redacted]

Through its conduct, Apple sacrificed short-term profits (from the increased demand for iTS music playable on portable digital players of any make) in order to maintain its monopolies in both the portable digital media player and digital audio file markets. Ex. 46; Ex. 47. But for its long-term strategy of excluding rivals, Apple's conduct would not have made economic sense. Apple's strategy ultimately succeeded: by disabling legitimate competitive efforts at interoperability, Apple was able to maintain its [redacted] market share in the online music market and steadily increased its share of the portable digital media market.

IV. LEGAL ARGUMENT

In order to prevail on their monopoly maintenance claim,[9] Plaintiffs must prove that Apple: (1) possesses monopoly power in the relevant markets; (2) has willfully maintained that power; and (3) has caused antitrust injury. *Am. Prof'l Testing Serv., Inc. v. Harcourt Brace Jovanovich Legal & Prof'l Pub'ns, Inc.*, 108 F.3d 1147 (9th Cir. 1997); *see also* Dkt. No. 377 at 5-8 (Motion to Dismiss Order) (sustaining Section 2 claim in Plaintiffs' Amended Complaint). As in previous motions, Apple challenges only Plaintiffs' ability to satisfy the willfulness element of their Section 2 claim. Mtn. at 11.

A. The Element of Willful Maintenance of Monopoly Power Presents Three Key Questions of Fact: Exclusionary Action, Business Justification and Disproportionate Harm to Competition

The willfulness element comprises actions taken "'to foreclose competition, to gain competitive advantage, or to destroy a competitor.'" *Eastman Kodak*, 504 U.S. at 482-83 (quoting *United States v. Griffith*, 334 U.S. 100, 107, 68 S. Ct. 941 (1948)). Exclusionary conduct is conduct that harms the competitive process and thereby harms consumers. *United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir. 2001). "If a firm has been 'attempting to exclude rivals on some basis other than efficiency,' it is fair to characterize its behavior as predatory." *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605, 105 S. Ct. 2847 (1985).

Whether the conduct at issue is exclusionary is a question of fact grounded in context. *Microsoft*, 253 F.2d at 65-66. "Where a defendant maintains substantial market power, [its] activities are examined through a special lens: Behavior that might otherwise not be of concern to the antitrust laws – or that might even be viewed as procompetitive – can take on exclusionary connotations when practiced by a monopolist." *Eastman Kodak*, 504 U.S. at 488 (Scalia, J. dissenting) (citing 3 P. Areeda & D. Turner, Antitrust Law ¶813, at 300-02 (1978)); *Image Technical*

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[9] Because Apple challenges only the willfulness element of Plaintiffs' Section 2 claims, and not the monopoly power element, Plaintiffs need not separately discuss their Section 2 attempted monopolization claim.

Servs., Inc. v. Eastman Kodak Co., 125 F.3d 1195, 1217 (9th Cir. 1997) ("*Image Tech. Servs. II*") (quoting same).

For example, a monopolist's false or disparaging comments about a competitor can be exclusionary, especially when combined with other anticompetitive acts. *Am. Prof'l*, 108 F.3d at 1152; *W. Penn Allegheny Health Sys., Inc. v. UPMC*, 627 F.3d 85, 109 & n.14 (3d Cir. 2010) (collecting cases). Similarly, a monopolist does not have an absolute right to refuse to deal with a competitor. Rather, such a right "exists only if there are legitimate competitive reasons for the refusal." *Eastman Kodak*, 504 U.S. at 483 n.32 (citing *Aspen Skiing*, 472 U.S. at 602-05); *accord Trinko*, 540 U.S. at 408; *Image Tech. Serv. I*, 903 F.2d at 620.

As one court of appeals has stated: "'Anticompetitive conduct' can come in too many different forms, and is too dependent upon context, for any court or commentator ever to have enumerated all the varieties." *Caribbean Broad. Sys., Ltd. v. Cable & Wireless PLC*, 148 F.3d 1080, 1087 (D.C. Cir. 1998) (reversing in part the district court's dismissal of complaint and holding that radio station's claim that defendants made misrepresentations to advertisers and the government in order to protect its monopoly stated Section 2 claim). While it is true, as Apple argues, that anticompetitive intent by itself is not sufficient to demonstrate a Section 2 claim, it is highly relevant to the determination whether the Apple's conduct was exclusionary. *Microsoft*, 253 F.3d at 59 (citing *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238, 38 S. Ct. 242 (1918) ("knowledge of intent may help. . . to interpret facts and predict consequences"); *Aspen Skiing*, 472 U.S. at 603.[10]

Evidence that a monopolist's conduct has caused anticompetitive effect moves the inquiry to the existence and validity of any "'valid business reasons'" that might justify the conduct. *Eastman Kodak*, 504 U.S. at 483; *Aspen Skiing*, 472 U.S. at 608-10. This inquiry into procompetitive justifications is again fact-specific, with genuine disputes as to each purported justification to be

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[10] Intent is an element of Plaintiffs' attempted monopolization claim. *Moore v. Jas H. Matthews & Co.*, 550 F.2d 1207, 1219 (9th Cir. 1977) (attempted monopolization can be inferred from "either specific intent coupled with monopoly power or from 'proof of specific intent to . . . exclude . . . competition accompanied by predatory conduct directed to accomplishing the unlawful purpose'").

resolved by the fact-finder. *Eastman Kodak*, 504 U.S. at 483-84; *see also Aspen Skiing*, 472 U.S. at 608 (the defendant bears the burden of "persuad[ing] the jury that its conduct was justified by any normal business purpose").[11]

Finally, even if the monopolist's procompetitive justification "stands unrebutted," plaintiff will prevail if it can demonstrate that the anticompetitive effects of the challenged conduct outweigh any procompetitive benefits. *Microsoft*, 253 F.3d at 59; *accord Aspen Skiing*, 472 U.S. at 605 n.32 (exclusionary conduct includes conduct that furthers competition "in an unnecessarily restrictive way"); *see generally* 3 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶651e3 at 121-22 (3d ed. 2008) ("Areeda"). This analysis is similar to the "rule of reason" analysis under Section 1 of the Sherman Act. *Microsoft*, 213 F.3d at 59; Areeda, ¶651e3, at 122.

B. Apple's Conduct Was Exclusionary

"Anticompetitive conduct is behavior that tends to impair the opportunities of rivals and either does not further competition on the merits or does so in an unnecessarily restrictive way." *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 894 (9th Cir. 2008) (citing *Aspen Skiing*, 472 U.S. at 605 n.32); *see generally* Areeda, ¶651. Apple engaged in a series of actions that a reasonable jury could easily conclude tended to impair the opportunities of its rivals other than on the merits and did so in an unnecessary or unnecessarily restrictive way. This is particularly true when the exclusionary acts of Apple are considered together, as they must be. *Cont'l. Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 699, 82 S. Ct. 1404 (1962) (jury must look to the

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[11] On page 16 n.8 of its motion, Apple cites three cases, two that are inapplicable because they simply stand for the position that an antitrust action cannot survive where no anticompetitive effects are alleged. *See SmileCare Dental Grp. v. Delta Dental Plan of Cal., Inc.*, 88 F.3d 780, 786 (9th Cir. 1996) (Ninth Circuit dismissed plaintiff's claims on a 12(b)(6) because it failed to allege any anticompetitive effects); *State of Ill. ex. rel. Burris v. Panhandle E. Pipe Line Co.*, 935 F.2d 1469, 1480-1481, 1484 (7th Cir. 1991) (pipeline company's "'lawful refusal to cut its own throat' . . . by excusing customers from their contractual obligations 'was not anticompetitive'"). These cases are not applicable here where the record is replete with anticompetitive effects. Apple's misquotes the third case on page 16 n.8. Had it left the quote in context, it would be it supports plaintiffs' position: The "pursuit of efficiency and quality control ***might*** be legitimate competitive reasons for an otherwise exclusionary refusal to deal, while the desire to maintain a monopoly share or thwart the entry of competitors would not." *Data Gen. Corp. v. Grumman Sys. Support Corp.*, 36 F. 3d 1147, 1183 (1st Cir. 1994).

monopolist's conduct as a whole); *Tele Atlas N.V. v. Navteq Corp.*, No. C-05-01673 RS, 2008 WL 4911230, at *2 (N.D. Cal. Nov. 13, 2008) ("What matters is whether the 'synergistic effect' of the alleged conduct is to harm competition, and thus perpetuate a monopoly.").

1. Apple's Software Updates Were Aimed at RealNetworks

[redacted]

The facts demonstrate that Apple's conduct was intended to and had the effect of excluding rivals from the marketplace:

> ***Most exclusionary conduct by dominant firms is strategic.*** Nondominant firms acting unilaterally typically lack the market position to make much strategic conduct work. Consider the *Microsoft* litigation. A nondominant seller of computer operating systems would have every incentive to maximize compatibility with other types of software, such as Internet browsers or word processors, even if it sold these applications itself. After all, it would be competing in the market with sellers of other operating systems, and customer choice would be heavily driven by compatibility concerns. ***But a market-dominating seller of operating systems stands in a different position: by limiting compatibility with rivals' software applications it can force buyers to switch to its own applications. Thus it becomes important to restrain the innovations of others or keep them out of the market.***

Areeda ¶651f, at 123.

Apple's efforts to identify countervailing, procompetitive effects of its exclusion of Harmony fall short, because none of them demonstrates (and certainly not as a matter of law) how excluding Harmony advanced any particular ***consumer*** interest. Particularly lacking is evidence of any actual economic efficiencies gained by its effort to stifle the interoperability introduced by Harmony.

First, Apple argues that it actions were procompetitive because its *earlier* launch of iTS was a "huge benefit" to consumers. Mtn. at 14, 15. But even assuming that is true, procompetitive

benefits from Apple's launch of iTS do not shield all of Apple's subsequent actions from antitrust scrutiny. As an initial matter, Apple has failed to show that its Harmony-blocking updates were necessary to maintain those procompetitive benefits. Apple has adduced no evidence that the record labels threatened to withhold music from Apple or required Apple to undertake major revisions of its FairPlay DRM in order to stop DRM-stripping hacks. Rather, Apple used the hacks as a pretext to modify the software in ways that did not necessarily increase the security of the DRM, but did have the effect of excluding its only real competitive threat. *See supra* at 9-10. Moreover, as a matter of law, pre-monopoly procompetitive conduct does not shield a monopolist from challenges to subsequent exclusionary conduct. *See, e.g.*, *Eastman Kodak*, 504 U.S. at 488 ("Behavior that might otherwise not be of concern to the antitrust laws – or that might even be viewed a procompetitive – can take on exclusionary connotations when practiced by a monopolist.").

Second, Apple argues its actions were procompetitive because, according to Apple, the actions of hackers (not RealNetworks) violated the Digital Millennium Copyright Act ("DMCA"). Mtn. at 15. Again Apple misses the point, for it identifies no economic efficiencies achieved that benefit ***consumers***. Preventing purported third-party violations of copyright law may be salutary, but it is no shield against antitrust scrutiny. *Image Tech. Servs. II*, 125 F.3d at 1219 ("Neither the aims of intellectual property law, nor the antitrust laws justify allowing a monopolist to rely upon pretextual business justification to mask anticompetitive conduct."). Moreover, Apple's contention is factually meritless, for the record is clear that its exclusionary actions against RealNetworks were not prompted by any genuine threat to DRM or the security solutions it had promised the music labels. *See supra* at §III.

2. Apple Falsely Disparaged and Threatened RealNetworks and Other Potential Competitors in Public Statements

Apple's software updates that disabled Harmony are not the only actions Apple took to exclude rivals. When RealNetworks first announced the Harmony technology in July 2004, and later when RealNetworks once again enabled Harmony-iPod interoperability, Apple issued public statements that disparaged RealNetworks, falsely implied that RealNetworks had violated the law,

and warned RealNetworks and any other would-be competitors that Apple would disable any interoperability. Ex. 28; *see supra* at 7.

In *American Professional*, the Ninth Circuit recognized that disparagement of a competitor can rise to the level of exclusionary conduct sufficient to support a Section 2 violation where there is evidence of a "significant and enduring adverse impact on competition." *Am. Prof'l*, 108 F.3d at 1152. *See also Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979); *Int'l Travel Arrangers, Inc. v. W. Airlines, Inc.*, 623 F.2d 1255, 1268, 1270 (8th Cir. 1980) (affirming Section 2 liability based on disparagement of competitor); *see generally UPMC*, 627 F.3d at 109 & n.14 (collecting cases); Areeda, ¶651h, at 126 ("Of course, in the presence of substantial market power, some kinds of tortious behavior could anticompetitively create or sustain a monopoly, and it would then warrant condemnation under §2.").

In this case, Plaintiffs have adduced ample evidence that Apple's disparagement of RealNetworks, together with its repeated software revisions intended to block interoperability, had a significant and enduring adverse impact on competition. *See supra* at 13; Ex. 48 at 494; Ex. 25.

Similarly, threats of legal action designed to deter lawful conduct by competitors are actionable under Section 2. *See, e.g.*, *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 86 S. Ct. 347 (1965) (holding that complaint alleging defendant attempted to monopolize by threatening to and pursuing legal enforcement of patent procured by fraud on Patent Office stated claim under Section 2); *Ritz Camera & Image v. SanDisk Corp.*, No. 10-cv-02787 JF/HRL, 2011 U.S. Dist LEXIS 18399 (N.D. Cal. Feb. 24, 2011) (Fogel, J.) (upholding complaint alleging Section 2 violations based on unfounded patent infringement actions); *see generally* Areeda ¶651h, at 126. Here, in order to maintain its market power, Apple threatened RealNetworks with legal action for purported violations of the DMCA. *See supra* at 7.

3. Apple's Refusal to Deal Is Not Protected

Apple's selective licensing of FairPlay also raises a triable issue of exclusionary conduct, because Apple's refusal to license FairPlay to actual or potential competitors tended to impair the opportunities of its rivals to compete other than on the merits, and did so in an unnecessary or unnecessarily restrictive way.

Aspen Skiing refutes Apple's argument that Apple had "no duty to ensure that competitors' products would continue to work with Apple's." Mtn. at 3, 19-24. In *Aspen Skiing*, the Supreme Court held that a monopolist's right to refuse to deal is not unqualified. *Aspen Skiing*, 472 U.S. at 600-01. Affirming the judgment for the plaintiff in a unanimous opinion, the Court found that the record "comfortably supports an inference that the monopolist made a deliberate effort to discourage its customers from doing business with its smaller rival." *Id.* at 610.

In *Aspen Skiing* the Supreme Court specifically condemned conduct demonstrating that the defendant "was not motivated by efficiency concerns and . . . was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival. *Id.* at 610-11. This so-called "sacrifice" test examines the defendant's willingness to sacrifice short-term revenues or profits in exchange for larger revenues anticipated to result from monopoly power or increased dominance. Areeda ¶651b2, at 102. That is precisely what Apple did here: it sacrificed the short-term profits it would have gained from interoperability in exchange for the monopoly profits it gained by excluding potential rivals.

Apple's argument that *Aspen Skiing* is limited to cases of prior cooperation misstates the law. Relying on out-of-circuit authority, Apple baldly asserts that a "unilateral refusal to license intellectual property is not an antitrust violation." Mtn. at 22-23. But Apple ignores binding Ninth Circuit authority holding that in certain circumstances a unilateral refusal to license intellectual property can be an antitrust violation. In *Image Tech. Servs. II*, the Ninth Circuit squarely held that a monopolist's unilateral refusal to license intellectual property can violate Section 2 if not supported by a valid business justification. *Image Tech. Servs. II*, 125 F.3d 1195. In that case (as here), the defendant offered up a pretextual business justification for its refusal to deal, which was rejected by the court. *Id.* While Apple will likely argue that *Image Tech. Servs. II*, was limited by the Supreme Court's subsequent *Trinko* decision, *Trinko* did not overrule *Image Tech. Servs. II*, and the language upon which Apple relies (stating that "there is no duty to aid competitors") is dictum. *See* J. Thomas Rosch, Commissioner, Federal Trade Commission, *The Role of Static and Dynamic Analysis in Pharmaceutical Antitrust*, (Feb. 18, 2010) (Ex. 49, at 11-12, *available at* www.ftc.gov/speeches/rosch/100218pharmaantitrust.pdf) (noting a circuit split between the Ninth

and Federal Circuits on whether a unilateral refusal to license intellectual property can violate Section 2, and noting that Justice Scalia's statements regarding whether monopolists have a duty to deal with rivals was dictum). Apple's reliance, therefore, on out-of-circuit authority in its brief is therefore squarely in conflict with Ninth Circuit authority and unavailing.[12]

Moreover, as previously recognized by this Court (*Tucker v. Apple Computer, Inc.*, 493 F. Supp. 2d 1090, 1100 (N.D. Cal. 2006)), while the *Trinko* court found the defendant's decision to cease participation in a prior cooperative venture in *Aspen Skiing* significant, it did not confine refusal to deal cases to those situations where there exists a prior course of dealing. Rather, the Court focused on the defendant's prior conduct to "[shed] light upon the motivation of its refusal to deal – upon whether its regulatory lapses were prompted not by competitive zeal but by anticompetitive malice." *Trinko*, 540 U.S. at 409.

C. Apple Lacks Valid Business Justifications for Its Exclusionary Actions Against Harmony

As demonstrated above, Apple acted to exclude Harmony "on some basis other than efficiency." The burden therefore shifts to Apple to prove a valid business justification for its actions. *Aspen Skiing*, 472 U.S. at 605, 608. The validity and sufficiency of a proffered business justification is a factual issue for the jury. *Image Tech. Serv. I*, 903 F.2d at 620 & n.10.

In *Eastman Kodak*, 18 independent service organizations ("ISO's") that serviced Kodak copying and micrographic equipment brought a Section 2 action against Kodak to challenge its policies limiting the availability of Kodak parts. As to the issue of willful acquisition or maintenance of monopoly power, the Court stated that there was evidence Kodak "took exclusionary action to maintain its parts monopoly and used its control over parts to strengthen its monopoly share of the Kodak service market." *Eastman Kodak*, 504 U.S. at 483. Kodak could therefore escape liability under Section 2 ***only*** if it could explain its actions on the basis of valid business reasons,

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[12] Apple's attempt to diminish the holding of *Image Tech. Servs. II*, (*see* Mtn. at 23 n.13), is similarly unavailing. Apple, like Kodak, did change its practices by modifying its software, and nothing in *Trinko* or *Image Tech. Servs. II*, requires that those prior practices necessarily entail a prior agreement with the rival.

which was the fact-finders' prerogative to accept or reject. *Id.* The Supreme Court therefore reversed summary judgment on the validity and sufficiency of Kodak's purported business justifications, and remanded for trial. *Id.*

Here, as in *Eastman Kodak*, none of the business justifications proffered by Apple is dispositive as a matter of law.

1. Apple's Purported Need to Satisfy the Labels

As it has throughout this litigation, Apple asserts that its actions against Harmony were required by the record labels. Mtn. at 2 ("the record labels could have closed down iTS if Apple did not repair the DRM"); *id.* at 17 ("Whether or not DRM was effective or a good idea, the labels required it as a condition of selling music to Apple . . . . "). Notably, however, Apple presents no evidence that suggests the record labels viewed RealNetworks' Harmony as a hack or a threat to DRM. Rather, the record labels ***supported*** Harmony because they wanted interoperability.

As declarations by the labels attest:

- "WARNER has an interest in having its music sold in the widest manner possible, through as many channels as possible" and entered into an agreement with RealNetworks to sell Warner's sound recordings., Ex. 1.
- "SONY entered into agreements with other companies, including Real Networks.", Ex. 2.
- "Universal has always had an interest in having its music sold in the widest manner possible, through as many channels as possible" and entered into an agreement with RealNetworks to sell Universal's music., Ex. 3; and
- "EMI was interested in having its recorded music made widely available though many different channels" and had an agreement with RealNetworks to sell downloads of EMI sound recordings., Ex. 4.

Indeed, Apple executives acknowledged in July 2004 that the labels wanted Apple to license FairPlay to RealNetworks. Ex. 22. Because (as the record labels recognized) RealNetworks posed no threat to DRM, Apple's contractual obligation to protect DRM cannot justify its exclusionary actions against RealNetworks.

2. Apple's Purported Need to Stop Hackers

Apple's main argument is that stopping hacks constituted a procompetitive business justification. Mtn. at 17. While stopping genuine hackers may be a salutary goal, that is not the end

of the inquiry. *Cf. Microsoft*, 253 F.3d at 71 (Microsoft's justification "is not an unlawful end, but neither is it a procompetitive justification for the specific means here in question."); *Image Tech. Servs. II*, 125 F.3d at 1219 ("Neither the aims of intellectual property law, nor the antitrust laws justify allowing a monopolist to rely upon pretextual business justification to mask anticompetitive conduct."). The record presented here demonstrates that Apple's software updates and threats were intended to, and had the effect of, stopping competition by a rival seller of online music files. *See supra* at 9-11.

3. Apple's Purported Right to Improve the iPod

Apple argues that it had the right to improve its product, citing *Tyco*, 592 F.3d 991. Mtn. at 18. But as described above, Apple's exclusionary conduct did not improve the performance of its iPod. Indeed, Apple's actions were specifically designed to ***restrict*** the existing performance capabilities of its product, by disabling its ability to play online music files not purchased through Apple and making the iPod databases more likely to be erased. Martin Decl., ¶¶74, 79. A reasonable juror need not necessarily view Apple's changes to FairPlay as a product improvement.

Judicial deference to product innovation or improvement does not mean that that a monopolist's product design decisions are per se lawful. *Microsoft*, 253 F.3d at 65 (citing, among other cases, *Foremost*, 703 F.2d at 545). Apple's suggestion that *Tyco* holds otherwise is incorrect. *See, e.g.*, Mtn. at 14 ("*Tyco* holds that companies do not engage in exclusionary conduct when they modify a product to improve it.").

In *Tyco*, the Ninth Circuit held that "a design change that improves a product ***by providing a new benefit to consumers*** does not violate Section 2 ***absent some associated anticompetitive conduct***." *Tyco*, 592 F.3d at 998-99. *Tyco* is distinguishable on both counts: here Apple's purported product improvements (a) did not provide any new benefit ***to consumers***; and (b) were accompanied by associated anticompetitive conduct (*i.e.*, targeted action against Harmony, refusals to deal and disparaging and false statements). *Cf. Microsoft*, 253 F.3d at 65-67 (integration of browser excluded competition but did not improve product and so violated Section 2); *Abbott Labs. v. Teva Pharms. USA, Inc.*, 432 F. Supp. 2d 408, 423 (D. Del. 2006) (upholding Section 2 claims alleging defendant's

introduction of new drug and discontinuation of old drug was motivated by anticompetitive intentions and did not provide any added medical benefit to consumers).

4. Apple's Purported Right to Avoid Dealing with RealNetworks

Apple argues that allowing Harmony to operate "would have required extensive, close cooperation between Apple and RealNetworks." Mtn. at 20-21. Apple relies on *Trinko*, 540 U.S. 398, for the proposition that it cannot be forced to deal with a competitor absent a pre-existing course of dealing between the two. Mtn. at 23-24. As discussed above, Apple has misstated the law governing refusals to deal. Equally important, Apple's assertion is belied by the record, which confirms that RealNetworks managed to produce Harmony and keep it operating for months ***without*** Apple's cooperation. *See supra* at 7-9. Apple's only obligation was to refrain from acts that impaired competition that legitimately arose through entirely legal (and record label-endorsed) attempts at interoperability.

Moreover, Apple's claim that allowing Harmony to operate would have required "extensive, close cooperation" between Apple and RealNetworks, and that such cooperation would have compromised the security of FairPlay, is not supported by the record. As Plaintiffs' expert explains, Apple would have had to disclose very limited technical information to RealNetworks, even after the 4.7 revision, with little or no threat to the security of FairPlay encrypted songs, in order to maintain interoperability. Martin Decl., ¶¶43-47, 64-65.

Likewise off-base is Apple's suggestion that, unless the Court grants summary judgment, it could be faced with the need to act as a "central planner" or to serve as a "day-to-day enforcer" of Apple's shared obligations with RealNetworks. Mtn. at 22. Plaintiffs are not seeking "forced efforts," "forced dealings" or any other such order to "force two competitors into a close, cooperative relationship." Mtn. at 22-24. The class period in this case ended on March 31, 2009, the date by which all music sold through iTS was DRM-free. Plaintiffs seek only damages through the date that Apple's exclusionary conduct ceased to affect the market.

D. The Anticompetitive Harm of Apple's Misconduct Outweighed Any Consumer Benefit Generated, Particularly Given Less Restrictive Alternative Means Available to Apple

Even if the Court were to find that Apple's asserted procompetitive justifications were non-pretextual, Plaintiffs would be able to show that Apple could have advanced these goals through less restrictive means, or that the anticompetitive harm caused by Apple's conduct outweighed any procompetitive benefit. *Microsoft*, 253 F.3d at 58-59. As the Ninth Circuit stated in *Cal. Computer Prods., Inc. v. IBM, Inc.*, 613 F.2d 727 (9th Cir. 1979): "The plaintiff need not show that the conceded monopolist's acts were of a kind that would be unlawful for an ordinary enterprise. Rather, the plaintiff must show that the defendant's acts 'unnecessarily excluded competition' from the relevant market," analogously to the rule of reason analysis under Section 1 of the Sherman Act. *Id.* at 735-36.

Nothing in *Tyco* precludes such balancing in this case. In *Tyco* the Ninth Circuit properly questioned the application of the balancing analysis in cases lacking any evidence of exclusionary conduct. *Tyco*, 592 F.3d at 1000 ("***If*** a monopolist's design change is an improvement, it is 'necessarily tolerated by the antitrust laws' ***unless*** the monopolist abuses or leverages its monopoly power in some other way when introducing the product."); *id.* ("***Absent*** some form of coercive conduct by the monopolist, the ultimate worth of a ***genuine*** product improvement can be adequately judged only by the market itself."). But where (as here) the record demonstrates exclusionary conduct (which, as shown above, here involves far more than mere product improvement), then the balancing analysis endorsed by *Microsoft* and *Cal. Computer Prods.* is not only permitted under *Tyco*, it is ***required*** by the broad prohibitory language of Section 2.

E. Plaintiffs' Derivative California UCL Claim Necessarily Survives

Apple argues that Plaintiffs' claim under California Business & Professions Code §17200, which is premised on Apple's violation of Section 2, must be dismissed if Plaintiffs' Section 2 claims are dismissed. Conversely, Plaintiffs' derivative UCL claim survives so long as Apple is not entitled to judgment on Plaintiffs' Section 2 claims as a matter of law. *See* Dkt. No. 377 at 8 (ruling that Plaintiffs' UCL claim survives if their Sherman Act claim does).

Additionally, California courts have recognized that an unfair business act or practice need not violate an antitrust law to be actionable under the UCL. *Chavez v. Whirlpool Corp.*, 93 Cal. App. 4th 363, 375 (2001). Where the conduct unreasonably restrains competition and harms consumers, the conduct is deemed unfair. *Id.* Apple engaged in unfair actions to entrench its monopolies and subsequently overcharged consumers for iPods. This unreasonable restraint on competition and harm to consumers is sufficient within the meaning of the UCL even if Apple succeeds on its motion against Plaintiffs Section 2 claims.

V. CONCLUSION

The Supreme Court has recognized that most antitrust claims should be resolved "on a case-by-case basis, focusing on the 'particular facts disclosed by the record.'" *Eastman Kodak*, 504 U.S. at 467. The record presented here is ample to permit a reasonable jury to find exclusionary conduct, invalid or pretextual procompetitive justifications and disproportionate anticompetitive effect – all of which would support a finding for Plaintiffs on their Section 2 claims against Apple. Accordingly, Apple's motion for summary judgment must be denied.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on February 28, 2011, I authorized the electronic filing of the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the e-mail addresses denoted on the attached Electronic Mail Notice List, and I hereby certify that I caused to be mailed the foregoing document or paper via the United States Postal Service to the non-CM/ECF participants indicated on the attached Manual Notice List.

I certify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on February 28, 2011.

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