IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF THE DISTRICT OF COLUMBIA

NATIONAL ASSOCIATION OF RECORDING MERCHANDISERS, INC.,

Plaintiff,

v.

SONY CORPORATION OF AMERICA and SONY MUSIC ENTERTAINMENT, INC.,

Defendants.

C.A. No. 00-164 (EGS)

BRIEF AMICUS CURIAE OF THE UNITED STATES

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IN THE UNITED STATES DISTRICT COURT
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BRIEF AMICUS CURIAE OF THE UNITED STATES

The United States submits this brief *amicus curiae* in response to the Court's request that the "United States Department of Justice file an amicus brief in this case addressing Defendant's Motion to Dismiss and plaintiff's response thereto." Order, August 15, 2001.

INTRODUCTION

The National Association of Recording Merchandisers, Inc. ("NARM"), "a trade association whose general voting membership is made up of resellers of recorded music," [1] brought this action against Sony Corporation of America and its wholly owned subsidiary, Sony Music Entertainment, Inc. (collectively "Sony"), First Amended Complaint ¶¶ 17-18 ("Compl."),

[1]NARM's Memorandum of Points and Authorities in Opposition to Sony's Motion to Dismiss NARM's First Amended Complaint 2 ("NARM Mem.")

alleging, *inter alia*, violations of the federal antitrust laws.[2] Sony is one of the five major "record" companies, *id.* ¶¶ 67, 69, collectively accounting for "approximately 85% of all sound recording sales" and itself accounts for "nearly 20% of all current sound recordings." *Id.* ¶ 72.

As summarized by NARM, the alleged conduct at the core of its complaint falls into two categories. One category consists of "[b]undling and tying Sony's sales of CDs to NARM retailers with other products or services, such as hyperlinks to sites owned or controlled by Sony or its allies." NARM Mem. 2. That is, Sony allegedly includes on its music CDs some material that, when the CD is used in a computer rather than an ordinary CD player, offers the user the opportunity to access Sony web sites on the Internet. Sony allegedly also includes "blow-in cards" — printed advertising material — in the package containing the CD. The second category consists of Sony's provision "to record clubs such as Columbia House . . . [of] substantial discriminatory pricing and promotional concessions not made available to NARM retailers." *Id.* In other words, Sony gives Columbia House, in which it owns a half interest, Compl. ¶ 35, a better deal on CDs than it gives others.

In responding to the Court's request that we address the Motion to Dismiss, and NARM's response to it, we focus on NARM's allegations under section 1 of the Sherman Act and under the Robinson-Patman Act.[3] We do not address whether NARM would lack representational

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[2]References to the "complaint" are to the First Amended Complaint, which included nine counts and alleged violations of section 1 of the Sherman Act, 15 U.S.C. 1 (Counts 1, 3, 4); section 3 of the Clayton Act, 15 U.S.C. 14 (Counts 2, 3); the Copyright Act, 17 U.S.C. 101 *et seq.* (Count 3); sections 2(a), (d), (e) of the Robinson-Patman Act, 15 U.S.C. 13(a), (d), (e) (Counts 5, 6); section 43 of the Lanham Act, 15 U.S.C. 1125 (Count 9); and the District of Columbia code (Count 7) and common law (Count 8).

[3]Although the complaint alleges violations of section 3 of the Clayton Act, all of the (continued...)

standing to sue Sony if, as Sony contends, Sony Music Division is an unincorporated division of defendant Sony Music Entertainment, Inc. without separate legal identity, nor do we address the claims that do not arise under the federal antitrust laws.

DISCUSSION

Because the Court has invited the views of the United States with respect to a motion to dismiss and we address only the sufficiency of NARM's complaint to state a claim under the federal antitrust laws, *see* Fed. R. Civ. P. 12(b)(6), we express no view as to the truth of NARM's allegations or the potential for any other antitrust claim in this industry.

The standards by which a complaint is to be judged are well-established. A complaint must contain "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). Rule 8 does not require a claimant to "set out in detail the facts upon which he bases his claim," *Conley v. Gibson*, 355 U.S. 41, 47 (1957), but only to "give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests." *Id.* Accordingly, "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Id.* at 45-46. Moreover, the Court should "liberally construe [it] in the plaintiff's favor and grant the plaintiff the benefit of all inferences that can be derived from the facts alleged." *Andrx Pharmaceuticals v. Biovail Corp. International*, 256 F.3d 799, 805 (D.C. Cir. 2001).

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[3](...continued)
conduct alleged to violate that section is also alleged to violate section 1 of the Sherman Act. For purposes of this case, there is no significant difference between the statutes requiring separate discussion of the Clayton Act claim.

Nonetheless, a complaint must allege a factual predicate. *DM Research, Inc. v. College of American Pathologists*, 170 F.3d 53, 55 (1st Cir. 1999) ("the price of entry, even to discovery, is for the plaintiff to allege a *factual* predicate concrete enough to warrant further proceedings"). Moreover, "'the court need not accept inferences drawn by plaintiffs if such inferences are unsupported by the facts set out in the complaint. Nor must the court accept legal conclusions cast in the form of factual allegations.'" *Andrx*, 256 F.3d at 805 (quoting *Kowal v. MCI Communications Corp*., 16 F.3d 1271, 1276 (D.C. Cir. 1994)). And a plaintiff may "plead himself out of court by alleging facts that render success on the merits impossible." *Sparrow v. United Air Lines, Inc.*, 216 F.3d 1111, 1116 (D.C. Cir. 2000); *see Jackson v. Marion County*, 66 F.3d 151, 153 (7th Cir. 1995) ("[a]llegations in a complaint are binding admissions").

NARM's lengthy complaint contains broad conclusory allegations and a plethora of factual allegations about the complex relationships in the music industry, and there is room for disagreement in interpreting many of those allegations. Nonetheless, it is our view that the complaint fails to provide an adequate factual predicate for NARM's claims that Sony has violated the federal antitrust laws through its inclusion of hyperlinks and related products and services in the music CDs that it sells to NARM retailers or through its relationships with record clubs such as Columbia House.

I. Has NARM Stated a Section 1 Claim Related to Sony's Hyperlinks and Related Products and Services?

In this section, we address NARM's claim that Sony's inclusion of hyperlinks and related materials with its music CDs violates section 1 of the Sherman Act. Section 1 provides: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or

commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C. 1. Accordingly, a "successful claim under Section 1 . . . requires proof of three elements: (1) a contract, combination, or conspiracy; (2) a resultant unreasonable restraint of trade in the relevant market; and (3) an accompanying injury." *Denny's Marina, Inc. v. Renfro Productions, Inc.*, 8 F.3d 1217, 1220 (7th Cir. 1993).[4]

Critically, the unreasonable restraint of trade must be a consequence of the concerted activity: "Section 1 of the Sherman Act condemns only those restraints of trade achieved by contracts, combinations, or conspiracies." *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 214 (D.C. Cir. 1986); *see Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986); *Copperweld Corp. v. Independence Tube Co.*, 467 U.S. 752, 768 (1984). This requirement implements the Sherman Act's "basic distinction between concerted and independent action," *id*. at 767 (internal quotation and citation omitted), pursuant to which the conduct of a single firm is governed solely by section 2 of the Sherman Act, 15 U.S.C. 2 — a section that declares unilateral conduct unlawful only when it threatens actual monopolization, *Copperweld*, 467 U.S. at 767, and pursuant to which NARM makes no claim. Concerted anticompetitive activity, on the other hand, is prohibited even without a showing that actual monopolization is threatened because it is "fraught with anticompetitive risk. It deprives

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[4]An antitrust plaintiff must also satisfy the interstate or foreign commerce element, which is not at issue in this case. A private plaintiff seeking treble damages under Section 4 of the Clayton Act, 15 U.S.C. 15, must demonstrate that he has been "injured in his business or property" as a result of the violation, but the injury need only be threatened in an injunctive action pursuant to section 16 of the Clayton Act. *See* 15 U.S.C. 26 (authorizing suits for injunctive relief "against threatened loss or damage by a violation of the antitrust laws"). In either case, the injury must be "antitrust injury;" *i.e.*, "the kind of injury the antitrust laws were intended to prevent; it must 'flow[] from that which makes defendants' acts unlawful.'" *Andrx*, 256 F.3d at 806 (quoting *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977)).

the marketplace of the independent centers of decisionmaking that competition assumes and demands [as] two or more entities that previously pursued their own interests separately are combining to act as one for their common benefit." *Id.* at 768-69. Thus, Section 1 violations ordinarily involve combinations "characterized by an express or implied agreement or understanding that the participants will jointly give up their trade freedom, or help one another to take away the trade freedom of others." *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 136 (1961).

NARM's various filings suggest that Sony's inclusion of hyperlinks and other products and materials directed to the ultimate consumer in the music CDs that it sells to NARM retailers may be characterized as unlawful tying, exclusive dealing, or reciprocal dealing — all well recognized categories of concerted action that may violate section 1 of the Sherman Act. NARM further contends that, whether or not Sony's conduct falls within those categories, it nonetheless constitutes an unreasonable restraint of trade in violation of section 1. We discuss each of those contentions separately.

A. Has NARM Stated a Section 1 Tying Claim?

"A tying arrangement is 'an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product.'" *Eastman Kodak Co. v. Image Technical Services., Inc.*, 504 U.S. 451, 461 (1992) (quoting *Northern Pacific Railway Co. v. United States*, 356 U.S. 1, 5-6 (1958)). Section 1 generally prohibits such arrangements if: (1) there are two separate products, (2) the defendant has market power in the tying product, (3) there is an agreement by a party to sell one of the products only on the condition that the buyer also buy a different ("tied") product (or refrain from acquiring the other product from a

competitor), and (4) the arrangement affects a "substantial volume of interstate commerce" in the tied product. *Eastman Kodak*, 504 U.S. at 461-62; *see Foster v. Maryland State Savings & Loan Ass'n*, 590 F.2d 928, 931 (D.C. Cir. 1978).

In our view, the critical question with respect to NARM's tying theory is whether the complaint adequately alleges the existence of two separate products.[5] The answer to that question turns on the "character of the demand for the two items." *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 19 (1984). The Court has focused on whether there is separate demand for the two items because the prohibition on tying stems from a concern with foreclosure of competition on the merits in the tied product, which can occur only if there can be such competition separate from competition in the tying product. *Id.* at 12-14, 19-22.[6] The tying

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[5]NARM's filings could be read to suggest that *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001), *cert. denied*, 70 U.S.L.W. 3107 (U.S. Oct. 9, 2001), supports finding a viable tying claim when there is only a single product. *See* Supplemental Citation of Authority and Memorandum 2-3 ("Supplemental"); Plaintiff's Reply to Defendant's Response to Supplemental Citation of Authority and Memorandum 1-2 "Supplemental Reply"). We think NARM's filings are better read to suggest, correctly, that if a tying claim fails for lack of a second product, there may nevertheless be a contract, combination, or conspiracy in violation of Section 1. *Microsoft* does not support a "one-product tie," instead making clear that "unless products are separate, one cannot be 'tied' to the other." 253 F.3d at 85. Although the court, in an explanatory parenthetical to a "see also" citation, observed that two district courts "consider[ed] a rule of reason tying claim after finding a single product under the per se rule," *id.* at 97, that may reflect only the telegraphic style of an explanatory parenthetical. In one of those cases, *Chawla v. Shell Oil Co.*, 75 F. Supp. 2d 626 (S.D. Tex. 1999), plaintiffs alleged two separate tying arrangements (one involving dealers as buyers (*id.* at 636), the other involving consumers buying at retail (*id.* at 642)), failing to allege two separate products only for the second tie (*id*. at 643); the court analyzed only the first tie under the rule of reason (*id.* at 643-44). And in *Montgomery County Ass'n of Realtors v. Realty Photo Master Corp.*, 783 F. Supp. 952, 961-63 (D. Md. 1992), *aff'd mem.*, 983 F.2d 1538 (4th Cir. 1993), the court, after finding only a single product, went on to analyze, under the rule of reason, a non-tying liability theory.

[6]In some circumstances, tying can also adversely affect competition in the market for the tying product. *See, e.g.*, 9 Phillip E. Areeda, *Antitrust Law* ¶¶ 1705c-e (1991) (explaining (continued...)

arrangement results in the "abdication of the buyers' independent judgment as to the 'tied' product's merits and insulates it from the competitive stresses of the open market." *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 605 (1953). This "forecloses other sellers of the tied product and makes it more difficult for new firms to enter that market." *Jefferson Parish*, 466 U.S. at 13 n.19 (quoting *Fortner Enterprises v. United States Steel Corp.*, 394 U.S. 495, 513 (1969) (White, J., dissenting)).

The Supreme Court has accordingly condemned tying arrangements that link distinct markets for products that are "distinguishable in the eyes of buyers." *Id.* at 19. Designing the tying product to incorporate the tied product does not preclude a finding that they are separate products for purposes of tying analysis. *Microsoft*, 253 F.3d at 88-89, 95. Rather, the *Jefferson Parish* test inquires whether "there is a sufficient demand for the purchase of [the tied product] separate from [the tying product] to identify a distinct product market in which it is efficient to offer" the two products "separately." 466 U.S. at 21-22; *accord Eastman Kodak*, 504 U.S. at 462 ("sufficient consumer demand so that it is efficient for a firm to provide" them separately).

NARM's complaint alleges, in conclusory terms, that there is a market for hyperlinks and related items that is distinct from the market for CDs. *See* Compl. ¶ 102 ("There is a market for Sony sound recordings on CDs that is separate from the market for Buy Now Links and other products directing customers to music-related Internet sites.") But it alleges no facts suggesting

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[6](...continued)
conditions under which tying entrenches pre-existing power in tying product market by burdening new entrants into that market with need for simultaneous entry into tied product market); *id.* ¶ 1705f (explaining conditions under which tying reinforces power in market for tying product by weakening a partial substitute for the tying product); *id.* ¶ 1703d2 (explaining conditions under which tying might reduce price competition in tying product market).

distinct demand on the part of NARM retailers or the consumers to whom they resell the CDs for the hyperlinks and related items. To the contrary, NARM alleges that the hyperlinks and related items are "solicitation products," Compl. ¶ 63, designed to entice CD users into visiting a Sony web site. One would not normally expect such products — which amount to advertising, *see id.* ¶ 56 ("bundle[d]" products may be "simple advertising" or cards "containing advertising and marketing information," the equivalent of "promotional literature") — to be distinct products that consumers would buy in the marketplace,[7] and the complaint suggests no special circumstances supporting the existence of separate consumer demand for them.[8]

In arguing that its complaint adequately alleges that the "solicitation products" satisfy the separate product requirement, NARM improperly equates demand for these products on the part of purchasers of music CDs with demand for advertising or similar services on the part of firms seeking to attract business from consumers of CDs. Thus, in addressing the market value of hyperlinks, NARM refers not to what a consumer would pay, but rather to commissions or fees that the web site to which the hyperlinks point might be willing to pay for sales or visits these links generate. Compl. ¶ 52. NARM alleges the value of the customer "delivered" through the

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[7]Indeed, the complaint repeatedly alleges that these items were "unwanted." Compl. ¶¶ 99-100. If by that NARM means that consumers have no desire to obtain these items (as opposed to preferring to obtain them from a source other than Sony), Sony's conduct could not have undermined competition in a market for their provision to consumers, and there is no tying violation. *See Jefferson Parish*, 466 U.S. at 16 (explaining that there can be no adverse effect on competition when a purchaser is forced "to buy a product he would not have otherwise bought even from another seller in the tied-product market").

[8]Collections of advertisements may constitute products for which there is consumer demand, and there may be consumer demand for individual advertisements that have historical or esthetic appeal, such as posters advertising concerts or art exhibitions. But there is no suggestion that these considerations apply here.

hyperlink, *id.* ¶ 53, not what that delivered customer might be willing to pay for the hyperlink, nor even that the customer would be willing to pay anything at all for it. There may be markets in which firms sell their services in "delivering" customers, or markets in which firms sell data of the kind that individuals visiting a web site might be willing to provide about themselves, *see* Compl. ¶ 105, but that does not mean that consumers have been forced to purchase those services as a condition of being allowed to purchase a Sony music CD. Similarly, although "advertising" can constitute a "separate product or service," as NARM argues (NARM Mem. 25), it is sold to advertisers, not consumers. Bundling hyperlinks and advertising with the CD thus would not foreclose competition in a market for their sale to consumers.

NARM's tying theory with respect to the inclusion on some of Sony's CDs of "third party Internet access software from American Online and Earthlink," Compl. ¶ 99, is similarly flawed.[9] Although there is a conclusory allegation of distinct markets,[10] there are no factual allegations regarding consumer demand for — consumer willingness to pay for — AOL or Earthlink access software separated, as it apparently is on Sony's CDs, from Internet service

[9]Internet access providers and online services like America Online (AOL) and Earthlink distribute widely to consumers, at no charge, computer software intended to link a consumers' computer to the facilities of the firm distributing the software, and through those facilities, to the Internet. Although there is no charge for the software, the consumer must (beyond an initial trial period) pay for access to those facilities and the Internet. Purchase of a Sony CD including such software provides only the software, not (perhaps beyond an initial trial period) Internet access, for which the consumer, should she choose to avail herself of the opportunity, must pay. AOL access software is specialized to work with AOL's service. Earthlink's software is specialized to work with Earthlink's service. This specialization distinguishes software of this kind from more general purpose software. *See Microsoft*, 253 F.3d at 84-97 (implicitly accepting district court's conclusion that web-browsing software and operating systems are distinct products).

[10]"There is a market for Sony sound recordings that is separate from the market for Internet services and the market for Internet service provider access software." Compl. ¶ 103. There is no tying allegation regarding "Internet services."

(beyond, perhaps, an initial free trial period).[11] Nor is there any suggestion that NARM members buy such software separately for distribution to their customers.

Thus, we are unable to discern in NARM's complaint allegations that, if proved, would establish that Sony's sale of music CDs including "solicitation products" and Internet access software constitutes "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product." *Eastman Kodak*, 504 U.S. at 461 (internal quotation omitted). If buyers of Sony music CDs would not seek to purchase solicitation products or Internet access software separately from independent sources, then Sony's alleged conduct does not constitute unlawful tying.[12]

B. Has NARM Stated a Section 1 Reciprocal Dealing Claim?

NARM has suggested that its Count 1 might alternatively be viewed as stating a claim for "reciprocal dealing." NARM Mem. 20. Reciprocal dealing is "a dealing in which two parties face each other as both buyer and seller and one party agrees to buy the other party's goods on condition that the second party buys other goods from it," *Betaseed, Inc. v. U and I Inc.*, 681 F.2d 1203, 1216 (9th Cir. 1982); in short, "if you buy from me, I'll buy from you," sometimes as

[11]NARM alleges that "[t]he products added to the CDs, such as . . . Internet access software . . . , are currently purchased or sold as products or services separate from the sound recordings with which Sony packages them because the acquisition of potential customers for Internet sales, and data concerning those potential customers, have a separate and identifiable cost of acquisition and market value." Compl. ¶ 105. This suggests that AOL or Earthlink might be willing to pay Sony to include their access software on Sony's CDs, *see id.* ¶ 101, not that consumers purchase such software.

[12]In any event, even if NARM adequately alleged separate demand for solicitation products or Internet access software on the part of consumers of music CDs, the complaint does not allege facts suggesting that Sony's inclusion of such products in its CDs would tend to foreclose opportunities to competing providers of the tied products.

a result of coercion. *Id.* When the arrangement is imposed by coercion, the impact on competition is similar to that of tying. *Id.* at 1219-20. In particular, such an agreement can result in comparable abdication of independent judgment, insulation from the competitive stresses of the open market, and foreclosure — in this case, foreclosure of other buyers, since the agreement precludes selling to them what is, by agreement, to be sold to the reciprocating buyer-seller. *Id.* at 1220.

NARM, however, alleges no such agreement, and the facts it does allege would not support an inference of such an agreement. The missing element is Sony's agreement to purchase something from NARM members in return for the members' purchase of CDs from Sony. NARM suggests that Sony is selling its enhanced CDs to NARM retailers on condition that the retailers "give Sony direct access to the retailers' customers and customer lists at no cost to Sony." NARM Mem. 21. But the complaint does not actually allege such a transaction. *See, e.g.*, Compl. ¶ 57 ("*In effect*, Sony forces retailers to give it access to each of their customers who buys a CD with Buy Now Links") (emphasis added). And the complaint makes clear that NARM members do not deliver either customers or information about them to Sony in exchange for the CD.

Rather, the NARM retailer's purchase of the extended CD is merely the first step in an extended chain of causation that may or may not lead to Sony receiving such information, depending on the actions of the customers: *If* the consumer puts an extended CD into the CD-ROM drive of a personal computer, rather than into a CD player, *id.* ¶¶ 32, 43, material including hyperlinks is presented to the user; the consumer may choose to activate the hyperlink, *id.* ¶¶ 43, 44, and if the consumer does so, Sony "solicits user information," *id.* ¶ 29, from the consumer,

who then chooses whether to provide it. *See also id.* ¶¶ 43, 44, 45, 46. Thus the consumer, and not the NARM retailer, determines whether and to what extent Sony will receive access to the consumer and information. In no realistic sense is Sony obtaining customer information pursuant to agreement with the NARM retailer, under the allegations of the complaint. By contrast, in *Northern Pacific Railway v. United States*, 356 U.S. 1 (1958), on which NARM relies, NARM Mem. 26, the railroad's sales contracts and leases included express "clauses which compelled the grantee or lessee to ship over its lines all commodities produced or manufactured on the land," 356 U.S. at 3.

Moreover, the complaint suggests no reason to believe that agreements between NARM retailers and Sony foreclose competition in a market for the provision of customer information. There is no allegation that Sony has entered into agreements with NARM members restricting their ability to provide such information to third parties. To be sure, Sony's ability to obtain information about buyers of CDs directly from those buyers may reduce the value of NARM retailers' "valuable proprietary data and trade secrets developed over years of cultivating and understanding and catering to their musical tastes and proclivities." Compl. ¶ 58. NARM characterizes Sony as using its "power to free ride on the extensive efforts and costs incurred by NARM retailers in developing their customer bases," NARM Mem. 21; *see also* Compl. ¶ 76 ("free riding on the goodwill and marketing success of NARM retailers"). Free riding may be inefficient in some circumstances, and agreements imposing restraints of trade may sometimes be found to promote competition, on balance, because they are designed to control free riding. *See*,

e.g., Eastman Kodak, 504 U.S. at 485 n.33. *See also Rothery*, 792 F.2d at 221.[13] But free riding on another's investment, in the absence of an agreement that impairs competition, is not a violation of section 1 of the Sherman Act. So far as the complaint indicates, NARM retailers remain free to use their data as they see fit and to sell it to any willing buyer.

C. Has NARM Stated a Section 1 Exclusive Dealing Claim?

NARM also suggests that Sony's inclusion of hyperlinks and related products and materials with its music CDs provides a basis for an "exclusive dealing" claim. NARM Mem. 26-27; Compl. ¶¶ 107, 108. An exclusive dealing arrangement is, in essence, a contract or sale with a formal or de facto "condition, agreement, or understanding that the . . . purchaser . . . shall not use or deal in" the products of the seller's competitors, 15 U.S.C. 14, or that the seller not sell to the purchaser's competitors, *see U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 594 (1st Cir. 1993) ("a supplier or dealer makes an agreement exclusively to supply or serve a manufacturer"). An exclusive dealing arrangement may violate section 1 of the Sherman Act if it unreasonably forecloses opportunities for competition in the market.

It is not clear to us that the complaint adequately alleges the existence of an exclusive dealing arrangement, much less that such an arrangement unduly forecloses opportunities for competition. NARM alleges that "Sony has entered into agreements restricting trade with

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[13]"Free riding," as the term is used in antitrust cases, typically refers to a retailer's reliance on the investments made by other retailers, rather than on its own investments, with the result that a "manufacturer would not be able to induce competent and aggressive retailers to make the kind of investment . . . necessary to distribute the product." *Eastman Kodak*, 504 U.S. at 485 n.33. *See also Rothery*, 792 F.2d at 221 (when carrier agent uses a van line's "reputation, equipment, facilities, and services in conducting business for its own profit, the agent enjoys a free ride at [the line's] expense. The problem is that the van line's incentive to spend for reputation, equipment, facilities, and services declines as it receives less of the benefit from them. That produces a deterioration of the system's efficiency").

NARM retailers who compete on the Internet by obligating others to deal exclusively with certain entities and prohibiting them from doing business with (or requiring less favorable terms for) NARM retailers." Compl. ¶ 107. And NARM alleges, in even more conclusory fashion, that "Sony . . . has entered into exclusive dealing agreements." *Id.* ¶108. But the complaint does not specify the nature of these agreements.

In its filings, NARM explains that "[t]he same conduct that constitutes the tying arrangement also constitutes exclusive dealing because" Sony is requiring NARM retailers "to purchase CDs on the condition that they provide, free of charge through hyperlinking, their customers to Sony to the exclusion of other Internet sellers of recorded music." NARM Mem. 26. But, as discussed above in connection with reciprocal dealing (*supra* pp. 12-13), the facts alleged in the complaint undermine the conclusory allegations that NARM retailers provide customers or customer information to Sony. And, in any event, there is not even a conclusory allegation that NARM retailers provide such information exclusively to Sony.

NARM offers a citation to a well-known antitrust treatise as support for its assertion that the "same conduct that constitutes the tying arrangement constitutes exclusive dealing," but that treatise does not support NARM's exclusive dealing claim. At the cited pages, the treatise does observe that "[o]ften the conclusion that a practice is exclusive dealing rather than tying results from a failure to meet tying law's . . . requirement of 'separate' tying and tied products." 11 Herbert Hovenkamp, *Antitrust Law* ¶ 1800b3, at 10 (1998). But it adds that "not every conclusion that tying law's separate product requirement is not met results in a finding of exclusive dealing." *Id.* at 11. Thus, in *Jefferson Parish*, "the hospital was a party to a contract providing that all anesthesiological services required by the hospital's patients would be

performed by Roux & Associates." 466 U.S. at 5. Justice O'Connor observed, "[w]hether or not the hospital-Roux contract is characterized as a tie between distinct products, the contract unquestionably does constitute exclusive dealing." *Id.* at 44 (O'Connor, J., concurring in the judgment). But that was because the contract provided for provision of anesthesiological services exclusively by Roux. In this case, on the other hand, the tying allegations do not include an allegation that there is an exclusivity provision.[14]

D. Has NARM Stated Any Other Section 1 Claim Related to CD Content?

NARM correctly observes that "the issue in a rule of reason analysis under Section 1 of the Sherman Act is not what the conduct at issue is called." Supplemental Reply 1; *see also* NARM Mem. 20. An anticompetitive agreement that does not fit into any well-established category of concerted restrictive conduct — such as tying, reciprocal dealing, or exclusive dealing — may nonetheless violate section 1 of the Sherman Act. We have been unable, however, to discern in NARM's complaint allegations that both identify an agreement relating to the content of Sony's CDs and suggest a plausible theory of anticompetitive effect flowing from that agreement.

We emphasize that our analysis is limited to section 1 of the Sherman Act, which applies only to concerted action in restraint of trade. NARM's complaint does not allege a violation of

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[14] Similarly, NARM refers to "exclusive arrangements with Internet search engines." NARM Mem. 27. But NARM does not allege that Sony is a party to exclusive arrangements with Internet search engines. It alleges instead that CDnow has exclusive agreements "with the most popular search engines and Internet portals." Compl. ¶ 90. Even if this adequately alleges exclusive dealing by CDnow, all that links Sony to these exclusive agreements is the allegation that "Sony, Time Warner and CDnow have agreed to continue to work together to explore strategic relationships into which they may enter," *id.* ¶ 39, and speculation that in the future "Sony will benefit from these exclusives." *Id.* ¶ 90.

section 2 of the Sherman Act, 15 U.S.C. 2, which proscribes unilateral monopolization and attempted monopolization. Much of the conduct described in the complaint appears to be unilateral in nature — so far as the complaint reveals, Sony unilaterally determines the content of its CDs, including hyperlinks and related material. As we have explained, although NARM retailers agree to purchase the CDs offered by Sony, we find no concrete allegations that they also agree with Sony to do (or refrain from doing) anything else, to the detriment of competition. *See Toscano v. Professional Golfers Ass'n.*, 258 F.3d 978, 984 (9th Cir. 2001).

We offer no view with respect to the potential for antitrust claims based on Sony's unilateral conduct. As the Supreme Court has noted, "[b]ecause the Sherman Act does not prohibit unreasonable restraints of trade as such — but only restraints effected by a contract, combination, or conspiracy — it leaves untouched a single firm's anticompetitive conduct (short of threatened monopolization) that may be indistinguishable in economic effect from the conduct of two firms subject to § 1 liability." *Copperweld*, 467 U.S. at 775. Nonetheless, a single firm's actions with respect to the design of its products may in some circumstances constitute monopolization or attempted monopolization in violation of section 2 of the Sherman Act. *See Microsoft*, 253 F.3d at 67. Such theories, however, are beyond the scope of NARM's complaint.

II. Has NARM Stated A Section 1 Claim Related to Sony's Arrangements with Columbia House?

Count 4 of NARM's complaint alleges that "Sony's licensing arrangements and related conduct constitutes illegal relationship licensing" that violates Section 1. Compl. ¶ 138. As we understand the allegation, it is, in essence, that "Sony has entered into licensing arrangements with Columbia House which favors Columbia House with substantial cost and promotional benefits not

made available to NARM retailers." *Id.* ¶ 134. NARM also characterizes this relationship as exclusive dealing. NARM Mem. 27.

In contrast to tying, reciprocal dealing, and exclusive dealing, "relationship licensing" is not a staple of antitrust litigation. The only judicial decision to employ the term appears to be *Six West Retail Acquisition, Inc. v. Sony Theatre Management Corp.*, 2000 WL 264295 (S.D.N.Y. Mar. 9, 2000),[15] in which the court denied a motion to dismiss a section 1 block booking count, concluding that the complaint stated a section 1 claim for "illegal relationship licensing," even though no block booking claim could be stated against most defendants. The *Six West* complaint alleged that "Sony Theatre" (a group of defendants) agreed with motion picture distributors to "exhibit in its theatres all of the motion picture product of a distributor. In order to obtain high quality motion pictures, Sony [Theatre agreed] to also exhibit the lesser motion pictures." *Id.* at *16 (quoting Amended Complaint) (court's emphasis omitted). Because new high quality motion pictures are typically exhibited subject to exclusivity restrictions that prevent their exhibition in competing theatres,[16] such agreements between exhibitors and distributors could "hinder other exhibitors' ability to acquire quality movies," *Six West*, at *18. In short, relationship licensing, as set forth in *Six West*, might restrain trade unreasonably in some circumstances, since it apparently

[15]The *Six West* litigation borrowed the term from a 1988 Department of Justice discussion of whether certain distribution practices in the motion picture industry violated existing antitrust decrees. *See* Report of the Department of Justice on the Legality of Customer Selection Under the Injunction in the Paramount Decrees Against Discrimination in Film Licensing, *United States v. Loew's Inc.* (S.D.N.Y. Equity No. 87-273).

[16]*See, e.g.*, *Harkins Amusement Enterprises, Inc. v. General Cinema Corp.*, 850 F.2d 477, 486 (9th Cir. 1988) ("Clearance is a contract term allowing an exhibitor a degree of exclusivity within a particular market"); *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 147-48 (1948) (discussing reasonable and unreasonable clearances).

amounts to a kind of exclusive dealing which involves licensing agreements that constrain the independent economic decisions of the parties to them and may tend to exclude others from acquiring product.

NARM does not allege a licensing relationship between Sony and Columbia House comparable to *Six West*'s relationship licensing. Although NARM contends that "Sony has entered into exclusive licensing arrangements with Columbia House, providing favorable pricing and promotional advantages that are not available to NARM retailers," NARM Mem. 27,[17] we find in the complaint no allegation that the licensing arrangement with Columbia House is exclusive, in a formal sense or as a practical matter. Indeed, NARM alleges that "[o]n information and belief, Sony has entered into similar favorable licensing arrangements with other record clubs and other strategic allies." Compl. ¶ 136. More importantly, there is no indication that Sony, by agreement or otherwise, is providing CDs exclusively to Columbia House (or to any group of customers that excludes NARM retailers). And although NARM contends that Sony gives Columbia House (and perhaps other record clubs as well) more favorable terms than it gives NARM retailers, we do not understand NARM to allege that the terms Sony offers NARM retailers are so unfavorable as to effectively preclude them from obtaining Sony CDs. Accordingly, the discrimination NARM alleges here does not raise the same competitive issues as the licensing practices in *Six West*.

[17]NARM cites paragraphs 99-100 of the amended complaint, but those paragraphs do not refer to licensing arrangements with Columbia House. NARM may have intended to refer to paragraphs 107 and 108, which allege the existence of exclusive arrangements but do not identify them.

As the Third Circuit observed in *Callahan v. A.E.V., Inc.*, 182 F.3d 237 (3d Cir. 1999), a case that both parties discuss,[18] "price discrimination *simpliciter* . . . is usually not a Sherman Act violation." *Id.* at 248. As the Third Circuit also noted, a different result might follow if the price discrimination were the product of an agreement and had a substantial effect on competition. *Id.* at 248-49. But we find no allegation in NARM's complaint to indicate that this is not the "ordinary price discrimination case, in which a single supplier offers different [terms] to different purchasers in order to advance its own interests." *Id*. at 248. We find no allegation that any Sony price discrimination is the product of an agreement to discriminate. *Cf. id*. at 240 & n.1 (price discriminating distributors agreed with defendant retailer not to give discount to other retailers).

We also do not find adequately alleged a broad conspiracy in the industry involving relationships, licensing, and the Internet. To be sure, the 132 paragraphs that Count 4 incorporates by reference, Compl. ¶ 133, mention a wide variety of relationships among significant actors in the music business.[19] We express no view as to the competitive effects of any of the relationships to which the complaint refers or as to the existence of anticompetitive agreements not described in the complaint. Nor do we express any view as to other competitive

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[18]*See* NARM Mem. 41; Reply Memorandum of Points and Authorities in Support of Defendants' Motion to Dismiss Plaintiff's First Amended Complaint 20.

[19]Sony and Time Warner Entertainment are alleged to be joint venture partners, and a merger of Time Warner's music business with that of EMI is mentioned. Compl. ¶ 35. Financial relationships between Time Warner and Sony on the one hand, and CDnow on the other are alleged. *Id.* ¶ 40. Universal Music and BMG are alleged to have merged their Internet retail operations into GetMusic.com. *Id.* ¶ 69. The number of record clubs is alleged now to be down to two, both owned by major record companies. *Id.* ¶ 80. CDnow allegedly has exclusives with search engines and portals. *Id.* ¶ 90. EMI has allegedly "taken an ownership position and entered licensing arrangements with Musicmaker.com." *Id.* ¶ 93.

issues in the music industry.[20] Our point is that unconnected assertions and hints at what might exist cannot substitute for specific allegations of concerted action in restraint of trade.

III. Does the Robinson-Patman Act Apply?

NARM alleges in Count 5 price discrimination in violation of Section 2(a) of the Robinson-Patman Act and in Count 6 other kinds of discrimination in violation of Section 2(d) and 2(e) of that Act. Both counts involve Sony's alleged differential treatment of Columbia House on the one hand, and NARM retailers on the other. We address here only whether the Robinson-Patman Act applies.

A threshold requirement for invocation of the Robinson-Patman Act is the sale of commodities. Section 2(a) of the Act prohibits discrimination "in price between different purchasers of commodities of like grade and quality . . . where such commodities are sold for use, consumption, or resale." 15 U.S.C. 13(a). For the provision to apply, therefore, there must be at least two sales of "commodities." Commodities in this context means tangible products. *See, e.g., Baum v. Investors Diversified Services, Inc.*, 409 F.2d 872, 875 (7th Cir. 1969) ("This court has indicated that the word 'commodity' as used in the [Robinson-Patman] Act is restricted to products, merchandise or other tangible goods."). Section 2 (d) prohibits a person from discriminating in making certain payments to one of its customers in connection with that customer's sale of "any products or commodities manufactured, sold, or offered for sale by such person." 15 U.S.C. 13(d). It thus also turns on sale (or manufacture) of "commodities." And Section 2(e) prohibits certain discrimination "in favor of one purchaser against another purchaser

[20]The Department of Justice recently confirmed that it was looking at potential anticompetitive practices and the competitive effects of certain joint ventures in the online music industry.

or purchasers of a commodity bought for resale," 15 U.S.C. 13(e); it likewise turns on sale of commodities. If Sony does not sell "commodities" to Columbia House, the Robinson-Patman Act does not prohibit the alleged discrimination.

NARM alleges that "Sony has entered into licensing arrangements with Columbia House which favors Columbia House with substantial cost and promotional benefits not made available to NARM retailers." Compl. ¶ 134. *See also id.* ¶¶ 135 ("these favorable licensing arrangements"), 136 ("Sony has entered into similar favorable licensing arrangements"), 138 ("Sony's licensing arrangements and related conduct constitute[] illegal relationship licensing"). NARM explains the nature of the arrangement: "the record companies will authorize their CD manufacturing plants to press the same CDs for the record clubs as for the record companies. Instead of making payment to the record companies for the manufactured CDs like other retailers, the record clubs only pay for the manufacturing service, and later pay the record companies royalties on the record clubs' sales." Compl. ¶ 81.

On its face, this arrangement does not appear to involve the sale of CDs by Sony to Columbia House. Instead, it looks like a license arrangement, combined with a sale of manufacturing services to Columbia House. The arrangement, as described, might involve a license (to Columbia House or to a CD manufacturing firm) of the right to reproduce a copyrighted work, *see* 17 U.S.C. 106(1), and a license to Columbia House of the right to distribute a copyrighted work, *see* 17 U.S.C. 106(3), with a royalty based on the number of copies distributed. And because a license is not a commodity, the Robinson-Patman Act provisions in question would not apply. *See Record Club of America, Inc. v. Columbia Broadcasting System*, 310 F. Supp. 1241, 1243 (E.D. Pa. 1970) ("The Act applies only to 'sales'

of commodities to different 'purchasers.' It does not apply to 'licensing' agreements or arrangements"); *Record Club of America, Inc. v. Capitol Records, Inc.*, 1971 Trade Cas. (CCH) ¶ 73,694, at 90,898 (S.D.N.Y. 1971) ("the right to manufacture embodied in these license agreements is not a 'commodity' within the meaning of the statute").

NARM refers to the relationship between Sony and Columbia House as a "*sham* licensing arrangement." Compl. ¶ 140 (emphasis added). NARM alleges no facts, though, to suggest that the arrangement actually involves the sale of a commodity — CDs — to Columbia House rather than a licensing arrangement. In its filings, NARM suggests "a series of factual issues" relevant to "whether there has been a sale in contrast to a true license[:] who has title to the CDs, who bears the risk of loss, who has the responsibility of selling the CDs and maintaining customer satisfaction, and whether the arrangement is a pretextual attempt to circumvent the discriminatory price and promotional prohibitions of the Robinson-Patman Act." NARM Mem. 39 n.11. But, as to all but the last issue, NARM alleges no facts at all. As to the last issue, NARM alleges, in its brief if not in its complaint, that Sony designed the arrangements "solely to evade the prohibitions on price discrimination." NARM Mem. 39. The economic and legal substance of the arrangement control, however, not Sony's reason for choosing a particular kind of arrangement. The statute defines its prohibitions, and there is nothing improper in arranging one's affairs so as not to fall within the prohibition. We see nothing in the allegations of the complaint that, if proven, would require that the licenses be declared a sham.[21]

[21]NARM alleges that Columbia House ultimately obtains CDs "at costs substantially below the prices paid by NARM retailers for identical CDs of like grade and quality." Compl. ¶ 81. Assuming that to be true, it does not support the conclusion that Sony sells CDs to Columbia House. A license agreement that allows Columbia House to pay another firm to manufacture CDs (continued...)

CONCLUSION

For the foregoing reasons, we believe that NARM's complaint fails to state a claim under Section 1 of the Sherman Act, and the Robinson-Patman Act does not apply to the transactions alleged.

Respectfully submitted.

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[21](...continued)
for it will obviously put CDs into the hands of Columbia House, and the cost to Columbia House does not alter the nature of the arrangement. *See Capitol Records*, 1971 Trade Cas. at 90,898 ("The fact that plaintiff may have paid more for 'finished' LP's and tapes through normal distribution channels than the cost to Capitol using licenses and its own manufacturing processes cannot be the basis for a price discrimination comparison"). NARM alleges that the licensing arrangement "constitute[s] a scheme that places form over substance," Compl. ¶ 81, but never addresses why or in what respect the arrangement is not, in substance, a license. In light of the NARM's allegations that suggest the arrangement between Sony and Columbia House is in substance a licence, *see id*. ¶¶ 39, 81, 135, 136, 138, it would seem incumbent upon NARM to say more than that the arrangement "places form over substance."

CERTIFICATE OF SERVICE

I hereby certify that on this 31st day of October, 2001, I caused a copy of the foregoing Brief Amicus Curiae of the United States to be served by hand delivery on the following:

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