

1 In re Apple iTunes Antitrust Litigation, 796 F.Supp.2d 1137 (N.D. Cal. 2011)

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3 JAMES WARE, Chief Judge.

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5 I. INTRODUCTION

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7 Plaintiffs[1] bring this class action against Defendant Apple Computer, Inc. ("Apple"),  
... alleging violations of the Sherman Act, 15 U.S.C. § 2, and related state law claims.  
... Plaintiffs allege that Apple has committed unlawful acts in issuing software updates for  
... its iPod, in violation of federal and state antitrust laws. {1139}

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11 II. BACKGROUND

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13 A. UNDISPUTED FACTS[4]

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15 In 2003, Apple launched its iTunes music {1140} store ("iT").[5] When Apple negotiated  
... with record labels about the terms under which Apple could sell digital music files online  
... through the iT, most of the labels required that the digital music files be protected to  
... guard against piracy. Apple implemented the required security solution through a  
... proprietary system called "FairPlay." The FairPlay system was used by Apple to encrypt the  
... songs offered on the iT.

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17 In July 2004, RealNetworks announced its Harmony technology. Using Harmony, RealNetworks  
... was able to make music purchased from its online music store playable on Apple's iPods. In  
... October 2004, Apple released an update of its iTunes software called iTunes 4.7. iTunes  
... 4.7 featured a redesigned version of FairPlay. The version of FairPlay used in iTunes 4.7  
... employed a new encryption method, which ended the interoperability of the July 2004  
... version of Harmony with the iPod.

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19 In September 2006, Apple released an update of its iTunes software called iTunes 7.0.  
... iTunes 7.0 included a redesign of FairPlay. This redesign prevented third-party  
... applications like RealPlayer (the "jukebox" used by RealNetworks) from placing music onto  
... the iPod, which was accomplished by making it impossible for any source other than iTunes  
... itself to write on the iPod's database. {1140}

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21 B. PROCEDURAL HISTORY

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25 III. STANDARDS

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27 A. SUMMARY JUDGMENT

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31 B. CLASS CERTIFICATION

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35 IV. DISCUSSION

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37 A. SUMMARY JUDGMENT

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39 Defendant moves for summary judgment as to all of Plaintiffs' claims on the grounds that:  
... (1) Section 2 of the Sherman Act permits Defendant to improve its products regardless of  
... the impact on competitors; and (2) because Plaintiffs' claim under Section 2 of the  
... Sherman Act fails, its state law UCL claim necessarily fails as well. (SJ Motion at  
... 12-24.) {1143}

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41 1. SECTION 2 OF THE SHERMAN ACT

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43 Section 2 of the Sherman Act prohibits monopolization or attempted monopolization. 15  
... U.S.C. § 2. "There are three essential elements to a successful claim of Section 2  
... monopolization: (a) the possession of monopoly power in the relevant market; (b) the  
... willful acquisition or maintenance of that power; and (c) causal `antitrust' injury."  
... Allied Orthopedic Appliances, Inc. v. Tyco Health Care Group LP, 592 F.3d 991, 998 (9th  
... Cir.2010).

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45 In this case, Defendant does not contest the sufficiency of Plaintiffs' Amended  
... Consolidated Complaint as to the first and third elements. Thus, the Court's analysis will  
... focus on the second element, namely, whether Defendant "willfully acquired or maintained"  
... monopoly power.

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47 If a design change is a product improvement, that design change "by itself does not  
... violate Section 2, even if it is performed by a monopolist and harms competitors as a  
... result." Tyco Health Care Group, 592 F.3d at 998-1000. "If a monopolist's design change is  
... an improvement," then courts may not "balanc[e] the benefits or worth of [the] product  
... improvement against its anticompetitive effects." Id. at 1000. "There is no violation of  
... Section 2 unless [a] plaintiff proves that some conduct of the monopolist associated with  
... its introduction of a new and improved product design `constitutes an anticompetitive  
... abuse or leverage of monopoly power, or a predatory or exclusionary means of attempting to  
... monopolize the relevant market.'" Id. (quoting *Foremost Pro Color, Inc. v. Eastman Kodak  
... Co.*, 703 F.2d 534, 545-46 (9th Cir.1983)).

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49 Here, two of Defendant's design changes to its software are at issue: (1) its introduction  
... of iTunes 4.7 in 2004; and (2) its introduction of iTunes 7.0 in 2006. The Court considers  
... each design change in turn.

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51 A. ITUNES 4.7

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53 At issue is whether Defendant's introduction of iTunes 4.7 constituted a genuine  
... improvement. Defendant contends that iTunes 4.7 was introduced in response to hackers who  
... had circumvented Defendant's previous anti-piracy software, and that the redesigned  
... version of FairPlay in iTunes 4.7 made files more difficult for hackers to crack, which  
... constituted a genuine improvement. Plaintiffs respond that the software updates in iTunes  
... 4.7 were in fact designed to make it impossible for RealNetworks' Harmony technology to  
... play RealNetworks songs on an iPod, and that Defendant's real aim was to end RealNetworks'  
... interoperability with the iPod, rather than to prevent hacks.

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55 Defendant presents evidence that iTunes 4.7 was designed to prevent hacks as follows:

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57 (1) The earlier versions of Defendant's anti-piracy software had been successfully  
... hacked.[13]

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59 (2) In late 2003 and early 2004, attacks by hackers on Defendant's software increased  
... in frequency, leading the

60 {1144} record labels whose music was sold on iTs to demand that Defendant take steps  
... to prevent the hacking.[14]

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62 (3) In accord with its contractual obligations with the record labels, Defendant  
... improved its FairPlay security system by fundamentally changing the way its encryption  
... technology worked, thereby making the system more difficult for hackers to crack.[15]

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64 Plaintiffs do not contend that earlier versions of Defendant's software had not been  
... hacked. Further, Plaintiffs concede that record labels required Defendant to have "content  
... protection to guard against piracy." Finally, Plaintiffs' expert presents testimony that  
... iTunes 4.7 "introduced a radically different" encryption technology which was "much more  
... resistant to attack" than previous versions of the software.[16] Based on this evidence,  
... the Court finds that it is not disputed that iTunes 4.7 constituted a genuine improvement.

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66 Because iTunes 4.7 was a genuine improvement, the Court may not balance the benefits or  
... worth of iTunes 4.7 against its anticompetitive effects. Tyco Health Care Group, 592 F.3d  
... at 1000.

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68 Therefore, Defendant's introduction of iTunes 4.7 could only be a violation of Section 2  
... if Plaintiffs can prove that some conduct of Defendant associated with its introduction of  
... iTunes 4.7 constituted "an anticompetitive abuse or leverage of monopoly power, or a  
... predatory or exclusionary means of attempting to monopolize the relevant market." Id.  
... [...]

69 I. REALNETWORKS'S PROPOSAL TO LICENSE FAIRPLAY

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74 Accordingly, the Court finds that Defendant's refusal to license FairPlay to RealNetworks  
... was not anticompetitive conduct that would give rise to Section 2 liability.

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76 II. DEFENDANT'S PUBLIC STATEMENT

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80 [T]he Court finds that Defendant's public statement was not anticompetitive conduct that  
... would give rise to Section 2 liability.

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82 In sum, the Court finds that the undisputed evidence shows that iTunes 4.7 was a genuine  
... improvement. Further, Plaintiffs present no evidence that Defendant engaged in conduct  
... associated with its introduction of iTunes 4.7 that would give rise to Section 2  
... liability. Accordingly, the Court GRANTS Defendant's Motion for Summary Judgment on  
... Plaintiffs' Section 2 claim as to Defendant's introduction of iTunes 4.7.

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84 B. ITUNES 7.0

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86 At issue is whether Defendant's introduction of iTunes 7.0 constituted a genuine  
... improvement. Defendant contends that iTunes 7.0 included improvements to FairPlay that  
... prevented third-party applications from corrupting the iPod by "injecting" content onto  
... its internal database.[23] Plaintiffs respond that iTunes 7.0 did not prevent corruption  
... of the iPod, but instead made the software worse by magnifying small errors into enormous  
... errors which treated the database as being devoid of data.

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88 Here, Defendant presents evidence that iTunes 7.0 was designed to prevent iPod corruption

88... as follows:

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90 (1) Third-party applications like RealPlayer could corrupt the iPod by modifying the  
... iPod's internal database and adding foreign files to it.[24]

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92 (2) To guard against the risk of corruption, the new code included in iTunes 7.0  
... ensured that only iTunes could write to the iPod's internal database.[25]

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94 In response, Plaintiffs provide the following evidence, based on the testimony of  
... Plaintiffs' expert, David Martin:[26]

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96 (1) Adding foreign files to the iPod's internal database would not corrupt the iPod,  
... because one of the intended functions of the iPod is to act as an external disk, and for  
... RealNetworks to treat the iPod as an external disk would introduce no more risk of  
... corruption than would already exist when an iPod user treats the iPod as an external  
... disk.[27] {1147}

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98 (2) The new code included in iTunes 7.0 did not guard against the risk of corruption,  
... but actually made the software worse, because it transformed small errors in the database  
... that did not meaningfully interfere with the user experience into enormous errors that  
... treated the database as devoid of all data.[28]

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100 In light of the parties' conflicting evidence, the Court finds that it is unable to  
... determine, as a matter of law, that iTunes 7.0 was introduced to guard against the risk of  
... corruption and was therefore a genuine product improvement. Thus, the Court finds that  
... Defendant is not entitled to summary judgment on Plaintiffs' Section 2 claim as to iTunes  
... 7.0.

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102 Accordingly, the Court DENIES Defendant's Motion for Summary Judgment on Plaintiffs'  
... Section 2 claim as to iTunes 7.0.

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104 2. THE UCL

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108 B. CLASS CERTIFICATION

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112 V. CONCLUSION

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114 The Court GRANTS in part and DENIES in part Defendant's Motion for Summary Judgment as  
... follows:

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116 (1) The Court GRANTS Defendant's Motion for Summary Judgment on all of Plaintiffs'  
... claims as to iTunes 4.7; and

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118 (2) The Court DENIES Defendant's Motion for Summary Judgment on all of Plaintiffs'  
... claims as to iTunes 7.0.[30]

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120 The Court DENIES as premature Plaintiffs' Motion for Class Certification and orders as  
... follows:

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122 (1) The Court sets June 27, 2011 at 9 a.m., as a further hearing on Plaintiffs' Motion

122... for Class Certification;

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124 (2) On or before June 6, 2011, the parties shall file simultaneous Supplemental Briefs  
... addressing the issues of how the class should be defined and the length of the class  
... period in light of the Court's ruling on Defendant's Motion for Summary Judgment.