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UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

METRO-GOLDWYN-MAYER STUDIOS	)	
INC., et al.,	)	CV 01-08541-SVW (PJWx)
	)	CV 01-09923-SVW (PJWx)
Plaintiffs,	)	
	)	
v.	)	
	)	ORDER GRANTING IN PART
GROKSTER, LTD., et al.,	)	PLAINTIFFS' MOTION TO DISMISS
	)	COUNTERCLAIMS
Defendants.	)	
	)	
_____	)	
	)	
JERRY LEIBER, et al.,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	
	)	
CONSUMER EMPOWERMENT BV a/k/a	)	
FASTTRACK, et al.,	)	
	)	
Defendants.	)	
_____	)	

**I. INTRODUCTION**

On January 9, 2003, this Court denied a motion by Defendant Sharman Networks, Ltd. ("Sharman") to dismiss for, among other reasons, lack of personal jurisdiction. On February 18, 2003, Sharman filed a First Amended Answer and Counterclaims ("FAAC").

1 Sharman brings three federal counterclaims against Plaintiffs<sup>1</sup>: (1)  
2 "refusal to deal" in violation of Section 1 of the Sherman Act; (2)  
3 "conspiracy to monopolize" in violation of Section 2 of the Sherman  
4 Act; and (3) declaratory relief as to copyright misuse. Sharman also  
5 counterclaims under two provisions of California law, for trust  
6 against public policy and unfair business practices.

7 Now before the Court is Plaintiffs' Motion to Dismiss the  
8 Counterclaims. For the reasons set forth herein, the Motion is  
9 GRANTED IN PART. Further briefing is ordered as provided below.

10  
11 **II. FACTUAL BACKGROUND**

12 A. Sharman's Business Plan: DRM Management

13 Sharman distributes Kazaa Media Desktop (the "Kazaa software"),  
14 one of the world's most widely-downloaded peer-to-peer filesharing  
15 clients, and operates the Kazaa.com website. Sharman claims that,  
16 when it was formed, its founders intended to create a platform for  
17 distributing *licensed* copyrighted works, which end-users would pay to  
18 receive. (In other words, a user could "buy" a song online, instead  
19 of buying a CD at the mall.) These works would be protected by  
20 Digital Rights Management ("DRM") controls. A DRM control works like  
21 a lock, which only an authorized user can open. Thus, any person can  
22 download a DRM-protected file to their computer, but only those who

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24  
25 <sup>1</sup> This litigation involves two consolidated cases: Metro-  
26 Goldwyn-Mayer Studios, Inc. ("MGM") v. Grokster, Ltd., CV 01-8541-  
27 SVW, and Lieber v. Consumer Empowerment BV, CV 01-9923-SVW.  
28 Sharman's counterclaims are directed only against the plaintiffs in  
the MGM v. Grokster case ("Plaintiffs" for purposes of this Motion),  
consisting of many of the world's largest motion picture studios and  
music recording companies.

1 have paid to access the file can actually open it (e.g., listen to  
2 it).

3 In the last year, Sharman has entered into a partnership with  
4 third-party "Altnet," which is not a party to this case. According  
5 to Sharman, Altnet licenses copyrighted works, and then encodes  
6 digital versions of those works with a DRM "lock." When a Kazaa user  
7 searches for content - say, music or video games - the Altnet files  
8 are displayed along with other content (some of which forms the basis  
9 of Plaintiffs' underlying lawsuit). An Altnet song or video game is  
10 downloaded like any other file. Unlike illegally traded files,  
11 however, only those who pay a fee to Altnet can actually use the  
12 Altnet files. Sharman alleges that this solution works: after only  
13 seven months, Altnet is issuing nearly fifteen million licensed files  
14 per month, for things such as video games, independent music content,  
15 and other works not owned or distributed by Plaintiffs. Sharman is  
16 paid a "fee" for those Altnet files distributed across the Kazaa  
17 software and "network."

18 While users can still illegally exchange unlicensed copyrighted  
19 works, Sharman has altered the Kazaa software to highlight licensed  
20 content from Altnet. Thus, when a user searches for a file using  
21 Kazaa, the DRM-protected Altnet content appears at the top of the  
22 list. Sharman also alleges that it uses (or can use) other  
23 "incentives" designed to promote the downloading of licensed content.

24 B. Alleged Conduct by Industry Plaintiffs

25 While there is considerable redundancy in the counterclaims, the  
26 essence of Sharman's grievance appears to be thus: Sharman alleges  
27 that Plaintiffs control as much as eighty-five percent of the market  
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1 for manufacturing, labeling and distributing copyrighted music and  
2 films. Sharman further alleges that Plaintiffs together have acted  
3 monopolistically and in restraint of trade by refusing to license any  
4 copyrighted works to Altnet. This conduct, the FAAC claims,  
5 unlawfully precludes Sharman and Altnet from competing effectively in  
6 the market for distribution of *licensed* copyrighted works.

7 Sharman includes a number of other allegations, though it is not  
8 clear to which specific claim(s) they relate. Sharman alleges, for  
9 instance, that there are companies affiliated with Plaintiffs that  
10 themselves distribute filesharing software, and that Plaintiffs have  
11 not insisted that these companies police their systems in the same  
12 manner Plaintiffs demand of Sharman. Sharman also asserts that  
13 Plaintiffs distribute "fake" songs to harm Sharman's business.

14 Sharman counterclaims under Section 1 of the Sherman Act, which  
15 prohibits conspiracies or combinations in restraint of interstate  
16 commerce, and under Section 2, which bars monopolization of trade.  
17 See 15 U.S.C. §§ 1, 2.

18 Sharman also brings analogous state antitrust claims under  
19 California's Cartwright Act, see Cal. Bus. & Prof. Code §§ 16700,  
20 16726, and separately claims that Plaintiffs' conduct violates the  
21 state's unfair competition law. See Cal Bus & Prof Code §§ 17200 et  
22 seq.

23 Finally, Sharman seeks a judicial declaration that Plaintiffs  
24 have misused their copyrights, and thus that those copyrights are  
25 unenforceable.

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1       **II. LEGAL STANDARD**

2           Dismissal pursuant to Rule 12(b)(6) is appropriate where the  
3 plaintiff fails to state a claim upon which relief may be granted.  
4 Fed. Rules Civ. P. 12(b)(6). For purposes of this Motion, the Court  
5 accepts as true all non-conclusory, material allegations of the FAAC  
6 and construes them in the light most favorable to Sharman. See  
7 Newman v. Sathyavaglswaran, 287 F.3d 786, 788 (9th Cir. 2002) (citing  
8 Schneider v. California Dep't of Corr., 151 F.3d 1194, 1196 (9th Cir.  
9 1998)). The Court also draws all reasonable inferences from these  
10 allegations in Sharman's favor. See Pareto v. F.D.I.C., 139 F.3d  
11 696, 699 (9th Cir. 1998).

12  
13       **III. DISCUSSION**

14           A. Section 1 of the Sherman Act

15           “To establish a section 1 violation under the Sherman Act, a  
16 plaintiff must demonstrate three elements: (1) an agreement,  
17 conspiracy, or combination among two or more persons or distinct  
18 business entities; (2) which is intended to harm or unreasonably  
19 restrain competition; and (3) which actually causes injury to  
20 competition, beyond the impact on the claimant, within a field of  
21 commerce in which the claimant is engaged (i.e., ‘antitrust  
22 injury’).” McGlinchy v. Shell Chem. Co., 845 F.2d 802, 811 (9th Cir.  
23 1988).

24           While Plaintiffs effectively concede that the FAAC properly  
25 alleges the second element, they contest its sufficiency with respect  
26 to the other two. The Court begins with the third element, as  
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1 Sharman's standing to bring both Sherman Act counterclaims depends  
2 upon whether it has properly alleged an antitrust injury.

3 1) Antitrust Standing

4 Section 4 of the Clayton Act provides that "any person who shall  
5 be injured in his business or property by reason of anything  
6 forbidden in the antitrust laws may sue therefor . . . and shall  
7 recover threefold the damages by him sustained, and the cost of suit,  
8 including a reasonable attorney's fee." 15 U.S.C. § 15(a). Despite  
9 the apparent expansiveness of this provision, and though the Supreme  
10 Court has intoned against engrafting artificial limitations on the  
11 private right of action, see, e.g., Pfizer, Inc. v. Government of  
12 India, 434 U.S. 308, 98 S. Ct. 584 (1978); Radiant Burners, Inc. v.  
13 Peoples Gas Light & Coke Co., 364 U.S. 656, 81 S. Ct. 365 (1961),  
14 standing under the Clayton Act is more limited than that required for  
15 Article III justiciability. See Associated General Contractors of  
16 California, Inc. v. California State Council of Carpenters, 459 U.S.  
17 519, 529-35, 103 S. Ct. 897 (1983).

18 "Therefore, courts have constructed the concept of antitrust  
19 standing, under which they 'evaluate the plaintiff's harm, the  
20 alleged wrongdoing by the defendants, and the relationship between  
21 them,' to determine whether a plaintiff is a proper party to bring an  
22 antitrust claim." American Ad Mgmt., Inc. v. General Tel. Co., 190  
23 F.3d 1051, 1054 (9th Cir. 1999) (internal citation omitted).

24 Although the standing inquiry is an elusive and highly contextual  
25 one, the Supreme Court has identified certain factors that inform the  
26 analysis, including:

27 ///

- 1) the nature of the plaintiff's alleged injury (whether it is the type the antitrust laws were intended to forestall);
- 2) the risk of duplicative recovery;
- 3) the directness of the injury;
- 4) the speculative measure of damages; and,
- 5) whether damages would be complex to apportion.

American Ad Mgmt., 190 F.3d at 1055 (citing Associated General, 459 U.S. at 538-45; Bubar v. Ampco Foods, Inc., 752 F.2d 445, 449 (9th Cir. 1985)).

a. Nature of the Alleged Injury

The most important factor relates to the nature of the alleged injury, i.e., whether it is an "injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful." Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 334, 110 S. Ct. 1884 (1990) (quoting Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489, 97 S. Ct. 690 (1977)). This reflects "the central interest [of the Sherman Act] in protecting the economic freedom of participants in the relevant market." American Ad Mgmt., 190 F.3d at 1057 (quoting Associated General, 459 U.S. at 538).

The Ninth Circuit has derived from this principle the correlative standing requirement that the "injured party be a participant in the same market as the alleged malefactors." Bhan v. NME Hosp., Inc., 772 F.2d 1467, 1470 (9th Cir. 1985), quoted in American Ad Mgmt., 190 F.3d at 1057. "Parties whose injuries, though flowing from that which makes the defendant's conduct unlawful, are experienced in another market do not suffer antitrust injury."

1 American Ad Mgmt., 190 F.3d at 1057; see also R.C. Dick Geothermal  
2 Corp. v. Thermogenics, Inc., 890 F.2d 139, 148 (9th Cir. 1989).

3         Although the FAAC is somewhat opaque in terms of identifying the  
4 relevant market(s), Plaintiffs appear to accept Sharman's position in  
5 its Opposition that the relevant markets are those for digital  
6 distribution over the Internet of copyrighted sound recordings and of  
7 major motion pictures. (See Sharman's Opp. to Mot. to Dismiss  
8 Counterclaims ("Opp.") at 1, 7; Pls.' Reply in Supp. of Mot. to  
9 Dismiss ("Reply") at 1-5.)

10         At first blush, it seems apparent that Altnet, and not Sharman,  
11 participates in this market. Plaintiffs note Sharman's repeated  
12 assertion that it is a distributor of "contentless" or "content  
13 neutral" peer-to-peer filesharing software. (See Sharman's Sept. 30,  
14 2002 Memo. in Supp. of Mot. to Dismiss First Amend. Compl. at 1, 25;  
15 Sharman's Nov. 18, 2002 Reply Memo. in Supp. of Mot. to Dismiss at 1,  
16 10.) Plaintiffs argue that Sharman does not itself distribute  
17 content (copyrighted or otherwise), and has never sought a license to  
18 distribute copyrighted works (from Plaintiffs or anyone else). Thus,  
19 Sharman is neither a competitor nor customer in the relevant market.  
20 Rather, Sharman's sole stake in that market arises derivatively from  
21 its contractual relationship with Altnet: the more works Altnet  
22 licenses and distributes, the more fees are paid to Sharman for  
23 facilitating that distribution.

24         Despite some seemingly contrary precedent, however, the Ninth  
25 Circuit in American Ad Mgmt. made clear that the "market participant"  
26 requirement does not limit standing to customers and competitors in  
27 the relevant market. See 190 F.3d at 1057-58. The Ninth Circuit's  
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1 pronouncement in this respect was informed by the Supreme Court  
2 decision in Blue Shield of Virginia v. McCready, 457 U.S. 465, 102 S.  
3 Ct. 2540 (1982).

4 In that case, plaintiff Carol McCready was a member of an  
5 employer-purchased Blue Shield group health insurance plan, which  
6 provided partial reimbursement for certain mental health treatment,  
7 including psychotherapy. McCready, 457 U.S. at 468. McCready  
8 alleged that Blue Shield would only reimburse for psychotherapy  
9 rendered by a psychiatrist, and would not do so for treatment by a  
10 psychologist who is not under the supervision of a physician. Id.  
11 McCready contended that the policy reflected an unlawful conspiracy  
12 to exclude psychologists from coverage under the plans. Id. at 469-  
13 70. As a result, McCready claimed she was injured when Blue Shield  
14 refused to reimburse her for treatment by a psychologist. Id. at  
15 470.

16 Because the anticompetitive conduct alleged in McCready targeted  
17 psychologists and attempted to exclude them from the health insurance  
18 market, petitioners in the case argued that McCready's injury did not  
19 flow from the allegedly unlawful conduct. Id. at 478. Indeed, the  
20 district court had concluded that the "'sector of the economy  
21 competitively endangered' by the charged violation extended 'no  
22 further than the area occupied by the psychologists.'" Id. at 470  
23 (quoting district court). The Supreme Court disagreed, observing  
24 that although McCready was not a competitor in the affected market,  
25 "the injury she suffered was inextricably intertwined with the injury  
26 the conspirators sought to inflict on psychologists and the  
27 psychotherapy market." Id. at 484.

1           The Ninth Circuit echoed this language in Ostrofe v. H.S.  
2 Crocker Co., 740 F.2d 739 (9th Cir. 1984), a case relied upon by  
3 Sharman. The plaintiff in Ostrofe was defendant Crocker's former  
4 marketing director. Id. at 741. Ostrofe allegedly refused to  
5 perform activities necessary to Crocker's purported conspiracy to  
6 restrain trade in the market for paper lithograph labels. Id. at  
7 741-42. When he refused to go along with the conspiracy, Ostrofe  
8 alleged, Crocker terminated him, and he was boycotted from further  
9 employment in the industry. Id. at 742. Although the plaintiff in  
10 Ostrofe was not a participant in the relevant market, the Ninth  
11 Circuit concluded that "his discharge was a necessary means to  
12 achieve the conspirators' illegal end as well as an integral and  
13 inextricable part of the anticompetitive scheme." Id. at 746.

14           Ostrofe is somewhat unique - and is illustrative - because  
15 although the plaintiff was not a participant in the restrained  
16 market, his injury was necessary and integral to the alleged  
17 antitrust scheme. Cf. Vinci v. Waste Mgmt., Inc., 80 F.3d 1372, 1376  
18 (9th Cir.), cert. denied, 469 U.S. 1200 (1985) (loss of job does not  
19 typically give rise to antitrust standing). Likewise, the injury to  
20 the plaintiff in McCready "was a necessary step in effecting the ends  
21 of the alleged illegal conspiracy." 457 U.S. at 479. Both cases  
22 stand for the proposition that, "[w]here the injury alleged is so  
23 integral an aspect of the conspiracy alleged, there can be no  
24 question but that the loss was precisely the type of loss" that the  
25 antitrust laws were intended to forestall. Id. (quotation marks  
26 omitted).

1           In contrast, a party does not have standing simply because it  
2 has a commercial relationship with a market participant, thereby  
3 giving it an economic interest in avoiding restraint of the relevant  
4 market by a third party. In Eagle v. Star-Kist Foods, Inc., 812 F.2d  
5 538, 539 (9th Cir. 1987), for instance, the Ninth Circuit considered  
6 claims brought by tuna fishermen and their union alleging that  
7 certain companies had conspired to set artificially low tuna prices.  
8 The fishermen were paid either a price per ton reflecting the  
9 ultimate retail price, or through a "share of the catch" arrangement.  
10 Id. Although the fishermen were indirectly injured as a result of  
11 the artificially low prices, they lacked standing because the  
12 anticompetitive conduct itself was directed to "the vessel owners,  
13 not the crewmembers or the union." Id. at 541; see also Legal  
14 Economic Evaluations, Inc. v. Metropolitan Life Ins. Co., 39 F.3d  
15 951, 954-56 (9th Cir. 1994) (consulting firms that advised tort  
16 plaintiffs about structured settlement annuities are not participants  
17 in the market for annuities); Exhibitors' Serv. v. American Multi-  
18 Cinema, 788 F.2d 574, 577-81 (9th Cir. 1986) (film exhibition  
19 licensing agent, which alleged injuries from anticompetitive conduct  
20 in market for first-run film exhibition, is not a participant in that  
21 market); Pocohontas Supreme Coal Co. v. Bethlehem Steel Corp., 828  
22 F.2d 211, 219-220 (4th Cir. 1987) (no standing for company that stood  
23 to earn royalty payments from third party's coal mining contract,  
24 which contract was allegedly terminated as a result of antitrust  
25 violations, where principal injury would be to the third party).

26           Sharman's alleged injuries arise only because it stands to  
27 benefit from Altnet's potential success in the relevant market. As  
28

1 Sharman is neither a competitor nor customer in the restrained  
2 market, and because its injury is incidental, and not integral, to  
3 the alleged anticompetitive scheme, Sharman does not have standing.

4 This conclusion is confirmed by the other factors considered in  
5 the standing analysis.

6 b. Directness of the Injury

7 Antitrust standing requires an inquiry into the "physical and  
8 economic nexus" between the alleged violation and the harm to the  
9 plaintiff. McCready, 457 U.S. at 477; see Associated General  
10 Contractors, 459 U.S. at 540. Thus, this factor looks to whether the  
11 alleged injury was a proximate cause of the defendants' allegedly  
12 anticompetitive conduct. American Ad Mgmt., 190 F.3d at 1058.

13 "A direct relationship between the injury and the alleged  
14 wrongdoing has been one of the 'central elements' of the proximate  
15 causation determination, and 'a plaintiff who complained of harm  
16 flowing merely from the misfortunes visited upon a third person by  
17 the defendants' acts [] generally [has been] said to stand too remote  
18 a distance to recover." Ass'n of Wash. Pub. Hosp. Dist. v. Phillip  
19 Morris, Inc., 241 F.3d 696, 701 (9th Cir. 2001) (no standing for  
20 public hospitals and their associations in case brought against  
21 tobacco companies for costs incurred in treating patients' smoking-  
22 related illnesses) (quoting Oregon Laborers-Employers Health &  
23 Welfare Trust Fund v. Phillip Morris, Inc., 185 F.3d 957, 963 (9th  
24 Cir. 1999) (quoting Holmes v. Securities Investor Protection Corp.,  
25 503 U.S. 258, 268-69, 112 S. Ct. 1311 (1992)); Eagle, 812 F.2d at 541  
26 ("The chain of causation between the injury and the alleged restraint  
27 in the market should lead directly to the 'immediate victims' of any  
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1 alleged antitrust violation."); Toscano v. PGA Tour, Inc., 201 F.  
2 Supp. 2d 1106 (E.D. Cal. 2002) (no standing for golfer who claimed  
3 PGA excluded rival senior golf tours, thereby depriving plaintiff the  
4 opportunity to play on such alternative tours, as his injury would be  
5 wholly derivative of the injuries to such tours).

6 Eagle v. Star-Kist Foods, supra, is the Ninth Circuit case  
7 involving facts perhaps most analogous to the instant case. In  
8 Eagle, the "immediate victim[s]" of artificially low tuna prices were  
9 the owners of the tuna fishing vessels. 812 F.2d at 541. The vessel  
10 owners had complete control over the negotiations and sales in the  
11 affected market. Id. Crewmember compensation was only later  
12 calculated as a proportion of the sale price. Id. Thus, the  
13 injuries to crewmember employees were strictly derivative of those  
14 suffered by the vessel owners themselves. Id. at 542.

15 Such is precisely the case here. Altnet is the company that has  
16 allegedly been thwarted in its efforts to license copyrighted content  
17 for digital distribution. Although Sharman's contractual services to  
18 Altnet facilitate the latter's participation in the relevant market,  
19 Sharman is, like the crewmembers in Eagle, compensated for its  
20 services in a manner reflecting the principal's success in the  
21 market. Any injury suffered by Sharman is entirely derivative of  
22 Altnet's alleged injuries, even if harm to Sharman is a foreseeable  
23 consequence of the conduct alleged.

24 Indeed, it is specifically not the design of the Clayton Act to  
25 provide recourse to every party arguably injured by antitrust  
26 violations. Rather, the primary legislative purpose of the Clayton  
27 Act's treble damage provision is enforcement of the antitrust laws -  
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1 that is, to "make private attorneys general out of the private  
2 parties" injured by anticompetitive conduct. Eagle, 812 F.2d at 542.  
3 Therefore, "the existence of an identifiable class of persons whose  
4 self interest would normally motivate them to vindicate the public  
5 interest in antitrust enforcement diminishes the justification for  
6 allowing a more remote party . . . to perform the office of a private  
7 attorney general." Associated General Contractors, 459 U.S. at 542,  
8 quoted in Eagle, 812 F.2d at 542. Compare Eagle, 812 F.2d at 542  
9 (denying standing to fishermen and noting that direct victims - the  
10 vessel owners - are sufficiently motivated to vindicate the statute),  
11 with Ostrofe, 740 F.2d at 747 (upholding standing for terminated  
12 marketing director and observing that it is unlikely any other victim  
13 had the same incentive to "bring the antitrust violators to  
14 account").

15 Here, Altnet, not Sharman, is the primary target of the conduct  
16 alleged and would suffer the principal injury. Accordingly, Altnet  
17 has the greatest motivation to enforce the antitrust laws in the form  
18 of a private claim, thereby further diminishing any justification for  
19 allowing Sharman to do so.

20 c. Duplicative Recovery

21 The Supreme Court has repeatedly rejected antitrust claims by  
22 certain classes of persons where there is a "risk of duplicative  
23 recovery engendered by allowing every person along a chain of  
24 distribution to claim damages arising from a single transaction that  
25 violated the antitrust laws." McCready, 457 U.S. at 474-75 (citing  
26 two price-fixing cases: Hawaii v. Standard Oil Co., 405 U.S. 251, 92  
27 S. Ct. 885 (1972) (state cannot sue for damages to its "general  
28

1 economy"), and Illinois Brick Co. v. Illinois, 431 U.S. 720, 97 S.  
2 Ct. 2061 (1977) (indirect purchaser cannot bring antitrust claim for  
3 portion of overcharge passed on to it)). Because a contrary rule  
4 could yield complex and splintered recoveries, the Supreme Court has  
5 limited standing to the first link in the chain of commerce.  
6 Illinois Brick, 431 U.S. at 746-47; see McCready, 457 U.S. at 474 (no  
7 risk of duplicative recovery because, although psychologists were  
8 primary target of alleged anticompetitive scheme, plaintiff's  
9 psychologist had already been paid for treatment and thus plaintiff  
10 had suffered the only compensable injury).

11 In the instant case, there is clearly a risk of duplicative  
12 recovery if Sharman is afforded standing. Altnet is the company that  
13 licenses and packages copyrighted content for distribution. It is  
14 Altnet that has allegedly been rebuffed by Plaintiffs in its attempt  
15 to license copyrighted works, and it is Altnet that charges and  
16 collects payment for access to such works. Sharman's sole stake in  
17 this market consists of contractual "fee[s]" paid by Altnet to  
18 Sharman for distribution and promotion of Altnet-licensed works via  
19 the Kazaa software. (FAAC ¶ 61.) According to Sharman, it is the  
20 deprivation of such fees - which are themselves contingent on  
21 Altnet's growth and successful distribution of copyrighted works -  
22 that constitutes the actionable injury. (Id.) Although some of the  
23 alleged antitrust injury flows to Sharman in the form of lost fees,  
24 the whole of the injury is borne initially by Altnet. In these  
25 circumstances, precedent countenances against affording standing to  
26 Sharman.

27 ///

1                   d.    Speculative Measure of Harm

2           The Supreme Court in Associated General identified two factors  
3 that bear upon the speculative nature of a damage claim: (1) whether  
4 the injury alleged is indirect; and (2) whether the alleged effects  
5 may have been produced by independent factors. 459 U.S. at 542,  
6 cited by American Ad Mgmt., 190 F.3d at 1059. As elucidated above,  
7 the injury alleged here is indirect. Moreover, Sharman's claim for  
8 lost fees under its contract with Altnet depends upon numerous  
9 independent factors relating to Altnet (e.g., whether Altnet would  
10 actually prevail in securing any of the licenses it seeks, how many  
11 such licenses would be secured, and the degree of success Altnet  
12 would then have in distributing licensed content).

13                   e.    Complexity in Apportioning Damages

14           It is not clear from the FAAC whether Sharman's compensation  
15 under the contract with Altnet consists of a simple percentage of the  
16 revenue received, or something more complex.

17           Even assuming any damages could easily be apportioned, however,  
18 this factor would alone favor standing, while the balance of the  
19 Associated General factors militate strongly against it. The Court  
20 concludes, therefore, that Sharman lacks standing and is not a proper  
21 plaintiff to bring these Sherman Act claims.

22                   B.    Section 2 of the Sherman Act

23           Because Sharman has not properly alleged antitrust standing, its  
24 Section 2 claim fails and is also dismissed.

25                   C.    Cartwright Act

26           Sharman also alleges violations of California's Cartwright Act,  
27 which contains antitrust prohibitions similar to those provided by  
28



1 the Sherman Act. See Cal. Bus. & Prof. Code §§ 16700 et seq. The  
2 standing provision is slightly different than that of the Clayton  
3 Act, however, authorizing suit by "any person who is injured in his  
4 or her business or property by reason of anything forbidden or  
5 declared unlawful by this chapter, *regardless whether such injured*  
6 *person dealt directly or indirectly with the defendant.*" Cal. Bus. &  
7 Prof. Code § 16750(a) (emphasis added).

8 Because this provision is broader than its Clayton Act analog,  
9 "the more restrictive definition of 'antitrust injury' under federal  
10 law does not apply to section 16750." Cellular Plus, Inc. v.  
11 Superior Court, 14 Cal. App. 4th 1224, 1234 (1993); see Knevelbaard  
12 Dairies v. Kraft Foods, Inc., 232 F.3d 979, 987 (9th Cir. 2000)  
13 (Cartwright Act "affords standing more liberally than does federal  
14 law."). While the standing provisions are broader, "[t]he exact  
15 parameters of 'antitrust injury' under section 16750 have not yet  
16 been established through either court decisions or legislation."  
17 Cellular Plus, 14 Cal. App. 4th at 1234. "Because the Cartwright Act  
18 has objectives identical to the federal antitrust acts," however,  
19 California courts do "look to cases construing the federal antitrust  
20 laws for guidance in interpreting the Cartwright Act." Vinci v.  
21 Waste Management, Inc., 36 Cal. App. 4th 1811, 1814 n.1 (1995)  
22 (collecting cases).

23 It is clear, for instance, that the Cartwright Act's more  
24 expansive standing provision does not dispense with the requirement  
25 that an antitrust plaintiff allege an "'injury of the type the  
26 antitrust laws were intended to prevent and that flows from that  
27 which makes defendants' acts unlawful.'" Morrison v. Viacom, Inc.,

1 66 Cal. App. 4th 534, 548 (1998) (quoting Kolling v. Dow Jones & Co.,  
2 137 Cal. App. 3d 709, 723 (1982) (citing Brunswick Corp. v. Pueblo  
3 Bowl-O-Mat., Inc., 429 U.S. 477, 487-89, 97 S. Ct. 690 (1977))).  
4 Rather, the "broader California definition resulted from the United  
5 States Supreme Court's restrictive decision in Illinois Brick Co. v.  
6 Illinois (1977) 431 U.S. 720, wherein the court precluded a lawsuit  
7 under federal antitrust law by indirect purchasers." Cellular Plus,  
8 Inc., 14 Cal. App. 4th at 1234; see also Knevelbaard, 232 F.3d at 991  
9 (same); California v. ARC America Corp., 490 U.S. 93, 97-99 (1989)  
10 (Cartwright Act's allowance of indirect purchaser standing not  
11 preempted by federal law). Thus, California law permits suit by an  
12 injured party who "dealt" with the alleged malefactor regardless  
13 whether the dealing was direct or indirect.

14 However, the party still must suffer an injury of the type the  
15 antitrust laws were meant to forestall, see, e.g., Morrison, 66 Cal.  
16 App. 4th at 548, which in turn requires that the party be a  
17 participant in the restrained market. See Knevelbaard Dairies, 232  
18 F.3d at 987-89. Under California law, an indirect purchaser  
19 participates (indirectly) as a customer in the relevant market, and  
20 thus may suffer a cognizable antitrust injury.

21 For the reasons illustrated above, however, Sharman does not  
22 participate, directly or indirectly, in the relevant market. While  
23 Altnet may be an actor in the market for lawful digital distribution  
24 of copyrighted works, Sharman participates principally in the market  
25 for distribution of "contentless" peer-to-peer filesharing software  
26 (regardless whether its founders had other intentions at the  
27 company's inception). It has never sought to license and distribute  
28

1 copyrighted works, through Altnet or otherwise, and thus cannot have  
2 been directly affected by Plaintiffs' alleged refusal to license such  
3 works. While Sharman's contractual relationship with Altnet may mean  
4 that Sharman will benefit consequentially from Altnet's success in  
5 the relevant market, this no more converts Sharman into a participant  
6 in that market than it would Altnet's attorneys. Because Sharman  
7 does not "deal[]" with the purported antitrust violator in any  
8 respect, it is not afforded standing under the Cartwright Act.

9 Moreover, while the scope of actionable injury is slightly  
10 different under the Cartwright Act, the standing analysis is  
11 nonetheless informed by many of the same factors considered supra.  
12 See Vinci, 36 Cal. App. 4th at 1814.

13 Accordingly, Sharman's Cartwright Act is dismissed for lack of  
14 standing.

15 D. Copyright Misuse

16 Sharman alleges that if Altnet could license mainstream content  
17 and promote it on Kazaa, users would download the licensed content  
18 instead of the unlawful alternative. Sharman maintains that because  
19 Plaintiffs have refused to license any content to Altnet, Kazaa users  
20 by default see only unlicensed versions of Plaintiffs' works. Thus,  
21 Sharman concludes, Plaintiffs have unreasonably failed to cooperate  
22 with Sharman to combat unlawful filesharing and staunch the very  
23 infringement that forms the basis of Plaintiffs' underlying suit.  
24 Sharman believes that this conduct violates the "public policy  
25 embodied in the grant of a copyright," and should be sanctioned by  
26 holding Plaintiffs' copyrights unenforceable under the doctrine of  
27 copyright misuse. (FAAC, Counterclaims ¶¶ 70, 71, 74.)

1 Copyright misuse is a relatively recent addition to the corpus  
2 of judge-made copyright law. Historically, most courts to consider  
3 the question held that a copyright holder's violation of the  
4 antitrust laws did not give rise to a defense in a copyright  
5 infringement action. See 4-13 Nimmer on Copyright § 13.09 & n.6  
6 (collecting cases). This contrasts with the long-recognized defense  
7 of patent misuse. See, e.g., Morton Salt Co. v. G. S. Suppiger Co.,  
8 314 U.S. 488, 62 S. Ct. 402 (1942). Although one Supreme Court  
9 decision did seem to imply that the same principle applied in the  
10 copyright context, see United States v. Loew's Inc., 371 U.S. 38, 83  
11 S. Ct. 97 (1962), the Fourth Circuit became the first appellate court  
12 to recognize explicitly a defense of copyright misuse. See Lasercomb  
13 America, Inc. v. Reynolds, 911 F.2d 970, 973 (4th Cir. 1990). The  
14 Ninth Circuit later joined with the Fourth Circuit and adopted this  
15 defense. See Practice Mgmt. Info. Corp. v. AMA, 121 F.3d 516, 521  
16 (9th Cir. 1997).

17 Indeed, Sharman asserts copyright misuse as an affirmative  
18 defense to Plaintiffs' claims for copyright infringement. (See FAAC  
19 at 10.) Because the Court can consider this defense in the context  
20 of Plaintiffs' suit against Sharman, and because, as Sharman  
21 concedes, copyright misuse cannot found a claim for damages (see Opp.  
22 at 17), the counterclaim appears redundant.

23 Sharman contends, however, that the declaratory relief it seeks  
24 is not duplicative of its affirmative defense, as a finding of misuse  
25 would "play[] an important notice function and public policy role in  
26 identifying for all the world the specific copyrighted works that  
27 will be unenforceable against anyone due to Plaintiffs' wrongful  
28

1 conduct." (Id. at 18 (emphasis added).) Without passing on  
2 Sharman's assumption that a finding of misuse would have such breadth  
3 of operation, the Court notes that this justification is somewhat  
4 specious. If the Court reaches the affirmative defense, any such  
5 notice would be equally effected by the Court's disposition of that  
6 defense. Rather, the separate declaratory claim presumably serves  
7 but one purpose: to ensure that the misuse issue will be decided, and  
8 any notice rendered, *even if* the affirmative defense is mooted by a  
9 finding that Sharman is not liable for infringement.

10 Sharman asserts jurisdiction for the sought-after relief under  
11 the copyright laws, and the Declaratory Judgments Act ("Act"), 28  
12 U.S.C. §§ 2201, 2202. (See FAAC, Counterclaims ¶ 31.) The Act was  
13 intended to afford relief to those victimized by "scarecrow"  
14 litigation (i.e., circumstances in which a potential plaintiff  
15 immobilizes others with the mere threat of litigation), by allowing  
16 district courts to declare the legal relations of affected parties.  
17 Cardinal Chem. Co. v. Morton Int'l, 508 U.S. 83, 96, 113 S. Ct. 1967  
18 (1993) (quoting Arrowhead Industrial Water, Inc. v. Ecolochem, Inc.,  
19 846 F.2d 731, 734-35 (Fed. Cir. 1988)). Because Plaintiffs' lawsuit  
20 against Sharman necessarily establishes the requisite controversy  
21 under the Act, the Court assumes that it has jurisdiction to hear a  
22 defense to infringement asserted as a declaratory counterclaim. See  
23 Cardinal Chem. Co., 508 U.S. at 96 (district court has jurisdiction  
24 to hear counterclaim for patent invalidity even where court has  
25 already found noninfringement<sup>2</sup>).

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26  
27 <sup>2</sup> The Court does not reach the question whether this holding  
28 applies to copyright misuse, but rather assumes for purposes of this  
Motion that it does. The Court notes, however, that copyright misuse

1 Sharman's reliance on Cardinal Chem. Co., *supra*, is inapt,  
2 however, inasmuch as Sharman suggests that it is dispositive as to  
3 whether the counterclaim must be entertained. That case was  
4 concerned primarily with issues of *appellate* jurisdiction. While the  
5 Supreme Court held that the Federal Circuit was not jurisdictionally  
6 obligated to vacate declaratory relief as to patent invalidity after  
7 affirming a district court's finding of noninfringement (i.e., the  
8 counterclaim for invalidity was not "moot" simply because  
9 noninfringement had been found and affirmed), the Court specifically  
10 noted that the Declaratory Judgments Act affords "the district court  
11 some discretion in determining whether or not to exercise []  
12 jurisdiction [under the Act], even when it has been established."  
13 Cardinal Chem. Co., 508 U.S. at 95 n.17 (citing Brillhart v. Excess  
14 Ins. Co. of America, 316 U.S. 491, 494-96, 62 S. Ct. 1173 (1942));  
15 accord Wilton v. Seven Falls Co., 515 U.S. 277, 286-88, 115 S. Ct.  
16 2137 (1995) (noting district court's "unique and substantial  
17 discretion" under the Act to declare rights of litigants). In other  
18 words, even where jurisdiction exists, the exercise of that  
19 jurisdiction "is committed to the sound discretion of the federal  
20 district courts." Huth v. Hartford Ins. Co., 298 F.3d 800, 802 (9th  
21 Cir. 2002).

22 The Declaratory Judgments Act is not intended to provide a forum  
23 for establishing the legal relations between declaratory defendants

24 \_\_\_\_\_  
25 is an equitable doctrine distinct in many respects from the  
26 (generally) case-independent, binary question of patent validity.  
27 Accordingly, regardless the posture in which it is presented -  
28 whether under the ambit of declaratory relief or as an affirmative  
defense - the issue of copyright misuse may well be jurisdictionally  
moot upon a finding that the alleged infringer is not liable for  
infringement.

1 and "all the world." (Opp. at 18.) Rather, the Act grants district  
2 courts the jurisdiction to "declare the legal rights and other legal  
3 relations of *any interested party*." 28 U.S.C. § 2201 (emphasis  
4 added). Copyright misuse has already been asserted by Sharman as an  
5 affirmative defense, and the Court will reach all aspects of that  
6 issue if necessary. Separately litigating that defense in a  
7 declaratory posture would not serve the purposes of declaratory  
8 relief, such as clarifying and settling the legal relations of the  
9 parties, or affording a declaratory plaintiff relief from the  
10 "uncertainty, insecurity, and controversy giving rise to the  
11 proceeding." Bilbrey v. Brown, 738 F.2d 1462, 1470 (9th Cir. 1984).  
12 Moreover, while concerns of federalism and comity are not present  
13 here, there are strong interests of judicial economy in avoiding  
14 needless duplication of these already elaborate proceedings. See  
15 Huth, 298 F.3d at 803; Government Empl. Ins. Co. v. Dizol, 133 F.3d  
16 1220, 1226 (9th Cir. 1998).

17 Accordingly, Sharman's counterclaim for declaratory relief as to  
18 copyright misuse is dismissed with prejudice.

19 E. Unfair Business Practices

20 Finally, Sharman claims violations of California's unfair  
21 competition law ("UCL"), Cal. Bus. & Prof. Code §§ 17200 et seq. The  
22 UCL defines unfair competition as any "unlawful, unfair or fraudulent  
23 business act or practice[s]," and provides a private cause of action  
24 for equitable relief. Cal. Bus. & Prof. Code §§ 17200, 17203, 17204.  
25 Sharman argues that the alleged violations of antitrust law state a  
26 claim under the "unlawful" prong of Section 17200, and that its other  
27  
28

1 allegations are cognizable under the "unfair" prong. (Opp. at 21-22.)

2 Given the broad sweep of Section 17200, the Court is inclined to  
3 deny the motion to dismiss this counterclaim. Even if Sharman's  
4 pleading is deficient with respect to some of the substantive  
5 elements of federal or state antitrust law, the UCL's prohibition on  
6 "unfair" business practices arguably brings within its radius conduct  
7 that might otherwise fall outside the strict confines of antitrust  
8 law. See Cel-Tech Communications, Inc. v. Los Angeles Cellular  
9 Telephone, 20 Cal. 4th 163, 181 (1999). "[T]he section was  
10 intentionally framed in its broad, sweeping language, precisely to  
11 enable judicial tribunals to deal with the innumerable new schemes of  
12 which the fertility of man's invention would contrive." Cel-Tech  
13 Communications, 20 Cal. 4th at 181.

14 However, because this claim was scarcely addressed in the moving  
15 papers (and was ignored entirely by Plaintiffs in their Reply), the  
16 Court reserves a final ruling and orders further briefing as detailed  
17 below.

18  
19 **IV. LEAVE TO AMEND**

20 Because the facts related to the question of antitrust standing  
21 are not in dispute, because Sharman has already once amended its  
22 counterclaims in response to Plaintiffs' identification of legal  
23 deficiencies, and because Sharman has not suggested any additional  
24 allegations that would alter the standing analysis, leave to amend is  
25 appropriately denied as to the federal and state antitrust claims.  
26 See Associated Contractors, 459 U.S. at 526 n.11 (sustaining  
27 dismissal of antitrust claims where plaintiff had already once  
28



1 amended its complaint to attempt to state a claim); Albrecht v. Lund,  
2 845 F.2d 193, 195-96 (9th Cir. 1988) (dismissal without leave to  
3 amend appropriate where sole issue is liability as a matter of  
4 substantive law); Orion Tire Corp. v. Goodyear Tire & Rubber Co., 268  
5 F.3d 1133, 1138 (9th Cir. 2002) (court may properly consider facts  
6 alleged for the first time in the moving papers in determining  
7 whether to grant leave to amend).

8  
9 **V. CONCLUSION**

10 Therefore, Plaintiffs' Motion to Dismiss [444-1] must be, and  
11 hereby is, GRANTED IN PART as to Counts I through IV of Sharman's  
12 Counterclaims, and those counterclaims are DISMISSED WITH PREJUDICE.

13 Plaintiffs are ORDERED to file a Supplemental Reply, addressing  
14 Sharman's Opposition to the Motion to Dismiss as it applies to the  
15 UCL claim, which brief shall not exceed ten pages and shall be filed  
16 no later than Monday, July 14, 2003. Sharman may then file a Sur-  
17 Reply not to exceed ten pages, which brief shall be filed no later  
18 than Monday, July 21, 2003.

19  
20  
21  
22 IT IS SO ORDERED.

23  
24 DATED: 7/2/2003

/s/

25 \_\_\_\_\_  
STEPHEN V. WILSON  
26 UNITED STATES DISTRICT JUDGE  
27  
28