

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

NATIONAL ASSOCIATION OF)
RECORDING MERCHANTISERS, INC.,)
a District of Columbia corporation,)
Nine Eves Drive)
Marlton, New Jersey)

Plaintiff)

v.)

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

SONY CORPORATION OF AMERICA,)
a New York corporation,)
550 Madison Avenue)
35th Floor)
New York, New York 10022-3321)

and)

SONY MUSIC ENTERTAINMENT, INC,)
a Delaware corporation,)
550 Madison Avenue)
New York, New York 10022-3321)

Defendants)

FIRST AMENDED COMPLAINT

This action is brought by the National Association of Recording Merchandisers, Inc. ("NARM"), on its behalf and on behalf of its members, to enjoin the Defendants from, *inter alia*, bundling products and services on digital sound recordings sold to NARM members, who have no choice but to purchase those sound recordings and who are forced to take the bundled products in the form of computer software add-ons, interactive "hyperlinks" to retail sales sites, "blow-in" promotional inserts to competitors, and other related products or services. The conduct of Sony alleged herein

constitutes an unlawful tying arrangement and exclusive dealing in unreasonable restraint of trade, misuse of copyright, price and related promotional discrimination, unfair competition, and false and deceptive advertising.

PRELIMINARY STATEMENT

Sony has engaged and continues to engage in an illegal course of conduct that threatens NARM and NARM members, particularly NARM retailers, with the erosion of their customer bases and the concomitant inability to survive as retailers and competitors for the sale of CDs. Sony's conduct includes: (1) bundling and tying the sale of CDs and other products and services such as hyperlinks to Internet retail music sites owned, controlled or directed by Sony and coercing NARM members to take the bundled products, something they would not otherwise do except for Sony's economic power; (2) adding to the monopoly of a copyrighted sound recording the obligation that buyers purchase another copyrighted product in order to secure the first; (3) entering into arrangements with Time Warner to provide Columbia House (a sound recording Internet and mail order retailer) with substantial pricing and promotional advantages not available to NARM members, who are in competition with Columbia House; (4) entering into various arrangements with Time Warner (one of the other major record companies), Columbia House and CDnow (one of the two leading Internet-based music retailers), including agreements to provide Columbia House and possibly CDnow with substantial pricing and promotional advantages not available to NARM members, who are in competition with these entities; (5) free riding on the substantial efforts of NARM retailers in developing customers and customer loyalty, and misappropriating their customer information and data for the benefit of Sony's owned, controlled or directed resellers such as CDnow and CH; (6) raising the costs to independent record companies to supply sound recordings to the public through NARM retailers by forcing retailers to

raise their margins on independent recordings to compensate for the effects of Sony's free riding and dilution of NARM retailers' sales; and (7) raising barriers to entry for NARM retailers into the market for Internet retail sales of digital sound recordings, including packaged goods and downloading, by appropriating an input critical to their ability to compete with Sony's retail sites, such as www.thestore.sonymusic.com and www.columbiahouse.com, and the preferred non-Sony retail site www.cdnnow.com, in which Sony is a major investor.

JURISDICTION AND VENUE

1. This action is brought under the Declaratory Judgment Act, 28 U.S.C. § 2201, and under Sections 4 and 16 of the Clayton Act, 15 U.S.C. §§ 15 and 26, to obtain injunctive and related relief, including reasonable attorneys fees and costs of suit, for injuries threatened by reason of the Defendants violations of Sections 1 of the Sherman Act, 15 U.S.C. § 1, and Section 3 of the Clayton Act, 15 U.S.C. § 14, and asserts claims for injuries threatened by reason of the Defendants violations of Section 28-4502 of the District of Columbia Code, for copyright misuse in violation of the aforesaid antitrust laws as well as the Copyright Act, 17 U.S.C. § 1 *et seq.*, for price and related promotional discrimination in violation of Sections 2(a), (d) and (e) of the Robinson-Patman Act, 15 U.S.C. §§ 13(a), (d), and (e), for unfair competition under District of Columbia law, and for unfair and deceptive advertising under the Lanham Act, 15 U.S.C. § 1051 *et seq.*

2. The activities of Defendants have and will continue to threaten to have substantial adverse competitive effects upon interstate commerce and upon commerce within the District of Columbia.

3. This Court has jurisdiction over Plaintiff's claims arising under the antitrust and copyright laws pursuant to 28 U.S.C. §§ 1331 and 1337, and pursuant to Sections 4 and 16 of the

Clayton Act, 15 U.S.C. §§ 15 and 26; under the Robinson-Patman Act pursuant to 15 U.S.C. § 13, and under the Lanham Act pursuant to 15 U.S.C. § 1051 *et seq.* There is complete diversity of citizenship between the parties, and this Court has diversity jurisdiction pursuant to 28 U.S.C. § 1332. This Court also has supplemental and pendent jurisdiction over Plaintiff's related District of Columbia law claims pursuant to 28 U.S.C. § 1367.

4. Venue is proper in this district pursuant to 15 U.S.C. § 22 and 28 U.S.C. § 1391(b) and (c), because the Defendants transact business or are found within the District and a substantial portion of the events giving rise to the claims hereunder occurred within the District.

THE PARTIES

5. Plaintiff National Association of Recording Merchandisers, Inc., (hereafter "NARM") is the principal trade association of music retailers and distributors that market and sell sound recordings to consumers. NARM is a not-for-profit corporation organized under the laws of the District of Columbia, with its principal place of business in the State of New Jersey. It is known as the preeminent trade association representing the retailing and wholesaling community of the music industry.

6. The more than one thousand members of NARM are retailers, wholesalers, distributors and suppliers of music and other pre-recorded entertainment software, including copyrighted sound recordings on compact discs ("CDs") and enhanced compact discs ("ECDs"). NARM's General members include retailers and wholesalers of music and other pre-recorded entertainment software. NARM's Associate members include suppliers of music and other pre-recorded entertainment software. NARM's members are present and do business in all fifty states of the United States of America and in the District of Columbia.

7. NARM's members include in-store retailers (so-called "brick-and-mortar" retailers) who sell from physical locations that their customers enter to make their selections. Among the retail members of NARM are the large music store chains such as Tower Records, The Musicland Group and TransWorld Entertainment, as well as smaller chains and numerous independent music stores.

8. NARM's members also include "online" retailers, marketing their merchandise over the Internet and selling it by taking orders over the Internet or, in some cases, by allowing customers to "download" a sound recording to their personal computers or other digital storage devices.

9. Many NARM members are both brick-and-mortar and online retailers.

10. One of the fundamental purposes of NARM is the promotion of the interests of merchants (retailers) and distributors (wholesalers) of music who market CDs (including ECDs) and other formats of sound recordings. NARM supports the freedom of its members to purchase and resell digital sound recordings without being forced to carry additional products that co-opt or misappropriate their customers by directing them to competing retail locations, or that give others direct access to NARM member customers.

11. Sony clearly understands that NARM's purpose is to represent the interests of the retailers and wholesalers of pre-recorded music, not the interests of the major record companies except insofar as the interests of their music distribution divisions are aligned with those of retailers, wholesalers and independent distributors.

12. NARM members are among the music retailers directly affected by the unlawful conduct described in this Complaint. NARM member retailers are engaged in the business of selling digital sound recordings and are, and will continue to be, coerced into purchasing the bundled products and services from major record companies without recourse. NARM seeks to protect its interests and

the interests of its members. Unless enjoined, the conduct of the Defendants will foreclose NARM member retailers from being able to effectively compete for the sale of recorded music to consumers, will force independent record companies to increase their wholesale margins, and will deny consumers the benefits of unfettered wholesale and retail competition.

13. NARM brings this action on its own behalf, and on behalf of its retail members doing business in this District and throughout the United States. Sony's actions are causing and will continue to cause the loss of NARM members' customers, the progressive destruction of NARM members' businesses, and an incipient loss of NARM's membership base.

14. NARM is governed by a Board of Directors, which sets the policy and strategic direction of NARM. The Board of Directors is empowered to exercise all powers of NARM and do all lawful acts and things that are not by statute or NARM's Bylaws required to be exercised or done by the members. Among those general powers is the power to initiate litigation on behalf of NARM or its members.

15. The decision by NARM to initiate this litigation was and remains duly authorized by NARM's Board of Directors in every respect. No member of NARM's Board of Directors dissented to the vote authorizing the initiation of this litigation. No member of NARM has challenged the Board's authority to make this decision or the procedure used to make it.

16. Sony Music Distribution is a member of NARM, and its parent company is Sony Corporation, a Japanese corporation with its principal place of business in Tokyo, Japan. Neither is a defendant herein.

17. Defendant Sony Corporation of America ("Sony America") is a New York corporation with its principal place of business in New York City. It is a wholly-owned subsidiary of Sony Corporation.

18. Defendant Sony Music Entertainment, Inc. ("Sony Music"), is a Delaware Corporation and a wholly-owned subsidiary of Sony America, with its principal place of business in New York City.

19. Defendants Sony America and Sony Music are hereafter collectively referred to as "Sony."

RELEVANT MARKETS

20. The unreasonable restraint of trade and related unlawful conduct threatens to depress and reduce competition in the following relevant product and/or service markets in the United States.

- a. The market for wholesale sales of digital sound recordings, including packaged goods (compact discs, digital versatile discs, and other tangible mediums of expression) and downloaded digital sound recordings;
- b. The market for retail sales of digital sound recordings, including packaged goods (compact discs, digital versatile discs, and other tangible mediums of expression) and downloaded digital sound recordings;
- c. The market for Internet retail sales of digital sound recordings, including packaged goods (compact discs, digital versatile discs, and other tangible mediums of expression) and downloaded digital sound recordings;
- d. The market for hyperlinks and other related products or services directly or indirectly leading consumers to Internet sites for the purchase of sound

recordings, including sites offering compact discs and/or downloading of recorded music.

- e. The market for consumer identification and data in relation to music listening preferences and buying patterns.

FACTUAL ALLEGATIONS

The Emergence of Compact Discs and Enhanced Compact Discs

21. Since the time sound recordings on vinyl records first hit the consumer market, record companies have marketed their phonorecords and other sound recordings principally by distribution through retail channels wherein the consumer purchases the product at retail outlets, with the vast majority of sales being made through specialty music retailers or the music departments of non-specialty merchants.

22. The most popular format for sound recordings today is the digital format recorded on a variety of digital storage devices, or tangible mediums of expression. Although digital storage devices include the compact disc (“CD”), digital versatile disc (“DVD”) and its audio equivalent (“DVD-Audio”), digital audio tape, floppy discs, computer hard drives and solid state microchips, by far the most popular digital recording medium for retail sound recordings today is the compact disc (“CD”). Sound recordings on CDs currently constitute approximately 83.3 percent of all pre-recorded music sales.

23. Although this First Amended Complaint will refer principally to Sony’s current conduct involving CDs, the relief requested comprises all recording mediums on which, like CDs, digital sound recordings and hyperlinks to Internet sites may be bundled together and recorded or stored, and all

modes of digital transmission of sound recordings and hyperlinks, (or other means of placing end users in direct contact with the copyright owner) and in which they can be bundled together.

24. CDs have the benefit of containing music in digital format, enabling them to be played through dedicated CD players and also through the CD-ROM drives of personal computers ("PCs"). The CD format is also a popular format for delivering pre-recorded computer programming using the same CD-ROM drive in which sound recordings are played. Emerging digital formats, such as memory sticks, can contain digital recordings in a compressed format and played in a PC or a portable device.

25. Record companies have recently begun to add visual and interactive features to their CDs so that, when played through a PC, the user can see visual images (both still and moving) and text relating to the CD, such as images of the artist, lyrics of songs, listings of previous CDs by the artist, and background information. These CDs are often referred to in the industry as an "enhanced" CD ("ECD") or, as Sony calls it, "CD EXTRA."

26. "Hyperlinks" consist of text or an image, displayed on a computer monitor, that is linked to a location in the same computer file (such as a footnote in a text document), a location in a different file (such as linking to an image file referenced in a text file), or a location on the Internet (using software such as Netscape or Internet Explorer in conjunction with the services of an Internet service provider, such as America Online or EarthLink). ECDs may contain all three types of hyperlinks. The hyperlinks are activated by a mouse click when the computer's pointing device is over the hyperlink. References to hyperlinks in this First Amended Complaint are limited to those hyperlinks from a file on a digital sound recording medium (typically an ECD) to a location on the Internet (sometimes referred to as a web page or an Internet site), or the activation of a pre-addressed electronic mail form.

27. Some record companies, and particularly Sony, have been adding to their ECDs with increasing frequency hyperlinks to Internet sites owned, controlled or directed by the record companies themselves, where subsequent sales of sound recordings are offered or made directly to the consumer.

28. The consumer is directed, either immediately from the ECD or after activating one or more hyperlinks to related Internet pages, to a “Buy Now” button or similar hyperlink that invites the consumer to initiate the actual process of ordering or buying sound recordings directly from the Internet retail site owned, controlled or directed by Sony. For simplicity, these hyperlinks, whether involving a direct “Buy Now” button or leading the consumer through other hyperlinked Internet pages from the ECD to get to the “Buy Now” button, will be referred to hereafter as “Buy Now Links.”

29. Sony’s Internet retail site also solicits user information, such as name, address, telephone and e-mail address without regard to whether the user makes a purchase.

30. CDs usually contain only the sound recording (typically a collection of copyrighted songs recorded by a particular artist) and incidental packaging information contained on the cover and liner notes.

31. A CD typically has one “track” for each copyrighted song, such that a CD album (a compilation) with fourteen songs will have fourteen tracks comprising one single album.

32. ECDs have an added track which contains additional audiovisual material or programming (“software”), which can be accessed only by a computer. A CD player will be unable to access the software track, but the computer CD-ROM drive will access it. ECDs are typically configured to automatically launch when the CD is inserted into the CD-ROM drive of a personal computer.

33. The additional material contained on an ECD constitutes material separate and distinct from the sound recording tracks. For example, several of Sony's ECD's contain the third-party computer programs needed to access popular Internet service providers such as America Online or EarthLink, which are commonly marketed and sold separately to consumers. They may also contain photographs of the artist or writings by the artist.

34. Internet Service Providers such as Earthlink pay for the right to be included on a CD, such as by paying Sony a commission on all new accounts signed by users who activated the hyperlink to contact Earthlink.

35. Sony and Time Warner Entertainment, the fifty-fifty joint venture owners of Columbia House, announced the proposed merger of Columbia House into CDnow, the second-largest Internet retailer of sound recordings. CDnow serves about 2.3 million customers with a catalog of about 500,000 titles online and is being merged with Columbia House, the largest record club in the United States with over a 16 million customer base. The agreement provided that Sony and Time Warner, together, would control the joint venture. The merged entity was to be owned 37% each by Sony and Warner Entertainment with a 26% ownership by the current shareholders of CDnow. Time Warner has also agreed to merge its music business with EMI, the fifth largest record company, creating a new entity — Warner EMI Music — resulting from the merger of Time Warner's music business with that of EMI.

36. Sony and Time Warner made strategic commitments to the merged entity, referred to hereafter as "CDnow/CH," designed to create a unique entity with powerful customer linkage and with tremendous cross-promotional activities backed by two of the world's largest media companies, with the intention of jointly owning or controlling three of the currently five major record companies.

37. The agreement called for the merged entity CDnow/CH to be the beneficiary of all of the Buy Now Links from ECDs produced by the sound recording companies who have an ownership interest in CDnow/CH.

38. After this lawsuit was commenced, Sony, Time Warner and CDnow terminated the merger of Columbia House into CDnow, and replaced it with a “Strategic Relationship.”

39. Notwithstanding their decision to cancel the merger following the filing of NARM’s original Complaint, Sony, Time Warner and CDnow have agreed to continue to work together to explore strategic relationships into which they may enter for the benefit of the businesses of CDnow and Columbia House. The parties to the now canceled merger announced that these strategic relationships would take the place of the merger. Sony will continue to provide special loans and financing to CDnow, as will Time Warner, and each will have a 17% ownership interest in CDnow.

40. With respect to the agreement entered into in lieu of the merger, CDnow president, Jason Olim, stated: “This new relationship with Time Warner and Sony, including their significant commitment to purchase 2,405,500 shares of CDnow common stock for 21 million in cash coupled with the conversion of existing and future borrowing under a 30 million short-term loan commitment to long-term convertible debt, allows us to focus on our primary businesses.” He noted that there was no change in the basic spirit of coordination and strategic alliance. Scott Flanders, the Chairman and CEO of Columbia House, stated: “I am pleased with this commitment to CDnow and am excited about this alliance with Jason and his colleagues. It’s unfortunate that we could not proceed with our merger as originally planned, but we expect our ongoing relationship to provide many benefits to both CDnow and to Columbia House and its parents.”

Hyperlinks and Related Products and Services

41. Sony purports to offer the additional material on the ECD as “free” material.

However, this additional material is subject to a restrictive license which, in and of itself, limits the rights of the owner of the sound recording to use that sound recording in the same way it could be used without the additional licensed software. For example, the consumer can, ordinarily, give away a lawfully acquired sound recording, but Sony’s “free” license to use the software contained in the same ECD with the sound recording prohibits the owner from transferring ownership.

42. Sony’s ECDs are referred to as “CD EXTRA.” Sony describes its ECDs on its site (<http://www.cdextra.com/html/what.html>, November 11, 1999) as follows:

CD EXTRA combines the worlds of Music and Multimedia. A traditional audio CD when placed in an audio CD player, CD EXTRA offers a **free** interactive multimedia experience when played in a computer’s CD-ROM drive *. CD EXTRA offers the music fan a closer look at their favorite artists, with many CD EXTRAs containing exclusive content. Other CD EXTRAs contain Internet Service Provider Software which allows you to connect to the Internet.

* CD EXTRA multimedia data will only play on CD-ROM drives with multi-session compatible firmware and software.

43. When a purchaser uses a Sony CD EXTRA, the Internet access will take the user to an Internet site owned, controlled or directed by Sony. For example, the Sony album by Destiny’s Child, “The Writing’s On the Wall,” © 1999 Sony Music Entertainment, Inc., manufactured by Sony subsidiary Columbia Records, contains what Sony describes as “a free Multimedia portion” that can be experienced by placing the CD (an ECD) into the CD-ROM drive of a computer to access the CD EXTRA data. At the first interactive screen to appear when doing so, viewers are presented with a link to <http://www.destinyschild.com> which, when activated, takes the user to a Sony Internet site

(<http://thestore.sonymusic.com/thestore>) offering “The Writing’s On the Wall” and other albums by Destiny’s Child for sale direct to the customer of the retailer who sold the ECD.

44. In another example, Sony’s CD by Yo-Yo Ma, “Soul of Tango: The Music of Astor Piazzolla,” comes bundled with additional interactive software. Inserting the CD into a personal computer activates the program. The opening screen gives the user the option of listening to the music on the sound recording or playing the program by clicking on a “Start Title” button. Starting the title launches images of Yo-Yo Ma and tango dancers, followed by the hyperlink offer to "Go to Yo-Yo Ma's Website." Activation of the hyperlink offers the option to "Connect me with Yo-Yo Ma's Website" which, when activated, gives the opportunity to select an Internet browser, followed by the hyperlink: "Go to Yo-Yo Ma's Website" which takes user to "Sony Classical," at <http://www.sonyclassical.com/>, where, among other selections, another Yo-Yo Ma sound recording appears among one of "This Week's Features." Activation of the link on the featured sound recording takes the user to "Sony Classical - Music" at <http://www.sonyclassical.com/music/62597/>, with the option to click on the "**buy it now!**" hyperlink (in bold). Activation of the "**buy it now!**" link takes the user to Sony’s “The Store” -- "the store@sonymusic.com" -- at http://thestore.sonymusic.com/thestore/music.asp?selection_id=062597, where the user is offered the option to "Click on a price to order." Doing so takes the user to "The Store @ Sony Music: Lookup Shopper," at http://thestore.sonymusic.com/thestore/music.asp?selection_id=062597, where the option is given to "sign in" or, if you are new, to "register now". In either case, there is also a request from Sony to provide an e-mail address for "Sales, Promotions, etc." Activation of the "Register Now" link takes the user to "SONYSTORE Registration," where Sony asks for the user’s name, e-mail address, regular address and telephone number, and also asks the user to "Join our mailing list? (Sales,

Promotions, etc.)." It carries the added assurance: "**Hey!** Filling this out **does not** mean you are paying for anything yet!" It is a requirement, however, that the form be filled out before proceeding. All of the above-referenced Internet web pages are owned or controlled by Sony, and not Yo-Yo Ma, as represented. In fact, Sony's "The Store" offers CDs from numerous other Sony artists, and is not limited to Yo-Yo Ma in the least.

45. In the case of Save Ferris' "It Means Everything," another Sony sound recording, the ECD comes bundled with software from Earthlink, an Internet service provider, offering one month of free Internet access. Inserting the CD into a personal computer activates the interactive software, and gives the user only two options: "go online" or "quit." Activation of the "go online" feature offers the user the option of going online using his or her own Internet service or using Earthlink by activating the bundled Earthlink software. Both options appear under the heading "Connect to SAVE FERRIS website!" and, once the option is selected, Sony invites the user to "go to the SAVE FERRIS website!" Activation of the hyperlink generates a request from Sony for the user's e-mail address, and does not allow the user to proceed until the e-mail address is provided. Upon doing so, the link continues not to Save Ferris' website, as represented, but to an Epic Records website. Epic Records is one of Sony's record labels. The website does, indeed, feature Save Ferris sound recordings for sale, along with the sound recordings of other Sony artists. Selection of a sound recording takes the user to Sony's "The Store," and again requests the user's identity and addresses, just as was the case for the Yo-Yo Ma sound recording.

46. In another example, when the Ricky Martin CD "Ricky Martin," published by Columbia Records (a Sony-owned record label). is played in a personal computer, the first interactive screen to appear contains, in addition to the option of listening to the various sound tracks, the option of

clicking on the hyperlink labeled “Take Me To rickymartin.com.” When the link is activated, the user will be linked to the site <http://www.rickymartin.com/>, which is labeled as the official site for Ricky Martin (“Ricky Martin - Official Site - Home Page”) Sony, however, and not Ricky Martin, owns the copyright. A mouse click on the “English” version of the next web page opens a “What’s New” window, that contains several bits of news and other hyperlinks. The bottom of the “What’s New” page contains several links, the first of which is labeled “MUSIC”. Activation of the “MUSIC” hyperlink takes the user to http://www.rickymartin.com/rickymartin/english/ricky_martin.html which, in turn, contains the “Buy Now US!” link. Activation of the “Buy Now US!” link takes the customer to “The Store,” http://thestore.sonymusic.com/thestore/music.asp?talent_id=31921, that contains a several other “Ricky Martin Selections for your consideration.” Among those is the very CD from which the Buy Now Link came, “Ricky Martin.” A click on “Ricky Martin” (the CD title) hyperlinks to <http://thestore.sonymusic.com/thestore/selection.asp?SELECTION%5FID=069891>, giving details about the album and offering to sell it in four different formats. A click on the CD format takes the customer to a form to “sign in” (for existing customers) or “register now” for first time visitors, just as the Yo-Yo Ma CD hyperlinks does, and also asking for the user’s identity and addresses.

47. Like in the case of Destiny’s Child, Yo-Yo Ma and Save Ferris, Ricky Martin fans who purchase his CD from NARM retailers are lured into Sony’s music retail store under the mistaken belief that they are going to the artist’s own site, which is not true. Nowhere is the consumer advised that the sites are owned, controlled or operated by Sony, except for a copyright notification. (Pursuant to the merger agreement with Time Warner and CDnow, the Buy Now Link would have lead to CH/CDnow.)

48. Sony treats the Multimedia portion as a separate product from the sound recording. Although Sony promotes the Multimedia portion as “free,” it purports to license its use with a license agreement that reads, in part, as follows (as contained in “The Writing’s On the Wall” CD album by Destiny’s Child, emphasis added):

SONY MUSIC ENTERTAINMENT INC. LICENSE
AGREEMENT

This legal agreement between you as end user and Sony Music Entertainment Inc. concerns this product, hereafter referred to as Software. By using and installing this disc, you agree to be bound by the terms of this agreement. *If you do not agree with this licensing agreement, please return the CD in its original packaging with register receipt within 7 days from time of purchase to: Sony Music Entertainment Inc., Radio City Station, P.O. Box 844, New York, NY 10101-0844, for a full refund.*

1. LICENSE; COPYRIGHT; RESTRICTIONS. *You may install and use your copy of the Software on a single computer. You may not network the Software or otherwise use or install it on more than one computer or terminal at the same time. The Software (including any images, text, photographs, animations, video, audio, and music) is owned by Sony Music Entertainment Inc. or its suppliers and is protected by United States copyright laws and its international treaty provisions. You may not rent, distribute, transfer or lease the Software. You may not reverse engineer, disassemble, decompile or translate the Software.*

49. The product to which in the License Agreement quoted above applies is the collection of separate Multimedia products that include the Buy Now Links — not to the copyrighted sound recordings on the CD. Sony does not require any similar license agreement relating to sound recordings on CDs.

50. Because the so-called “free” Multimedia products on the CD, which include hyperlinks to Sony’s “thestore” and promote the direct retail sale by Sony of CDs of many other Sony artists as well, Sony benefits from the free and unrestricted distribution of the Multimedia products that it has

subjected to its restrictive License Agreement. The only explanation for Sony's conduct in deliberately copyrighting and purporting to license (as opposed to selling) the free Multimedia products is that, by doing so, Sony intends to prevent the unbundling of the sound recording from the Multimedia products, including the Buy Now Links.

51. Hyperlinks, and particularly Buy Now Links, to online retail sites normally command substantial market value in a competitive market, such as a 15% commission on all sales generated from the linked location or a certain fee for a number of "page views" derived from the hyperlink.

52. Sony does not pay for placement of the hyperlinks it bundles with its sound recordings. Sony does, however, offer to pay for placement of hyperlinks when not bundled with a CD.

53. The Buy Now Links at issue here have substantial market value. Each customer delivered through a Buy Now Link has a value of at least \$50 per customer on average and each Buy Now Link has a value for its potential of delivering a customer.

54. The value of Buy Now Links launched from ECDs is much greater than the average market value for hyperlinks to other retail sites. When a Sony owned, controlled or directed Internet site receives a visit from the hyperlinked consumer who bought a particular artist's CD, Sony immediately knows that its prospective new customer is already a music store customer, has access to and uses the Internet, and has an interest in that particular artist and his or her genre of music. Thus, music retailers are forced to deliver not just a "cold call" prospective customer, but a "hot prospect" on whom the customer data is especially valuable.

55. Once prospective customers are linked to Sony's Internet site, they are asked to disclose their identities, including their electronic mail (or "e-mail") addresses, which Sony uses to continue to make direct solicitations to them.

56. In addition to Buy Now Links, Sony also bundles its sound recordings with other unwanted products designed to drive NARM members' customers to Internet sites owned, controlled or directed by Sony. Such products may include simple advertising for the Internet retail site selected by Sony (by listing the uniform resource locator, or "URL," for the site), or the inclusion of separate "blow-in cards" containing advertising and marketing information designed to invite customers to visit the Sony-related retail site by either typing the URL into their own Internet browser or by activating the Buy Now Links embedded in the ECD. "Blow-in cards" are paper inserts containing text and/or images, most often printed on both sides in full color on glossy paper, which are inserted into the CD box during one step in an assembly line, using an automated process that essentially "blows" the card into the box. Blow-in cards are the equivalent of requiring retailers to give each of their customers promotional literature advertising their competitor's store.

Coercion of NARM Retailers and Free-Riding

57. By coercing NARM retailers to carry its CDs with Buy Now Links and/or other bundled products soliciting NARM retailers' customers to shop at Sony-related sites, Sony is misappropriating the valuable consumer information and data relating to those customers who activate the Buy Now Links or act upon the bundled solicitation products. In effect, Sony forces retailers to give it access to each of their customers who buys a CD with Buy Now Links. As a consequence, the CD acquired for resale by a NARM retailer has significantly less value to retailers that compete with Sony's own sites or other sites designated by Sony such as Columbia House and possibly CDnow. Conversely, Sony's acquisition of such consumer information and data has value for Sony, and even more value if Sony or any of its joint ventures compete with the NARM retailer in marketing sound recordings to those consumers. While the NARM retailer is forced to share its consumer information

and possibly lose a customer with no compensation, Sony obtains valuable consumer information free of charge, and may gain that customer for itself, at the competing NARM retailer's expense.

58. NARM retailers' customer lists are confidential and contain valuable proprietary data and trade secrets developed over years of cultivating customers and understanding and catering to their musical tastes and proclivities. Music retailers have built their customer bases through substantial effort and expense over a number of years. Top quality customer service comes at a high cost. Advertising and promotion to develop brand image and customer loyalty by retailers, be they national chains such as Tower Records (a member of NARM) or single-store retailers well known locally, has also come at a substantial cost.

59. The Internet has presented a new opportunity for NARM retailers to not only promote their stores but also to directly obtain customers and make sales through the Internet, and in many cases expanding their sales territories beyond the geographic limitations of their physical locations. The major record companies, including Sony, have long recognized the value of these customer-building efforts, and have strongly supported them through cooperative advertising and artist-driven promotions.

60. Sony, as well as the other major record companies, are also keenly aware of the vulnerability of music retailers to free riders, be they sellers of pirated sound recordings or simply knock-off retailers free riding on the marketing and customer development efforts engaged in and financed by NARM retailers. Sony and the other major record companies have made substantial efforts to protect against free-riding.

61. Having now decided to enter the music retailing market either on its own or through strategic alliances with another major record company and a particular retailer, such as CDnow, Sony

has opted to gain its own free-ridership by using existing NARM retailers to divert customers to its own retail locations or other sites designated by it.

62. The “Strategic Relationship” among Sony, Time Warner, Columbia House and CDnow threatens to compound the free-riding effect of the current practice of record companies of embedding these Buy Now Links (or other marketing products) in their CDs without providing any compensation to the retailers that are forced to carry them, and without giving the retailers the option of carrying the CD without the unwanted products.

63. The value gained by Sony from the presence of the Buy Now Links equals the value lost to NARM retailers who must distribute the Buy Now Links. The new “Strategic Relationship” and planned strategic commitments threaten to increase the value of the Buy Now Links to Sony and its allies, Columbia House and CDnow because it allows Sony to take greater advantage of every new hyperlinked customer by offering to sell that customer the CDs manufactured by Sony’s competitors as well, taking advantage of CDnow’s half million CD library and its more far-reaching Internet network. Consequently, the harm to NARM retailers from the forced distribution of Sony’s Buy Now Links and other bundled solicitation products is much greater as a result of the “Strategic Relationship” and so is the harm to consumers from the anticompetitive effects of such conduct.

64. Retailers do not have the option of refusing to carry CDs bundled with unwanted products because the market shares of the five (soon to be four) major record companies, individually or collectively, are so large that NARM retailers would go out of business were they to refuse to carry the sound recordings of any one of those companies, including Sony.

65. The “Strategic Relationship” with Columbia House and CDnow exacerbates and exemplifies the effects of the existing discriminatory licensing arrangements favoring record clubs.

CDnow may enjoy the very same or similar favorable pricing arrangements currently given to Columbia House, as well as other competitive advantages and benefits not made available by Sony, and other record companies to NARM retailers, and particularly not to NARM Internet retailers.

66. It is likely that previous commitments to provide favorable prices, promotional allowances, special financing, and forgiveness of debt that were part of the merger proposed between Columbia House and CDnow will be perpetuated despite the termination of the merger within the framework of the reconfigured “Strategic Relationship” and strategic commitments contemplated under that relationship.

67. The “five major record companies” are now effectively four, as Time Warner and EMI announced on or about January 23, 2000, that they have agreed to merge their respective music businesses, making the new company the largest or second largest record company in the world.

68. Sony will continue to be a joint venture partner of the new Warner EMI Music entity. Sony and Time Warner (or Warner EMI Music) will both have an interest in the financial and sound recording retail market success of Columbia House and CDnow.

69. The two remaining major record companies, Universal Music and BMG, recently merged their respective Internet retail operations into GetMusic.com. Thus, Sony’s alliance with Time Warner and EMI (or Warner EMI Music) effectively reduces all of the major record companies, which together account for approximately 85% of all sound recordings sold in the United States, into two Internet retail operations that compete with their retailer customers, NARM’s retail members.

Sony Has Economic Power And A Unique Array of Music Products

70. The grant to an author of the special privilege of a copyright carries out a public policy adopted by the Constitution and laws of the United States to promote the progress of science and

useful arts by securing to authors the exclusive right to their original works for a limited period of time. The public policy that includes original works within the granted monopoly excludes from it all that is not embraced in the original expression. It equally forbids the use of the copyright to secure an exclusion or limited monopoly not granted by the copyright act and which is contrary to public policy to grant.

71. Each individual sound recording is a unique copyrighted product, and the result of the creative work of songwriters and sound recording artists. Although record companies such as Sony, or their record labels, may acquire the copyright from the artist, consumer demand is based upon the appeal of the artist and the particular qualities of the individual sound recording. Retailers must choose the sound recordings they will offer for sale to the public on the basis of consumer demand for the sound recording and not consumer demand for a particular record label.

72. Sony, as have the four (now effectively three) other major recording companies, has succeeded in aggregating the copyrights associated with each of its individual sound recordings into a single economic unit that combines the rights Sony has acquired from many artists to form a bargaining block representing nearly 20% of all current sound recordings, giving Sony clear market power over each individual NARM retailer. The combined market shares of the five (now effectively four) major record companies is approximately 85% of all sound recording sales.

73. Even a fraction of Sony's new releases (particularly top-selling new releases), when taken together, constitute a critical percentage of the total available sound recordings. They are essential for the long term survival of most individual NARM retailers.

74. The CDs of Sony and of each of the other major sound recording companies are so critical to the long term survival of NARM retailers that, for almost any given NARM retailer, the

option of going without the Sony CDs that may contain Buy Now Links and other products and services soliciting customers to retail sites owned, controlled or directed by Sony would be so harmful that the retailer has no real choice but to carry the ECD despite the harm.

75. It is essential that each retailer carry the top hits of Sony and of each of the other major record companies. By combining an essential group of products carried by two (soon to be three) of the largest sound recording companies in the world, Sony's joint ownership (with Time Warner) of Columbia House, coupled with the types of strategic relationships favored in the merger with CDnow, plus the commitment to pursue similar relationships in the future, place Sony in a powerful position because the participating record companies will direct NARM retailer customers to retail sites owned or controlled by Sony or in which Sony has a substantial economic and/or ownership interest.

76. By free riding on the goodwill and marketing success of NARM retailers, Sony, as well as the other major record companies, is not only harming those retailers, but is also harming competing record companies, primarily the smaller, independent record companies who do not have the market power to gain free access to customers and potential customers. Because NARM retailers must make up their losses from the subsequent sales diverted by Sony to Sony, those retailers must increase their margins on all of their sound recordings. Thus, the independent record companies that compete with Sony must allow the retailers who carry their products to obtain higher margins to recover their cost of carrying Sony's Buy Now Links.

77. As the cost of subsidizing the Buy Now Links and other tied products and services of Sony is borne by music retailers, the cost of retailing all CDs in the inventory of NARM retailers will reflect the added cost of that subsidization, which in turn will erode their ability to offer lower-priced CDs to consumers. Sony is creating no new efficiencies, but rather is free-riding on the efficiencies of

others and making its rivals less efficient in the process. There are no legitimate business reasons for Sony to free-ride on its rivals' efficiencies in this manner.

78. Music retailers cannot reasonably price each CD to reflect the presence of hyperlinks to competing retail sites owned, controlled or directed by Sony and other record companies (and often have no idea which ECDs contain such links until after the CDs are received and on their shelves). The revenue lost as a result of the Buy Now Links will be made up by increasing the retail margins on all CDs, including CDs from record companies that do not include Buy Now Links and related products or services with their CDs, particularly the small, independent record companies and newer artists who are manufacturing their own CDs.

79. Through the use of Buy Now Links, Sony, as well as other record companies, is able to reap the benefit of the CDs bundled or tied with such Buy Now Links in steering new customers to its owned, controlled or directed Internet sites, and imposing a price squeeze on NARM music retailers while, at the same time, effectively either increasing the retail prices of CDs from competing independent record companies or forcing those competing independent record companies to absorb the cost themselves.

The Efforts To Dominate Internet Retailing

80. Several years ago, record clubs were developed by three of the five major record companies. There are now only two significant record clubs in the United States — Columbia House (jointly owned by Sony and Time Warner) and BMG Music Service (owned directly, or through a subsidiary, by German media giant Bertelsmann AG). Columbia House and BMG Music Service each sell pre-recorded music, both through mail order and the Internet. They sell to “members” who have typically responded to loss leading promotions. For example, during late 1999 Columbia House

offered new members 12 CDs free or 15 CDs for the price of one (twelve CDs free for joining, plus the option of getting two additional free CDs with the purchase of one CD at the regular price); BMG Music Service offers 12 CDs for the price of one (seven free selections, one purchase at the regular club price within one year, followed by four more free CDs).

81. The record clubs are able to make these offers because they obtain CDs at costs substantially below the prices paid by NARM retailers for identical CDs of like grade and quality, ranging as much as fifty percent (50%) less than the prices paid by NARM retailers. Through a scheme that places form over substance, the record companies will authorize their CD manufacturing plants to press the same CDs for the two 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.

82. Moreover, because of their enormous financial resources, the major record companies generally have superior bargaining power over the artists, such that the contracts with the artists leave little room for negotiation. Because of the major record companies' superior bargaining power over artists, it is common for them to obtain the artists' acquiescence to charging royalties on only one half of the CDs sold by the record clubs, as distinct from the royalties charged on all, or substantially all, CDs sold by the major record companies to NARM retailers. Sony is no exception, having obtained artist approval to not collect royalties on approximately one half of the CDs sold (or given away) by Columbia House, and a reduced royalty on others.

83. The substantial pricing and promotional advantages granted to record clubs, such as Columbia House, has caused injury to NARM retailers in the form of lost customers, lost sales and lost profits. The price and related promotional disparity has enabled the record clubs to achieve over a

15% market share of the retail market for sound recordings. Recently, there has been a decline in sales, and currently the two record clubs account for something less than 10% of the total retail market for sound recordings.

84. According to recently published reports, Bertelsmann AG and Time Warner have been holding discussions regarding the possibility of merging BMG Music Service into Columbia House.

85. The popularization of the Internet has brought with it the phenomenon of “online retailing,” “e-commerce” or “Internet sales,” all of which refer to the sale of cassette tapes and CDs through the Internet. Consumers can access the Internet retailer’s Internet (or “web”) site using a uniform resource locator, browse the titles of CDs being offered or search for specific CDs, make their selections, and pay by credit card. The CDs are then delivered by mail. The CDs may also be delivered electronically through a digital download. Although downloading currently comprises only a small fraction of all sound recording sales, it is an increasingly popular and rapidly growing method by which consumers may obtain copies of sound recordings.

86. Online CD retailers need not send out printed catalogs or other mail to solicit sales by mail or telephone order. Instead, online retailers make their catalogs available to consumers primarily through the Internet. Some online retailers may simply list all of the sound recordings offered for sale, possibly segregated by type. Others will allow customers to search for sound recordings from large catalog databases by a variety of search criteria, including the name of the artist, the name of the album, genre, or by sales or air play ranking. Internet retailers may also include interactive features allowing customers to sample portions of a given sound recording, receive electronic mail notices, or set their own “favorites” parameters for future visits. Marketing may include online information concerning upcoming concerts, opportunities for online chats with a recording artist, exclusive interviews of an

artist, and reviews of various sound recordings. When the prospective customer's e-mail address is known, marketing may also include direct e-mail solicitation.

87. Although Internet sales of CDs is relatively new, it is growing at a very rapid pace. Until 1996, sales volume was so low that it was not even measured. By 1997, 0.3% of CD sales were through the Internet. From 1997 to 1998, sales of sound recordings over the Internet nearly quadrupled, from 0.3% to 1.1%. Current estimates are that Internet sales of prerecorded music more than doubled in 1999 over 1998, comprising 2.3% of total pre-recorded music sales. Analysts expect the rapid growth to continue, reaching 14.6% of total music sales in 2003, or \$2.5 billion in sales over the Internet.

88. Until recently, establishing an Internet sales site had been relatively simple. Brick-and-mortar retailers as well as record clubs have been able to create Internet retail sites, and new companies have been established to retail exclusively through the Internet. One of these, Amazon.com, began by selling books over the Internet, and has added CDs to its product line.

89. Although "opening" an Internet store may be relatively simple, the costs of acquiring Internet market share are very high. Internet customer acquisition costs are high and many leading Internet retailers have maintained or increased their market position only by investing heavily in customer acquisition at a net loss to date. Investors appear to justify such losses by placing a high value on the competitive advantages of first movers on the Internet, which rewards those who can raise their market shares the most rapidly. Sony's use of Buy Now Links helps increase its own market share while at the same time handicapping its rivals, who cannot sell such ECDs without at the same time promoting Sony's designated Internet retail sites. By deliberately slowing the rate at which NARM

retailers can increase their own Internet market shares, Sony assures itself of an increased first mover advantage.

90. The merged entity of CDnow/CH was to have succeeded to CDnow agreements, which provide exclusives with the most popular search engines and Internet portals, thereby foreclosing access to the starting points for a substantial number of Internet shoppers. If a statement attributed in the press to CDnow's president is in fact true, the "Strategic Relationship" now contemplated with CDnow will continue to serve Sony's interests in foreclosing competing retailers from the Internet retail market because Sony will benefit from these exclusives. These agreements will enhance the effectiveness of Sony's, forced hyperlink marketing — by NARM retailers — of Sony owned, controlled or designated Internet retail locations because they direct CD consumers to those locations for free at the expense of NARM retailers, who have made substantial investments in developing and maintaining these consumers as customers for their own retail outlets and Internet sites. The exclusives that CDnow enjoys include exclusive agreements with Yahoo, Excite, GeoCities, Rolling Stone Network, JAMtv as well as premiere status with MTV and VH1. Thus, NARM retailers will be forced to market a competing Internet retail site even as their own access to some of the most popular portals for advertising or accessing their own Internet retail sites is shut off by Sony or its favored retailer, CDnow.

91. Sony agreed with Time Warner and CDnow to guarantee the merged entity — CDnow/CH — a number of other competitive advantages and benefits by Sony and Time Warner. Under the reconfigured "Strategic Relationship" Sony has agreed to enter into strategic commitments to benefit the businesses of Columbia House and CDnow. There is reason to believe, that these strategic commitments will include some of those that were part of the original merger, such as:

- a. hyperlinks and preferences in hyperlinks to the CDnow/CH web sites of all new releases of CDs by Sony (and its joint venture partners) not available to NARM retailers;
- b. CDs at substantially reduced prices through the vehicle of licensing arrangements not made available to NARM retailers;
- c. 50 million dollars of advertising assistance per year not available to NARM retailers;
- d. access to consumer databases owned by Sony (and its joint venture partners), including the database previously owned by Columbia House, which would also include the identity of customers misappropriated from NARM retailers through the coerced hyperlinking of the record companies.

92. In 1999, Universal Music Group and BMG, two of the five major record companies, merged the BMG record club into a joint venture of GetMusic.com, which has similar licensing arrangements and promotional advantages as does Columbia House and sells music from all record companies. UMG and BMG have combined market shares of about 44% of all sound recording sales in the United States.

93. EMI, the remaining member of the five major recording companies, has taken an ownership position and entered licensing arrangements with Musicmaker.com, which also will be the recipient of preferential treatment and will carry over 500,000 titles of the major record companies. EMI has agreed to merge with Time Warner's music business, which already has a retailing joint venture with Sony. Thus, the four remaining major record companies have a combined market share of approximately 85% of all sound recording sales, and have established between them two sound

recording retail businesses (each including Internet and mail order divisions) which compete directly with NARM retailers even as they cross-license product to each other on terms not available to the NARM retailers that compete with them.

Raising Barriers To Entry For CD Retailing On The Internet

94. There are now effectively only four major recording companies that control approximately 85% of the sales of recorded music in the United States: Universal approximately 27%; BMG approximately 17%; Sony approximately 17%; and Warner EMI Music (a combination of the music businesses of Time Warner and EMI) approximately 24%. Universal and BMG have combined their Internet retailing forces. Sony and Time Warner have agreed to combine their Internet retailing forces through Columbia House (and possibly through CDnow), and Time Warner has, in turn, agreed to combine with EMI (into Warner EMI Music)..

95. The retail distribution of sound recordings has been a highly efficient distribution system, making available a broad range of sound recording titles and genres to consumers throughout the United States. NARM retailers engage in intense price competition with each other.

96. With the onset of the Internet, expanded opportunities have been presented for accessing sound recordings through sales as packaged goods on the Internet or by the consumer downloading recorded music directly from a wide range of retail distribution alternatives on the Internet. As a consequence, consumers now have a wide range of choices for obtaining recorded music. Retailers may include traditional retailers, the artists, the record companies, and others. The methods of Internet purchase can be as a packaged product sent through the mail or a digital download from a server.

97. When free from artificial barriers to entry, the broad range of retailing opportunities presented by the Internet is pro-competitive for retailers, artists and other resellers of recorded music. However, the conduct of Sony of engaging in joint ventures to have a major stake in an Internet retail leader such as CDnow and to control a mail order/Internet leader such as Columbia House, together with horizontal agreements to refuse (or charge more for) certain services to its retail competitors, and to force its retail competitors to promote the Sony and Sony designated Internet retail sites, raises artificial barriers to entry for others who wish to sell sound recordings through the Internet. The barriers to entry — initially established by giving special pricing and promotional benefits to the joint venture Internet retail operations designated by Sony which will inhibit competition by other Internet retailers — will be exacerbated by Sony's free riding on NARM retailers' customer information and data through the use of CDs containing Buy Now Links, blow-in solicitations and other direct marketing products that raise the cost of doing business for Sony's Internet retail competitors.

COUNT I: UNLAWFUL TYING/EXCLUSIVE DEALING (SHERMAN ACT)

98. Plaintiff repeats, realleges and incorporates by reference the allegations contained in Paragraphs 1 through 97 as though fully set forth herein.

99. Sony has tied and bundled the sale of copyrighted sound recordings on CDs with unwanted separate products, including Buy Now Links, blow-in cards and direct solicitations, directing consumers to competing retail sites owned, controlled or directed by Sony, including but not limited to Sony's "thestore", and has also bundled them with third party Internet access software from America Online and Earthlink. Because the unwanted products are recorded onto the same CD as the sound recording, or otherwise included inside factory-sealed packaging, NARM retailers cannot unbundle the unwanted tied products.

100. NARM's members who are CD purchasers and resellers are coerced into purchasing CDs that contain Buy Now Links or other unwanted products directing their customers to competing sites owned, controlled or directed by Sony.

101. NARM's members who are CD purchasers and resellers are coerced into purchasing CDs that contain Internet access software from America Online and Earthlink, and forecloses NARM retailers from being able to effectively offer such Internet access software and services as separate products, much less benefit from payments received by such Internet access providers to promote their service.

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.

103. 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.

104. Sony has sufficient economic power in the tying products, which represent an aggregate of unique sound recordings, to coerce NARM retailers into taking the tied or bundled products, something they would not otherwise do but for Sony's economic power.

105. The products added to the CDs, such as Buy Now Links, Internet access software and direct solicitations to Internet sites owned, controlled or directed by Sony, 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.

106. Sony, CDnow and Columbia House each currently pay entities other than NARM retailers for generating consumer traffic to or sales from their or other designated Internet sites through hyperlinks and other vehicles.

107. Sony has entered into agreements restricting trade with 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.

108. Sony has created a tying arrangement and has entered into exclusive dealing agreements which constitute unreasonable restraints of trade that are unlawful *per se* and/or under the rule of reason in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

109. The unlawful conduct engaged in by the Defendants has injured and, unless enjoined, will continue to injure competition in the relevant markets described in Paragraph 20, above, by:

- a. foreclosing NARM retailers from competing on the merits in the market for retail sales of digital sound recordings and also the market for Internet retail sales of digital sound recordings;
- b. foreclosing independent record companies from effectively competing in the market for wholesale sales of digital sound recordings;
- c. depriving consumers of the efficiencies of enhanced competition for sound recordings in, and Buy Now Links affecting, the relevant markets, including but not limited to, lower prices for CDs.

COUNT II. TYING/EXCLUSIVE DEALING (CLAYTON ACT)

110. Plaintiff repeats, realleges and incorporates by reference the allegations contained in Paragraphs 1 through 109 as though fully set forth herein.

111. Sony has tied and bundled the sale of copyrighted sound recordings on CDs with unwanted separate products, including Buy Now Links, blow-in cards and direct solicitations, directing consumers to competing retail sites owned, controlled or directed by Sony, including but not limited to Sony's "thestore," and has also bundled them with third party Internet access software from America Online and Earthlink.

112. NARM's members who are CD purchasers and resellers are coerced into purchasing CDs that contain Buy Now Links to competing sites owned, controlled or directed by Sony.

113. NARM's members who are CD purchasers and resellers are coerced into purchasing CDs that contain Internet access software from America Online and Earthlink, and forecloses NARM retailers from being able to effectively offer such Internet access software and services as separate products, much less benefit from payments received by such Internet access providers to promote their service.

114. 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.

115. 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.

116. Sony has sufficient economic power in the tying products, which represent an aggregate of unique sound recordings, to coerce NARM retailers into taking the tied or bundled products, something they would not otherwise do but for Sony's economic power.

117. The products added to the CDs, such as Buy Now Links, Internet access software and direct solicitations to Internet sites owned, controlled or directed by Sony, 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.

118. Sony, CDnow and Columbia House currently pay entities other than NARM retailers for generating consumer traffic to or sales from their Internet sites through hyperlinks.

119. Sony has entered into agreements restricting trade with 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.

120. Sony has tied and bundled the sale of copyrighted sound recordings on CDs with unwanted Buy Now Links, Internet access software and other products directing consumers to competing retail sites owned, controlled or directed by Sony, including but not limited to “The Store,” Columbia House and CDnow/CH, conduct which may substantially lessen competition or tend to create a monopoly, and which is unlawful *per se* and/or under the rule of reason in violation of Section 3 of the Clayton Act, 15 U.S.C. § 14.

121. The unlawful conduct engaged in by the Defendants has injured and, unless enjoined, will continue to injure competition in the relevant markets described in Paragraph 20, above, by:

- a. foreclosing NARM retailers from competing on the merits in the market for retail sales of digital sound recordings and also the market for Internet retail sales of digital sound recordings;

- b. foreclosing independent record companies from effectively competing in the market for wholesale sales of digital sound recordings;
- c. depriving consumers of the efficiencies of enhanced competition for sound recordings in, and Buy Now Links affecting, the relevant markets, including but not limited to, lower prices for CDs.

COUNT III. COPYRIGHT MISUSE

122. NARM repeats, realleges and incorporates the allegations in paragraphs 1 through 121 as though fully set forth herein.

123. Sony holds the copyright to thousands of sound recordings, including CDs and ECDs.

124. Sony's copyrights are limited to the rights set forth in 17 U.S.C. § 106, and do not include the right to require purchasers of phonorecords or copies to purchase unwanted products as a condition of sale.

125. Sony's copyrights in its sound recordings are generally limited to the right to reproduce the copyrighted work in copies or phonorecords (17 U.S.C. § 106(1)), the right to prepare derivative works (17 U.S.C. § 106(2)), the right to distribute copies or phonorecords of the copyrighted work to the public for sale or other transfer of ownership, or by rental, lease or lending (17 U.S.C. § 106(3)), and the right to perform the copyrighted work publicly by means of a digital audio transmission (17 U.S.C. § 106(6)), sometimes referred to as a "download."

126. Sony's distribution right in its sound recordings is extinguished upon the first sale of the sound recording in the United States (17 U.S.C. § 109), except that no one may commercially rent or lease Sony sound recordings without Sony's consent. Section 109 provides that, following the first sale of a lawfully made CD, the owner "is entitled," without the authorization of the copyright owner, to

transfer ownership of the CD and, with one narrow exception, to transfer possession such as by lending it to a friend at no charge.

127. Once Sony sells its sound recordings to NARM members, Sony has absolutely no right under the Copyright Act to prevent NARM retailers or their customers from reselling them, trading them or giving them away. Similarly, Sony has no right under the Copyright Act to restrict NARM retailers or their customers who purchase Sony CDs from playing them for personal enjoyment in any machine or device, including CD players, DVD players or personal computers, nor in preventing them from playing them in any number of different machines. Sony has absolutely no right under the Copyright Act to prevent the owner of a Sony CD from lending it to a friend without remuneration.

128. Sony has extended its copyright in its CDs in contravention of the Copyright Act by adding to the CDs additional software that it purports to license to the person who places it in their personal computer. The license gives the user no option but to either agree to Sony's terms or return the CD to Sony for a refund. The license restricts the user from exercising the rights to which the user is entitled under the Copyright Act, by prohibiting the user from lending it, playing it in a different machine, selling it or giving it away.

129. Sony has tied and bundled the sale of copyrighted CDs with unwanted Buy Now Links, Internet access software and other products directing consumers to competing retail sites owned, controlled or directed by Sony, including but not limited to Sony's "The Store."

130. NARM's members who are CD buyers and resellers are coerced into purchasing copyrighted CDs that are bundled with unwanted Buy Now Links and other products directing consumers to competing retail sites owned, controlled or directed by Sony.

131. Sony has added to its lawful monopoly of copyrighted sound recordings, which carry with them limited copyright rights, separate and distinct copyrighted and/or trademarked material — including Buy Now Links — which it requires NARM members to take as a condition of obtaining the desired sound recordings.

132. Sony's expansion of its copyrights in individual sound recordings beyond the rights conferred by copyright law have the purpose and effect of controlling the market for Buy Now Links and other products or services that directly or indirectly lead consumers to competing Internet sound recording retail sites, and of forcing NARM members to carry such Buy Now Links and other products and services without any choice or compensation. Such an expansion of economic power beyond the limited power granted by copyright law is against public policy, unauthorized by Congress, is unlawful *per se* and/or under the rule of reason in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1 and Section 3 of the Clayton Act, 15 U.S.C. § 14, and constitutes copyright misuse as an unlawful extension of the limited monopoly granted to it under the Copyright Act in violation of said Act and the antitrust laws.

COUNT IV. ILLEGAL RELATIONSHIP LICENSING

133. NARM repeats, realleges and incorporates the allegations in paragraphs 1 through 132 as though fully set forth herein.

134. 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 who compete with Columbia House, one of Sony's strategic allies, for the sale of identical Sony CDs.

135. Under the reconfigured “Strategic Relationship” between Sony, Columbia House and CDnow it is likely that these favorable licensing arrangements will be granted to CDnow, another strategic ally.

136. On information and belief, Sony has entered into similar favorable licensing arrangements with other record clubs and other strategic allies.

137. Sony’s bundling of Buy Now Links, other software programming, and other materials on CDs sold to NARM retailers constitutes a form of arrangement designed to favor Sony and the strategic allies of Sony, such as Columbia House, which compounds the unreasonableness of its other strategic licensing arrangements that favor a select group of competitors. The combined effect of Sony’s conduct will have and threatens to have a substantial adverse effect upon competition with injury to NARM retailers’ who are unable to compete with these favored competitors.

138. Sony’s licensing arrangements and related conduct constitutes illegal relationship licensing, which elevates the interests of Sony and its strategic allies over that of NARM retailers and hinders NARM retailers from competing on the merits and diverting business from them to the favored allies. This conduct constitutes an unreasonable restraint of trade under Section 1 of the Sherman Act.

COUNT V. PRICE DISCRIMINATION IN VIOLATION OF THE ROBINSON-PATMAN ACT

139. NARM repeats, realleges and incorporates the allegations in paragraphs 1 through 138 as though fully set forth herein. (Count V was Count IV in the original Complaint.)

140. Through its sham licensing arrangement with Columbia House, Sony discriminates in the price it charges competing retailers by providing identical sound recordings to Columbia House at substantially lower prices than the prices made available to competing NARM retailers for CDs of like

grade and quality. The price differences range to as much as fifty percent (50%) as between the favored customers and non-favored NARM retailers..

141. Sony and other record companies have entered into arrangements with each other and with Columbia House and other favored retailers to provide millions of dollars in promotional and marketing assistance not made available to NARM retailers, and substantial marketing and promotional benefits, such as access to customer databases, exclusive product content and related goods, and favored or exclusive positioning of hyperlinks to favored retailers on Internet sites owned, controlled or directed by these record companies.

142. These substantial price and related economic and promotional benefits result in prices to Columbia House and other favored retailers, that are substantially lower than the prices made available to NARM retailers who compete with them. As a consequence, competition for the sale of these CDs has been adversely affected and the non-favored NARM retailers have been injured, suffering lost customers, lost sales and lost profits.

143. The substantial price and related economic and promotional benefits provided to Columbia House and other favored retailers, and not made available to NARM retailers, constitute a violation of Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a).

**COUNT VI. PROMOTIONAL AND ADVERTISING DISCRIMINATION IN
VIOLATION OF THE ROBINSON-PATMAN ACT**

144. NARM repeats, realleges and incorporates the allegations in paragraphs 1 through 143 as though fully set forth herein. (Count VI was Count V in the original Complaint.)

145. Sony and other record companies have entered into arrangements with Columbia House to provide promotional allowances, services and marketing assistance not made available to

NARM retailers on proportionally equal terms in connection with the resale of identical CDs of like grade and quality, including as well access to customer databases, exclusive product content and related goods, and favored or exclusive positioning of hyperlinks to their Internet sites or Internet sites owned, controlled or directed by Sony.

146. The substantial economic and promotional benefits to Columbia House contemplated under the reconfigured “Strategic Relationship” with CDnow, and which are not made available to NARM retailers, constitute violations of Sections 2(d) and 2(e) of the Robinson-Patman Act causing injury to NARM retailers in the form of lost customers, lost sales and lost profits.

COUNT VII: VIOLATION OF SECTION 28-4502 OF THE DISTRICT OF COLUMBIA CODE

147. Plaintiff repeats, realleges and incorporates by reference the allegations contained in Paragraphs 1 through 146 as though fully set forth herein. (Count VII was Count VI in the original Complaint.)

148. By reason of the foregoing conduct, specifically including the conduct alleged in Counts I-IV herein, Sony has created a tying and/or exclusive dealing arrangement which constitutes an unreasonable restraint of trade or which may substantially lessen competition or tend to create a monopoly, and which is unlawful *per se* and/or under the rule of reason in violation of Section 28-4502 of the District of Columbia Code.

149. The unlawful conduct engaged in by the Defendants has injured and, unless enjoined, will continue to injure competition in the relevant markets described in Paragraph 20, above, by:

- a. foreclosing NARM retailers from competing on the merits in the market for retail sales of digital sound recordings and also the market for Internet retail sales of digital sound recordings;
- b. foreclosing independent record companies from effectively competing in the market for wholesale sales of digital sound recordings;
- c. depriving consumers of the efficiencies of enhanced competition for sound recordings in, and Buy Now Links affecting, the relevant markets, including but not limited to, lower prices for CDs;
- d. depriving NARM retailers of business opportunities relating to the products bundled with Sony's sound recordings; and
- e. depriving consumers of the full value and transferability of Sony sound recordings.

COUNT VIII. UNFAIR COMPETITION IN VIOLATION OF DISTRICT OF COLUMBIA LAW

150. NARM repeats, realleges and incorporates the allegations in paragraphs 1 through 149 as though fully set forth herein. (Count VIII was Count VII in the original Complaint.)

151. The most important component NARM retailers bring to the retail distribution of digital sound recordings is the customer. NARM retailers generally do not manufacture the goods they sell. Rather, NARM retailers invest heavily through the expenditure of labor, skill and money in developing sound recording retail customer contacts. They build substantial retail establishments, whether of bricks-and-mortar or online, designed to draw customers in to shop for sound recordings. They hire and train knowledgeable staff who can make the experience for the customer more rewarding. They

learn about their customers, and their customers' preferences. They merchandise the sound recordings creatively and communicate to the customer important information concerning artists and their sound recordings. They enable customers to make informed selections with which they will be satisfied, and overall strive to make the shopping experience so rewarding that the customers will return.

152. By forcing NARM retailers to carry Buy Now Links and other products as a condition of selling Sony's sound recordings, by using those unwanted Buy Now Links and other products to drive NARM retailers' customers to Sony-controlled Internet retail sites, by misrepresenting Sony-controlled Internet retail sites to the public as being an artist's "official" or otherwise sponsored or endorsed retailer Internet site, by entering into agreements to refuse to do business with NARM retailers who wish to advertise on the Internet, by entering into exclusive agreements to prevent NARM retailers from advertising on major third party Internet sites or major Internet search engines, by bundling copyrighted works to prevent NARM retailers from technically unbundling the unwanted products, by refusing to permit NARM retailers from purchasing sound recordings apart from the unwanted products, by free riding on NARM retailers' efforts, thereby increasing NARM retailers' costs and the costs of Sony's record company rivals, and by appropriating for themselves – without giving NARM retailers any choice or bargaining rights in the matter – information and data concerning NARM retailers' customers, Sony has engaged and continues to engage in unfair competition in violation of District of Columbia law, as well as in independently unlawful conduct under federal and state (including District of Columbia) law.

**COUNT IX. FALSE AND DECEPTIVE ADVERTISING IN VIOLATION OF THE
LANHAM ACT**

153. NARM repeats, realleges and incorporates the allegations in paragraphs 1 through 152 as though fully set forth herein. (Count IX was Count VIII in the original Complaint.)

154. By creating a system of hyperlinks to sites purporting to be the recording artist's "official" or otherwise sponsored or controlled Internet site without disclosing that the sites are owned, controlled or directed by Sony, and by arranging to have Buy Now Links included in Internet sites accessed from a recording artist's ECD or on Internet sites purported to be owned, controlled or directed by the artist, Sony is making misleading use of the trademarks associated with the sound recording artist's name and purposely misleading consumers into believing that certain artists either sponsor or endorse the sound recording retailer promoted by Sony and the Buy Now Links to Sony's designated Internet retail site.

155. NARM retailers' customers typically do not shop for CDs from Sony record labels, as such. Rather, their music selection is based upon artist or genre preference, irrespective of which record label publishes the work.

156. Misrepresenting a music an Internet site as being that of an artist, or misrepresenting a given music retailer as being a retailer suggested, recommended or endorsed by an artist, constitutes a material misrepresentation of fact likely to influence a consumer's music purchasing or Internet surfing decisions.

157. Sony's conduct alleged in this Count is in violation of the Lanham Act, 15 U.S.C. § 1125, and constitutes false and deceptive advertising causing injury to consumers and to NARM members.

CLAIMS FOR RELIEF

WHEREFORE, NARM demands the entry of judgment in its favor and against the Defendants as follows:

(a) that the Court adjudge and decree that the Defendants have unlawfully engaged in bundling and tying the sale of CDs and other products to NARM member retailers in violation of Section 1 of the Sherman Act and Section 3 of the Clayton Act;

(b) that the Court adjudge and decree that the Defendants have engaged in illegal relationship licensing in violation of Section 1 of the Sherman Act and Section 3 of the Clayton Act.

(c) that the Court adjudge and decree that the Defendants have unlawfully engaged in bundling and tying the sale of CDs and other products to NARM member retailers in violation of Section 28-4502 of the District of Columbia Code;

(d) that the Court adjudge and decree that the Defendants have unlawfully misused their copyrights in their sound recordings to force NARM members to carry separate unwanted products;

(e) that the Court adjudge and decree that the Defendants have engaged in illegal relationship licensing in violation of Section 1 of the Lanham Act;

(f) that the Court adjudge and decree that the Defendants have unlawfully engaged in price discrimination in violation of Section 2(a) of the Robinson-Patman Act;

(g) that the Court adjudge and decree that the Defendants have unlawfully engaged in granting discriminatory promotional advertising services and/or payments in violation of Sections 2(d) and 2(e) of the Robinson-Patman Act;

(h) that the Court adjudge and decree that the Defendants are engaged in unfair competition in violation of District of Columbia law;

(i) that the Court adjudge and decree that the Defendants have engaged in unfair competition in violation of the Lanham Act;

(j) that the Court enter a permanent injunction enjoining the Defendants from engaging in the unlawful and unfair conduct described in this First Amended Complaint;

(k) that the costs of suit and reasonable attorneys' fees be awarded to Plaintiff; and

(l) that the Court order such other and further relief as the Court finds just and proper.

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