Netflix sues Blockbuster to shut online service

By Gina Keating

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PASADENA, California (Reuters) - Online DVD rental company Netflix Inc. on Tuesday sued rival Blockbuster Inc. for patent infringement, asking a federal judge in Northern California to shut down Blockbuster's 18-month-old online rental service and award Netflix damages, according to a copy of the filing.

Blockbuster declined to comment, saying it had not received a copy of the lawsuit.

Netflix, which was founded in 1999, holds two U.S. patents for its business methodology, which calls for subscribers to pay a monthly fee to select and rent DVDs from the company's Web site and to maintain a list of titles telling Netflix in which order to ship the films, according to the patents, which were included as exhibits in the lawsuit.

The first patent, granted in 2003, covers the method by which Netflix customers select and receive a certain number of movies at a time, and return them for more titles.

The second patent, issued on Tuesday, "covers a method for subscription-based online rental that allows subscribers to keep the DVDs they rent for as long as they wish without incurring any late fees, to obtain new DVDs without incurring additional charges and to prioritize and reprioritize their own personal dynamic queue -- of DVDs to be rented," the lawsuit said.

The lawsuit says No. 1 U.S. rental chain Blockbuster, which launched its online rental service in 2004, was aware that Netflix had obtained a patent for its business method and was seeking a second, but willfully and deliberately violated the existing patent.

Netflix, which is represented by the San Francisco law firm of Keker & Van Nest, is demanding a jury trial and asks that Blockbuster Online be enjoined from using Netflix's business method and be forced to pay damages and court costs.
"We felt it necessary to take this action to protect our rights as inventors of the very unique business methods that Netflix offers," Netflix spokesman Steve Swasey said on Tuesday.

"Netflix created a very unique service, from the dynamic queue, to the idea of letting subscribers keep movies as long as they want with no late fees, to the idea of allowing customers to get new DVDs as soon as they return old ones," Swasey said.

Since launching its online rental service in August 2004, Blockbuster has poured more than $300 million into setting it up and marketing it.

But a debt load of more than $1 billion and weakness in its primary business of store-based movie rentals forced the Dallas-based company to cut back its marketing investments this year in Blockbuster Online, which has 1 million subscribers, compared with 4.2 million for Netflix.

Shares of Netflix closed down 72 cents to $27.41 a share on Nasdaq before the suit was reported, while shares of Blockbuster fell 8 cents to $3.80 on the New York Stock Exchange.

Wedbush Morgan analyst Michael Pachter, who also is an attorney, said it was unclear whether Netflix's challenge to Blockbuster's online service would be upheld by the federal court.

"It's my opinion that it won't be," Pachter said. "Blockbuster detrimentally relied on their silence as consent. If in fact (Netflix) feels so damaged they should have sought injunctive relief before Blockbuster rolled out its service."

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