Netflix awarded business model patent, immediately sues Blockbuster

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Reuters reported last night that Netflix has filed a patent infringement lawsuit against Blockbuster, seeking damages and a halt to Blockbuster's online rental operations. The suit was filed just hours after a Netflix patent describing its business model was approved, and the legal claims rest on the patent. The patent abstract reads as follows:

*Approach for renting items to customers*

[...]

According to a computer-implemented approach for renting items to customers, customers specify what items to rent using item selection criteria separate from deciding when to receive the specified items. According to the approach, customers provide item selection criteria to a provider provides the items indicated by the item selection criteria to customer over a delivery channel. The provider may be either centralized or distributed depending upon the requirements of a particular application. A "Max Out" approach allows up to a specified number of items to be rented simultaneously to customers. A "Max Turns" approach allows up to a specified number of item exchanges to occur during a specified period of time. The "Max Out" and "Max Turns" approaches may be used together or separately with a variety of subscription methodologies.

As usual, the rest of the document goes into excruciating detail on the business model, and it all reads like a fair description of what both Netflix and Blockbuster Online are doing. The patent application was filed in May 2003, a year and a half before Blockbuster started offering a Netflix-like service, so there is little danger of Blockbuster showing proof of prior art. That doesn't mean that other companies can't do the same, but time will tell.

Reuters mentions a second patent, and says that it was issued in 2003 and describes "the method by which Netflix customers select and receive a certain number of movies at a time, and return them for more titles." That's a part of the patent issued yesterday; Netflix does hold another one, but it deals with the DVD mailing envelopes, and was issued in 2005. That patent may or may not have bearing on the lawsuit, but it's clearly the fresh one that holds the greater promise for legal remedies.

Netflix contends that Blockbuster knew of the pending patent application, but "willfully and deliberately" launched a copycat service anyway. Blockbuster has shifted its business focus from being a traditional chain of rental stores into something more progressive:
"Our business model going forward focuses on delivering more to our customers," says Blockbuster spokesman Jeff Sieg in an e-mail interview with Ars. "Blockbuster is no longer just a chain of video stores. We are an in-store/online retailer and we are becoming more integrated every day. We will continue exploring ways to leverage our integrated capabilities to differentiate Blockbuster as the one brand that movie rental customers can access in-store or online."

If Netflix has its way, that may be a difficult path to follow. However, some observers think that the suit has little merit:

"It's my opinion that [the suit] won't be [upheld in court]," says Wedbush Morgan analyst Michael Pachter. "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."

However, it's hard to seek injunctive relief before the patents that are being broken get approved. By that standard, Netflix acted almost immediately. Reuters doesn't mention that Pachter happens to be one of the most aggressive Blockbuster cheerleaders in recent memory, who called Netflix a "worthless piece of crap with nice people running it" in a Smart Money interview last year.

If there is a weakness in the legal case, it would be the fact that patenting business methods is seen by some as an unsustainable practice. But it's part of the legal system and Netflix seems to be using this tool to their advantage. Unless the court gets creative in its interpretation of patent law, bad things are in store for Blockbuster, and the moat that keeps new competitors from challenging the market dominance of Netflix in online movie rentals just widened considerably.

Blockbuster could pull a Research In Motion and settle the suit, then beg Netflix to let it pay for a license to do business under the patented Netflix model. Going into a protracted court battle could be a bad idea, since Netflix is comfortably profitable and nearly debt-free while Blockbuster has resorted to closing stores to cut costs, still barely breaks even, and carries US$1.1 billion in long-term debt. And Netflix hired the same high-priced law firm (Keker & Van Nest) that is handling Google's defense in the Microsoft hiring practices lawsuit.

But then again, maybe this will all be irrelevant in a couple of years, when legal downloads and other Video on Demand (VOD) services could dominate the filmed entertainment market. Maybe Blockbuster and Netflix will be part of that scene, maybe not (but the scene better be different from the recent Movielink offering), though Blockbuster better come up with a plan if they want to make it that far. Honestly, they didn't need more problems right now.