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Second Circuit Court Of Appeals Rules That Antitrust Complaint Satisfies Twombly Pleading Standards

On January 13, 2010, the United States Court of Appeals for the Second Circuit reversed a district court's dismissal of a class action lawsuit accusing the major record companies of conspiring in violation of the antitrust laws to fix the prices for music purchased on the internet. *See Starr v. Sony BMG Music Entertainment, et al.,* No. 08-5637-cv (2nd Cir., Jan. 13, 2010) ("*Starr*"). Specifically, applying the heightened pleading standard required by the United States Supreme Court's decision in *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544 (2007), the Court found that "[t]he present complaint succeeds where Twombly's failed because the complaint alleges specific facts sufficient to plausibly suggest that the parallel conduct alleged was the result of an agreement among the defendants." While the precise impact of the pleading standard required by *Twombly* for antitrust cases remains uncertain, for now, the *Starr* decision will be one that is carefully studied by attorneys bringing, and defending against, antitrust lawsuits.

The Defendants in the *Starr* case include Sony Corp., Sony BMG Music Entertainment, Bertelsmann Inc., Vivendi's Universal Music Group, Time Warner Inc., Warner Music Group Corp. ("WMG"), and EMI. The plaintiffs allege that the defendants violated Section 1 of the Sherman Act by conspiring to "restrain the availability and distribution of Internet Music, fix and maintain at artificially high and non-competitive levels the prices at which they sold Internet Music and impose unreasonably restrictive terms in the purchase and use of Internet Music."

Twenty-eight cases were filed in state and federal courts and consolidated in the Southern District of New York. Plaintiffs allege that the conspiracy was carried out, in part, by way of two joint venture music services launched by some the named defendants "MusicNet" and "Duet" (later renamed "pressplay"). All defendants signed distribution agreements with MusicNet or pressplay and sold music directly to consumers over the Internet through these ventures. Plaintiffs alleged that these joint ventures and instances of parallel conduct by the defendants were sufficient to state a claim under Section 1 of the Sherman Act.

Defendants filed a motion to dismiss the complaint for, among other things, failing to satisfy the *Twombly* pleading requirements. The district court found that plaintiffs did not challenge the existence or creation of the joint ventures, and thus the operation of the joint ventures did not yield an inference of an illegal agreement, and that plaintiffs' "bald allegation that the joint ventures were shams is conclusory and implausible."

The district court also held that defendants' imposition of unpopular terms and pricing structures was not against defendants' individual economic self-interest when viewed against the backdrop of widespread music piracy. Finally, the district court rejected plaintiffs' argument that governmental investigations of the defendants, including an investigation by the Department of Justice ("DOJ"), was a sufficient "antitrust record" to justify the problematic inference against the defendants that "once a criminal, always a criminal," particularly since the DOJ had closed one of those investigations. Thus, the district court granted defendants' motion to dismiss the complaint. Plaintiffs appealed.

On appeal, the Second Circuit Court of Appeals first stated that *Twombly* only requires that a plaintiff allege facts "to raise a reasonable expectation that discovery will reveal evidence of illegal agreement," and that the critical question is whether the alleged parallel conduct "stem[s] from independent decisions or from an agreement."

The Second Circuit then held that the following non-conclusory allegations, taken together, sufficiently alleged the plausible existence of an agreement as opposed to independent action.

- Defendants control over 80% of the market for music sold online.
- All defendants signed distribution agreements with either MusicNet or Duet/Pressplay.
- Defendants used most favored nation clauses (MFNs) in their licenses to maintain high fees for songs, and attempted to hide their MFNs because they knew they would attract antitrust scrutiny.
- Defendants refused to do business with the second largest Internet music retailer.
- An industry commenter had observed that "nobody in their right mind" would want to use the defendants' services because of unpopular restrictions.
- Internet music allowed costs to be eliminated, but no price reductions followed the dramatic cost reductions, "as would be expected in a competitive market."
- Edgar Bronfman, Jr., CEO of WMG, allegedly was quoted stating that pressplay was formed as an effort to stop the "continuing devaluation of music."
- In or about May 2005, all defendants raised wholesale prices from about $0.65 per song to $0.70 per song.
- Price-fixing investigations of the defendants were being conducted by the Department of Justice and the New York Attorney General.

The appeals court found that, based on the foregoing factual allegations, the complaint alleges "specific facts sufficient to plausibly suggest that the parallel conduct alleged was the result of an agreement among the defendants." As to the district court's refusal to find an inference of

conspiracy based on the DOJ and other governmental investigations of defendants, the court found that "defendants cite no case to support the proposition that a civil antitrust complaint must be dismissed because a criminal investigation undertaken by the Department of Justice found no evidence of conspiracy," and also noted that complaint alleges that the DOJ subsequently launched two new investigations into whether defendants engaged in collusion and price fixing. Finally, the Second Circuit held that the allegations concerning defendants would "plausibly contravene each defendant's self-interest 'in the absence of similar behavior by rivals.'" Therefore, plaintiffs had pled an actionable antitrust violation.

While the Second Circuit considered the facts alleged in plaintiffs' complaint sufficient to permit the court to find "plausible grounds to infer an agreement" as required by *Twombly*, it is not clear which of these factual allegations nudged the complaint over the *Twombly* threshold.

Finally, the Second Circuit rejected defendants' argument that plaintiffs were required to allege facts that tend to exclude independent self-interested conduct as an explanation for defendants' parallel behavior. In addition, in light of the allegations of parallel conduct, the court held that plaintiff was not required to identify the specific time, place or person related to the conspiracy allegations.

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