# Antitrust Advisory: Internet Music Price-Fixing Case against Record Companies Is Back Online

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On January 13, 2010, the U.S. Court of Appeals for the Second Circuit vacated the dismissal of an antitrust suit brought against several record companies for their alleged conspiracy to fix online record prices. *Starr v. Sony BMG Music Entertainment*, No. 08-5637-cv (2nd Cir., Jan. 13, 2010). Plaintiffs had alleged a conspiracy by the record companies 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." The Second Circuit, disagreeing with the district court, held that the complaint contained "plausible grounds to infer an agreement" between Defendants as required by the Supreme Court in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007).

## Background

Defendants Sony Corporation and Universal Music Group Recordings, Inc. had created pressplay, a joint venture originally called Duet. Similarly, Defendants Bertelsmann, Inc., Warner Music Group Corp., and EMI had jointly formed MusicNet.

In 2005 and 2006, 28 cases were filed by Plaintiffs in various state and federal courts alleging that Defendants had agreed to fix the price of music sold on the Internet through their joint ventures. The cases were consolidated in the Southern District of New York by the Judicial Panel on Multidistrict Litigation.

Plaintiffs alleged several instances of parallel conduct by Defendants in the operation of their joint ventures. First, Plaintiffs alleged that Defendants each signed distribution agreements to sell music over the Internet through pressplay or MusicNet. Plaintiffs also alleged that to buy music through either pressplay or MusicNet, consumers were required to sign similar Digital Rights Management agreements that contained many unpopular restrictions, and to pay the same unreasonably high fees for each song. Plaintiffs further alleged that Defendants used most favored nation clauses (MFNs) in their licenses to maintain the same high fee for songs, and that they all refused to do business with the second largest Internet music retailer.

The record companies argued to the district court that the Plaintiffs had failed to state a claim under *Twombly* because they did not allege facts that "tend to exclude independent self-interested conduct as an explanation for Defendants' parallel behavior."

On October 9, 2008, the district court granted Defendants' motion to dismiss.

## The Second Circuit's Decision

On appeal, the Second Circuit vacated the district court's dismissal, holding that under *Twombly*, a plaintiff need only allege sufficient facts "to raise a reasonable expectation that discovery will reveal evidence of illegal agreement."

The Second Circuit noted that the critical question in a Sherman Act Section 1 case is whether the alleged parallel conduct "stem[s] from independent decisions or from an agreement, tacit or express." The Second Circuit found that certain allegations, taken together, place the parallel conduct in a context that raises a suggestion of a preceding agreement, not merely parallel conduct that could just as well be independent action.

- First, Defendants controlled 80% of the market for online music.
- Second, an industry commenter had noted that "nobody in their right mind" would want to use the services, suggesting that some form of agreement would be needed to render the enterprises profitable.
- Third, one Defendant CEO was quoted as saying that pressplay was formed expressly as an effort to stop the "continuing devaluation of music."
- Fourth, Defendants attempted to hide their MFNs because they knew they would attract antitrust scrutiny.
- Fifth, whereas eMusic charged $0.25 per song, Defendants' wholesale price was about $0.70 per song.
- Sixth, there were pending price-fixing investigations by the Department of Justice and the New York Attorney General.
- Finally, Defendants raised wholesale prices in May 2005, even though Defendants' costs of providing Internet music had decreased substantially earlier that year.

The Second Circuit also made clear that *Twombly* did not require a plaintiff to allege facts that tend to *exclude* independent self-interested conduct as an explanation for defendants' parallel behavior. The "plausibly suggesting" threshold for a conspiracy complaint remains considerably less than the "tends to rule out the possibility" standard applied at the summary judgment stage of such cases.

As this case demonstrates, lower courts continue to wrestle with the Supreme Court's creation in *Twombly* of a gatekeeping function, and its requirement that a plaintiff's complaint, plausibly and with sufficient specificity, demonstrate the existence of an agreement as opposed to independent action. Several courts of appeal have upheld dismissals of antitrust conspiracy complaints where the plaintiff had no more than a theory and a suspicion. See, *e.g.*, *Rick-Mik Enters., Inc. v. Equilon enters. LLC*, 532 F.3d 963, 975-976 (9th Cir. 2008) (dismissing Section 1 price-fixing complaint under *Twombly* where complaint alleged only that defendant conspired with "numerous" banks to fix the price of credit and debit card processing fees and received kickbacks from "numerous" banks as consideration for its unlawful agreement); *Kendall v. Visa U.S.A., Inc.*, 518 F.3d 1042, 1048-50 (9th Cir. 2008) (where plaintiffs alleged no facts to support their theory that defendant banks conspired or agreed with each other, dismissing Section 1 claim because plaintiffs pleaded only legal conclusions, and "failed to plead the necessary evidentiary facts to support those conclusions"); *In re Travel Agent Commission Antitrust Litigation*, 583

F.3d 896, 903 (6th Cir. 2009) ("to survive a motion to dismiss, the complaint must contain either direct or inferential allegations respecting all material elements to sustain a recovery under some viable legal theory … and conclusory allegations or legal conclusions masquerading as factual allegations will not suffice") (internal quotation and citation omitted).

But here, according to the Second Circuit, the district court should not have dismissed this conspiracy complaint. Without defining any standards beyond the general *Twombly* discussion, and considering the alleged facts as a whole, the Second Circuit found facts, suggestions, and concerns that provided a sufficiently plausible suggestion of conspiracy—as opposed to independent action—to allow the case to proceed. The Second Circuit did not suggest that all of the numerous factors it recounted were required to meet *Twombly*, but in practice Plaintiffs will likely use these factors as templates to attempt to craft *Twombly*-proof complaints. The post-*Twombly* jurisprudence will need to evolve further before clarity as to how courts treat antitrust conspiracy complaints emerges.

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*For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.*

**Bruce D. Sokler**
(202) 434-7303
BDSokler@mintz.com

**Robert G. Kidwell**
(202) 661-8752
RGKidwell@mintz.com

**Farrah Short**
(202) 585-3518
FShort@mintz.com