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## *Starr v. Sony BMG: Conduct, Context and the Presumption of Truth*

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## ***Starr v. SONY BMG: Conduct, Context, and the Presumption of Truth***

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### **I. INTRODUCTION**

In *Starr v. Sony BMG*,<sup>2</sup> the Second Circuit became the first court of appeals to vacate a district court's judgment which had dismissed a federal antitrust complaint as failing to meet the standards for pleading a Sherman Act conspiracy enunciated in *Twombly*.<sup>3</sup> The court directed that the case be remanded to the district court,<sup>4</sup> where Plaintiffs may prosecute their allegations that the Defendants, the four major music labels, agreed to fix prices and restrain trade in the market for Internet Music.

While the federal courts continue to wrestle with the issues of the nature and extent of the pleading changes wrought by *Twombly*, the *Starr* panel unanimously agreed that *Twombly* did not elevate the standard on a motion to dismiss Section 1 claims to that for summary judgment. The court further held that the complaint made adequate allegations not only of parallel conduct but also of "further circumstances" sufficient to make plausible the suggestion that the Defendants' alleged conduct was undertaken pursuant to an agreement to restrain trade, rather than independently by each firm.

### **II. THE TWOMBLY DECISION**

The general pleading standard is found in the Federal Rule of Civil Procedure. In cases not involving enumerated "special matters," Rule 8(a)(2)<sup>5</sup>

requires only 'a short and plain statement of the claim showing that the pleader is entitled to relief,' in order to 'give the defendant fair notice of what the . . . claim is and the grounds upon which it rests.'<sup>6</sup>

Prior to *Twombly*, the FRCP Rule 8(a)(2) standard used by the courts on motions to dismiss under Rule 12(b)(6) was that "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief."<sup>7</sup> Thus, if a plaintiff's statement of claim "left open the possibility," however doubtful, of a remote chance that she could prove any "set of facts" entitling her to recover, her claim could not be dismissed pre-discovery.<sup>8</sup> In addition to introducing "plausibility" to the Rule 12(b)(6) lexicon, *Twombly* announced the "retirement" of *Conley's*

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<sup>2</sup> *Starr v. Sony BMG Music Entertainment*, 592 F.3d 314 (2d Cir. Jan. 13, 2010).

<sup>3</sup> *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) ["*Twombly*"].

<sup>4</sup> Defendants have petitioned the Second Circuit for rehearing and rehearing *en banc*, and that Petition remains pending as of this writing. The court has not requested a submission from Plaintiffs.

<sup>5</sup> *Twombly*, 550 U.S. at 555.

<sup>6</sup> *Conley v. Gibson*, 355 U.S. 41, 47, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957) ["*Conley*"].

<sup>7</sup> *Conley*, 355 U.S. at 45-46.

<sup>8</sup> *Twombly*, 550 U.S. at 561.

“beyond doubt/any set of facts” formulation.<sup>9</sup> In its place, *Twombly* required plaintiffs to allege “enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement.”<sup>10</sup>

But *Twombly* continued *Conley*’s other well-settled “general standards.”<sup>11</sup> These included accepting the well-pleaded allegations as true (whether or not they are believed) and drawing all reasonable inferences from such allegations in favor of Plaintiffs. Although it did not require “particularity,” *Twombly* required “more than labels and conclusions” in support of grounds that “raise a right to relief above the speculative level.”<sup>12</sup>

*Twombly* applied what it described as a new “gloss” on the well-settled standards of Rule 8(a)(2) to consider what a plaintiff must plead to state a claim that corporations had agreed to divide markets in violation of Section 1 of the Sherman Act:

In applying these general standards to a § 1 claim, we hold that stating such a claim requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made. Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement. And, of course, a well-pleaded complaint may proceed even if it strikes a savvy judge that actual proof of those facts is improbable, and ‘that a recovery is very remote and unlikely.’<sup>13</sup>

A plaintiff must therefore merely allege “enough fact” or a “circumstance” that, taken as true, points toward an illegal agreement. The allegations need only raise a plausible inference of agreement. They do not need to raise a probable inference of agreement. And, even if it is “improbable” or “remote and unlikely” to a “savvy judge” that the allegations will be proved during discovery, allegations which raise a plausible inference of agreement must be permitted to go forward.

*Twombly* also confirmed that Rule 8(a)(2) requires no heightened degree of pleading particularity, and the heightened standard of particularity of Federal Rule 9(b) does not apply in determining whether a Section 1 claim has been stated.<sup>14</sup> *Twombly*’s facts were crucial. Very briefly, the *Twombly* Defendants, who were not alleged to be price-fixers, were regional telephone companies which, under prior regulation, had been excluded from offering their services in each others’ markets. The Supreme Court emphasized that, in the recent past, the “Baby Bells” had been regional divisions of AT&T and had not competed with one another.<sup>15</sup> Thus, their alleged parallel conduct was parallel inaction in not seeking to enter the newly-opened markets, which inaction might not be “anything more than the natural, unilateral reaction of each [Baby Bell] intent on keeping its regional dominance.”<sup>16</sup>

The *Twombly* complaint asserted only bare allegations of parallel conduct in Defendants’ refraining from competing against one another in their respective territories. The Supreme Court

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<sup>9</sup> *Id.* at 563

<sup>10</sup> *Id.* at 556.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 555.

<sup>13</sup> *Id.* at 556 (emphasis supplied) (footnote omitted), quoting *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974).

<sup>14</sup> *Id.* at 569 n. 14 (broadening the scope of Rule 9 “can only be accomplished ‘by the process of amending the Federal Rules, and not by judicial interpretation’”).

<sup>15</sup> *Id.* at 566.

<sup>16</sup> *Id.*

took pains to note that such parallel inaction “gets the complaint close to stating a claim, but without some further factual enhancement it stops short of the line between possibility and plausibility.”<sup>17</sup> “The inadequacy of showing parallel conduct or interdependence, without more, mirrors the ambiguity of the behavior [at issue in *Twombly*] consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market.”<sup>18</sup>

The defendants in *Twombly* had, lawfully, never had to compete before. Why should an inference of conspiracy be drawn from their inaction now? In the context of the facts before it, *Twombly* required some “further circumstance,” in addition to parallel inaction, that “points toward” a prior agreement.<sup>19</sup> What the *Twombly* plaintiffs needed was not “heightened fact pleading of specifics” but a “further circumstance” to “nudge[] their claims across the line from conceivable to plausible.”<sup>20</sup>

### III. THE *IQBAL* DECISION.

In *Iqbal*,<sup>21</sup> the Court made explicit that application of the *Twombly* “plausible pleading” standard was not limited to antitrust complaints. Plaintiffs in *Iqbal* challenged the constitutionality of their pretrial confinement after they had been classified as persons of “high interest” because of their suspected links to the September 11 attacks. They asserted that the challenged detention policies purposefully discriminated against Arab Muslim defendants on prohibited grounds. Although the well-pleaded allegations of the complaint are deemed to be true on a Rule 12(b)(6) motion, the Court held that Plaintiffs’ allegations that the Attorney General and the director of the FBI “willfully and maliciously agreed” to subject plaintiffs to harsh conditions of confinement were conclusory and therefore not entitled to the presumption of truth. Absent those allegations, the majority held that plaintiffs had not stated a plausible claim.

*Iqbal* thus explained *Twombly* as holding that “[a] claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged....Determining whether a complaint states a claim for relief will...be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense.”<sup>22</sup> Writing for four dissenting justices, Justice Souter (who had authored the *Twombly* decision) here took issue with the majority’s characterization of the alleged facts as conclusory, arguing that in light of the complaint’s subsidiary contextual allegations regarding the September 11 attacks and their aftermath, the allegations did provide the necessary plausibility and should have been credited on the motion to dismiss.<sup>23</sup>

### IV. THE *STARR* ALLEGATIONS

The *Starr* complaint alleges that the Defendant music labels account for 80 percent of the Digital Music sold to end users in the United States. “Digital Music” is defined to include “Compact Disks” as well as “Internet Music.” Plaintiffs further allege that Defendants agreed to restrain trade in the market for Internet Music by fixing prices and requiring onerous non-price

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<sup>17</sup> *Id.* at 557.

<sup>18</sup> *Id.* at 554.

<sup>19</sup> *Id.* at 557.

<sup>20</sup> *Id.* at 570.

<sup>21</sup> *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1950 (2009).

<sup>22</sup> *Iqbal*, 129 S. Ct. at 1949-50.

<sup>23</sup> *Id.* at 1960-61.

terms which made downloading digital music files unattractive for the consumer, thereby discouraging consumers from abandoning Defendants' profitable Compact Disk business. Such an overarching plan would make economic sense only if effected pursuant to an agreement among the music labels; if one label broke ranks and offered attractive terms, the others would be unable to obtain the unattractive terms from their customers.

Among the parallel conduct alleged was that the Defendants established and controlled two joint ventures for their Internet music business, each of which charged unreasonably high prices and imposed unpopular "digital rights management" terms. Such terms included, for example, charging excessive fees, preventing the use of downloaded music on iPods, and allowing the user to "own" the music only temporarily.

Plaintiffs alleged that the CEO of one Defendant was quoted as admitting that Defendants entered into their joint ventures to "determine the price. . . . because we are concerned that the continuing devaluation of music will proceed unabated unless we do something about it." Neither in the district court nor the court of appeals did Defendants ever try to address this admission.

Each Defendant also allegedly used "most favored nations" clauses in their licensing agreements ("MFNs"), which guaranteed the Defendant-licensor terms no less favorable than those offered to other licensors, and which enforced a price floor of about 70 cents per song. Also, a CEO of another Defendant was quoted as admitting that the reason the Defendant had used a "secret side letter" to memorialize an MFN with one of the joint ventures was that "there are legal/antitrust reasons why it would be bad idea to have MFN clauses in any, or certainly all, of these agreements." Although Defendants did address this admission, which indicated knowledge of what the different competitors were doing, the court of appeals found that such admission added to plausibility.<sup>24</sup>

Plaintiffs further alleged that, although Defendants' costs of producing Internet Music dramatically declined, they continued to increase their prices in parallel fashion.<sup>25</sup> Plaintiffs made numerous other allegations that placed 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,"<sup>26</sup> and those allegations were analyzed at length in the court of appeals' opinion.<sup>27</sup> They included (but were by no means limited to) several government investigations by federal and New York authorities, including an investigation into price-fixing as to which the Justice Department issued no findings (in conspicuous contrast to the findings released after an earlier investigation).

## V. STARR IN THE DISTRICT COURT

The district court granted Defendants' motion to dismiss under Rule 12(b)(6), holding that Plaintiffs had failed to challenge the existence of the joint ventures, and that the allegations of the operation of the joint ventures did not yield a reasonable inference of an illegal agreement.<sup>28</sup> The district court also held that each of the other circumstances and conduct did not allow a reasonable inference of prior agreement and, in particular, that the unpopular digital rights terms were not,

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<sup>24</sup> 592 F.3d at 319.

<sup>25</sup> Compare *In re Flat Glass Antitrust Litig.*, 385 F.3d 350, 355 & n. 5, 361, 362, 366 (3d Cir. 2004) (reversing summary judgment in a price-fixing case, in significant part, because evidence that price increases occurred when costs declined constitutes a "plus factor").

<sup>26</sup> *Twombly*, 550 U.S. at 557.

<sup>27</sup> 592 F.3d at 323-25.

<sup>28</sup> *In re Digital Music Antitrust Litig.*, 592 F.Supp.2d 435 (S.D.N.Y. 2008).

when viewed against a backdrop of widespread illegal music downloading, against Defendants' individual economic self-interest, and thus were consistent with independent action.

## VI. STARR IN THE COURT OF APPEALS

The court of appeals reviewed the conduct and context allegations, and stated that the complaint “does not resemble those our sister circuits have held fail to state a claim under *Twombly*,” which held that a complaint requires “enough factual matter (taken as true) to suggest that an agreement was made.”<sup>29</sup> Departing from the district court, the court of appeals found that Plaintiffs had challenged the operation of the joint ventures as a means to implement Defendants' anticompetitive agreements. In such context, the court of appeals concluded, contrary to the district court, that Plaintiffs had pleaded sufficient facts to state a plausible claim that Defendants' conduct was undertaken pursuant to an agreement to restrain trade. “Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of an illegal agreement.”<sup>29,30</sup>

Plaintiffs argued that *Twombly* established that the plausibility standard for pleading an unlawful agreement at the motion to dismiss stage was less demanding than the standard for proving an unlawful agreement at the summary judgment stage. Under the latter standard, a plaintiff seeking damages for a violation of Section 1 “must tend to rule out the possibility that the defendants were acting independently.”<sup>31</sup> Under *Twombly*, however, the “antecedent question” of dismissal under Rule 12(b)(6) required that a complaint must only (1) give fair notice to Defendants of Plaintiffs' claims, and (2) contain enough to raise a right to relief above the speculative level.<sup>32</sup>

The district court, however, had read *Twombly* to require that a Section 1 complaint include allegations of “plus factors” or “factual enhancements” which tend to exclude the possibility of independent action.<sup>33</sup> Defendants pressed that argument before the Second Circuit, but the court of appeals clarified that a Sherman Act plaintiff is not required on a motion to dismiss to satisfy the summary judgment standard by alleging facts that “tend[] to exclude independent self-interested conduct as an explanation for defendants' parallel behavior,” and that *Twombly* had worked no change to this standard.<sup>34</sup>

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<sup>29</sup> 592 F.3d at 325, quoting *Twombly*, 550 U.S. at 556.

<sup>30</sup> *Id.*, quoting *Twombly*, 550 U.S. at 556.

<sup>31</sup> 550 U.S. at 554, citing *Matsushita Electric Indus. Co. Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986) and *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 (1984). “While a showing of parallel ‘business behavior is admissible circumstantial evidence from which’ agreement may be inferred, it falls short of ‘conclusively establish[ing] agreement or . . . itself constitut[ing] a Sherman Act offense.’” *Twombly*, 550 U.S. at 553, quoting *Theatre Enterprises Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537, 540-41 (1954). Thus, **to survive summary judgment**, a plaintiff must not only adduce evidence of facts “pointing toward” an unlawful agreement, but also must go further and submit evidence tending to exclude the possibility of individual decision-making. Compare *Twombly*, 550 U.S. at 557 with *Matsushita*, 475 U.S. at 588.

<sup>32</sup> 550 U.S. at 555 & n. 3. In *Erickson v. Pardus*, 127 S. Ct. 2197, 2200 (2007), decided barely two weeks after *Twombly*, the Supreme Court reaffirmed that under Rule 8(a)(2), “[s]pecific facts are not necessary; the statement need only ‘give the defendant fair notice of what the . . . claim is and the grounds upon which it rests,’” accepting all well-pleaded allegations in the complaint as true and drawing all reasonable inferences in favor of the non-moving party. *Id.* (quoting *Twombly*, 550 U.S. at 555).

<sup>33</sup> 592 F. Supp. 2d at 441..

<sup>34</sup> *Id.*

## VII. CONCLUSION

The Second Circuit's *Starr* opinion offers an excellent roadmap through the uncertain territory of pleading a Section 1 complaint. The sparse complaint in *Twombly* had come "close to stating a claim."<sup>35</sup> In the case-specific inquiry demanded by motions to dismiss, *Starr* held that the complaint before it alleged far more, both in terms of conduct and underlying context, than did the almost-sufficient complaint in *Twombly*.<sup>36</sup>

But the Supreme Court in *Iqbal* split 5 to 4 on the issue of whether certain allegations were worthy of the presumption of truth on a Rule 12(b)(6) motion, or whether they were mere conclusions unworthy of the presumption. Thus, "the effects of [*Twombly* and *Iqbal*] across the full spectrum of federal cases are still uncertain and the subject of considerable controversy and even pending legislation, but in the antitrust setting it is clear that the law now requires, before defendants are forced to bear the potentially enormous expense of discovery, that plaintiffs allege facts that raise a reasonable expectation that discovery will reveal evidence of the alleged antitrust violation."<sup>37</sup>

In *Starr*, unlike in *Twombly*, the court found that various admissions and other types of such evidence were present.

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<sup>35</sup> *Id.* at 557.

<sup>36</sup> 592 F.3d at 325.

<sup>37</sup> In re Air Cargo Shipping Services Antitrust Litig., No. 06-MD-1775, 2009 WL 3443405 at \*1 (E.D.N.Y. Aug. 21, 2009).

On July 22, 2009, Sen. Arlen Specter introduced S. 1504, a bill entitled the "Notice Pleading Restoration Act of 2009," which would provide that "Federal courts shall not dismiss complaints under rule 12(b)(6) or (e) of the Federal Rules of Civil Procedure, except under the standards set forth by the Supreme Court of the United States in *Conley v. Gibson*, 355 U.S. 41 (1957)." The bill was read and referred to the Senate Judiciary Committee. On November 19, 2009, Rep. Jerrold Nadler introduced H.R. 4115, a bill entitled the "Open Access to Courts Act of 2009," which would "amend Title 28, United States Code, to provide a restoration of notice pleading in Federal courts, and for other purposes." The bill was referred to the Subcommittee on Courts and Competition Policy on December 11, 2009.