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I. INTRODUCTION

In *Starr v. Sony BMG Music Entertainment*,[2] plaintiffs alleged that Sony BMG, EMI, Universal Music Group, and Warner Music Group—which allegedly "control over 80 percent of Digital Music sold to end purchasers in the United States"[3]—had engaged in a conspiracy to maintain high prices for music sold over the Internet. Before 2007, the defendants might well have declined even to challenge the legal adequacy of that allegation. But, in 2007, the Supreme Court decided *Twombly*,[4] which changed the analysis that applies to antitrust conspiracy claims.[5] The *Starr* defendants filed a motion to dismiss, arguing that plaintiffs' allegations did not satisfy *Twombly*. The district court agreed,[6] but the Second Circuit reversed. The Second Circuit held that the standard developed in the summary judgment context for evaluating the adequacy of circumstantial evidence of a Section 1 conspiracy should not be transposed to the motion-to-dismiss context. But the Second Circuit's decision, by allowing a vague set of factual allegations and an equally vague set of claimed violations to proceed past a motion to dismiss, ignored *Twombly*'s most basic lesson: An antitrust plaintiff, in the absence of any direct claim of agreement, must support a claim of conspiracy with clear factual allegations and persuasive inferences.

II. THE *STARR* FACTS

The facts of *Starr* are complicated and span several years. By late 2001, the Internet was a double-barreled threat to the major record labels: the availability of music downloaded over the Internet was undermining demand for CDs, and the proliferation of illegal file sharing meant that the labels were gaining no revenue from Internet distribution. In late 2001, allegedly in response to these concerns, the four defendants paired off and created two joint ventures that sold music directly over the Internet—"MusicNet" and "pressplay."[7] The services were expensive and unpopular, in part because they "required consumers to agree to unpopular Digital Rights Management terms ('DRMs')."[8] "Eventually"—the opinion does not say when in relation to the formation of the joint ventures—"defendants and the joint ventures began to sell Internet Music

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[2] 592 F.3d 314 (2d Cir. 2010).

[3] *Id.* at 318.

[4] Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007).

[5] That this change goes beyond antitrust conspiracy claims was confirmed by the Court's decision in Ashcroft v. Iqbal, 129 S. Ct. 1937 (2009).

[6] In re Digital Music Antitrust Litig., 592 F. Supp. 2d 435 (S.D.N.Y. 2008).

[7] *See* Starr, 592 F.3d at 318; see also Digital Music, 592 F. Supp. 2d at 442.

[8] Starr, 592 F.3d at 318.

to consumers through entities they did not own or control."[9] Third parties, however, "could only sell defendants' music if they contracted with MusicNet to provide Internet Music for the same prices and with the same restrictions as MusicNet itself or other MusicNet licensees."[10] The Second Circuit stated that "[d]efendants also used Most Favored Nation clauses ('MFNs') in their licenses that had the effect of guaranteeing that the licensor who signed the clause received terms no less favorable than the terms offered to other licensors."[11] (Note that the court is here referring not to the licenses that MusicNet granted to other retailing entities but to the license that the defendants granted *to* MusicNet.)

The role of pressplay in this activity is obscure, but the CEO of Warner Music was quoted as saying (the date is not revealed) that pressplay "ha[d] what we call an affiliate model where we determine the price, and we offer a percentage of that price to the retailing partner. . . . The reason we've chosen that, frankly, is because we are concerned that the continuing devaluation of music will proceed unabated unless we do something about it."[12]

"After services other than defendants' joint ventures began to distribute defendants' Internet Music, defendants 'agreed' to a wholesale price floor of about 70 cents per song, which they enforced in part through MFN agreements."[13] The opinion does not make clear whether the wholesale price at issue allegedly applied to music purchased directly from individual defendants—in addition to or as opposed to from the joint ventures—or the extent to which the joint ventures continued to operate or what services they provided. The opinion noted that "eMusic, the most popular online music service selling Internet Music owned by independent labels[] currently charges $0.25 per song and places no restrictions on how purchases can upload their music."[14] "[A]ll defendants refused to do business with eMusic."[15] And, "in or about May 2005, all defendants raised wholesale prices from about $0.65 per song to $0.70."[16] Finally, the complaint alleges "that defendants' price-fixing is the subject" of three federal and state investigations.[17]

III. THE *STARR* RULINGS

The district court granted defendants' motion to dismiss. The court stated that, in judging the adequacy of plaintiffs' allegations, "*Twombly* . . . requires that [plaintiffs] plead"—not just parallel conduct—but "further facts tending to show conspiracy."[18] Citing *Matsushita*,[19] the district court stated that a Section 1 plaintiff must plead "'plus factors'—the additional circumstantial evidence, beyond parallel conduct, that must exist to ensure 'that the inference of conspiracy is reasonable in light of the competing inferences of independent action.'"[20] The

[9] *Id.*
[10] *Id.*
[11] *Id.* at 319.
[12] *Id.* (internal quotation marks omitted).
[13] *Id.* The court noted that "[t]he allegation that defendants agreed to this price floor is obviously conclusory, and is not accepted as true." *Id.* at 319 n.2.
[14] *Id.* at 319.
[15] *Id.*
[16] *Id.* at 323.
[17] *Id.* at 324.
[18] In re Digital Music 592 F. Supp. 2d at 445.
[19] Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986).
[20] In re Digital Music, 592 F. Supp. 2d at 441.

district court found that none of the complaint's allegations supported an inference of conspiracy under that standard.

The court of appeals reversed. It indicated that the district court had applied the wrong standard: "While for purposes of a *summary judgment motion*, a Section 1 plaintiff must offer evidence that 'tend[s] to rule out the possibility that the defendants were acting independently,' . . . to survive a motion to dismiss . . . a plaintiff need only allege 'enough factual matter (taken as true) to suggest that an agreement was made.'"[21] After reviewing the complaint's "non-conclusory factual allegations of parallel conduct," the court listed the allegations that "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.'"[22] They included the facts that the industry is concentrated; that the joint ventures offered service on unpopular terms "suggesting that some form of agreement among defendants would have been needed to render the enterprises profitable;" that a defendant's CEO had suggested that one of the joint ventures was formed "to stop the 'continuing devaluation of music;'" that defendants "attempted to hide their MFNs;" that eMusic charged must less for the songs it sold; the existence of investigations; and the parallel price increase in May 2005 "even though . . . defendants' costs of providing Internet Music had decreased substantially."[23]

IV. *TWOMBLY*'S TEACHING

Twombly's central teaching is that lower courts must distinguish between a direct allegation of conspiracy and an inferential one. Inferential allegations involve conclusions drawn from observed facts, rather than the observed facts themselves. There may not be much of a step from observed facts to inferences—wet umbrellas in the stand, wet slickers on the coat-rack, and the sound of thunder support, rather uncontroversially, an inference of rain—but there is this basic difference: Assuming that the observed facts are communicated with equal precision to two individuals, there is no reason *a priori* to assume that one individual will be able to draw an inference from the observed facts better than another. Different individuals will, in fact, have a different ability to draw inferences, even on identical facts—because of expertise, experience, and analytical insight. Nevertheless, while anyone can draw inferences from facts, not anyone can supply the facts themselves. You need a witness, as the song says.

When an allegation is inferential, a district court can take a more active role in evaluating the sufficiency of an allegation to state a claim.[24] That makes good sense. Suppose, for example, that my neighbor alleges that I ran my car into his mailbox. If my neighbor alleges that he *saw* me hit his mailbox, or if he alleges that the mailman saw me hit his mailbox, the court really has no basis for questioning, on a motion to dismiss, whether I hit the mailbox. The allegation may be mistaken or deliberately false, but that is not—except perhaps in extraordinary cases—a matter for resolution at a motion to dismiss.[25] On the other hand, if the allegation is that—while no one saw me hit the mailbox—the plaintiff infers that I did (based on the fact that there are paint chips on the mailbox and a matching scratch and dent on my car), the defendant can ask

[21] Starr, 592 F.3d at 321 (quoting Twombly, 550 U.S. at 554, 556) (emphasis added).

[22] *Id.* at 323 (quoting Twombly, 550 U.S. at 557).

[23] *Id.* at 323-34.

[24] *See* Twombly, 550 U.S. at 565 (sufficiency of inferential allegation "turns on the suggestions raised by [alleged] conduct viewed in light of common economic experience").

[25] *See* Neitzke v. Williams, 490 U.S. 319, 327 (1989) ("Rule 12(b)(6) does not countenance . . . dismissals based on a judge's disbelief of a complaint's factual allegations.").

the court to rule on whether those facts—accepted as true—are legally sufficient. The facts may be *consistent* with my having struck the mailbox. But they are also consistent with someone else having struck the mailbox, perhaps while driving my car. Is the inference allowed for purposes of surviving a motion to dismiss?

Back to antitrust. In the case of horizontal price fixing, bid rigging, and market allocation, the existence of an agreement is likely to be *the* critical fact separating lawful from unlawful conduct.[26] In some instances, plaintiffs may be able to make direct allegations of conspiracy—based on information received, perhaps at second hand, from a direct observer that an agreement was reached.[27] If a complaint alleges that the CEO of Acme and the CEO of Allied met in Aruba on December 8 and agreed at that meeting to raise prices, it may be difficult for a court to dismiss that claim.[28] But in many other instances, the allegations of conspiracy will be purely inferential: no witness saw the agreement made, but the set of observable facts allows a reasonable observer to draw an inference that the conduct observed was the result of actual coordination. In such cases, a district court can subject the asserted inference to further scrutiny—that is, the district court can evaluate the legal adequacy of the inference.[29]

But where is the line drawn, at a motion to dismiss, between a legally permissible inference and a legally insufficient one? Antitrust *circa* 2007 had a well-developed body of law related to the inference of agreement from facts—but it was a body of law developed in the context of summary judgment, not in the context of motions to dismiss. To what extent is that body of law transferable to the new context? On the one hand, it could be argued that the rules of permissible inferences developed in the summary-judgment context can be imported into the motion-to-dismiss context without doing violence to the basic difference between the two. At a motion to dismiss, all allegations are accepted as true and a defendant has no opportunity to introduce evidence of its own; at summary judgment, allegations must be supported by evidence, and a defendant can provide exculpatory context. If the uncontradicted allegations in the complaint, supported by evidence, would not create a jury issue at summary judgment, why should they be sufficient at the earlier stage of litigation? On the other hand, after discovery, a plaintiff may well be able to flesh out allegations with additional evidence suggestive of conspiracy—evidence sufficient to put what looked like a weak inferential case well over the line.

V. HOW STRONG AN INFERENCE?

The *Starr* case holds that the standard of inference at the motion-to-dismiss stage is different from the standard at the summary-judgment stage. The court rejected defendants' formulation that a complaint's allegations must "tend[] to exclude independent self-interested

[26] At least if one assumes a proper plaintiff—that is, one with antitrust standing. In many antitrust cases, the critical issue is not the existence of agreement, but, instead, the contours of the agreement and its market effect.

[27] This may occur, for example, in the wake of a government indictment, or based on the investigation of private parties and the statements of disgruntled ex employees.

[28] It may be correspondingly easy, however, to test the basis for that claim and to impose sanctions if the plaintiff lacked a good-faith basis for making it.

[29] The majority in Twombly set aside the "direct allegations" of agreement in the complaint at issue in that case because "on fair reading these are merely legal conclusions resting on the prior allegations" of parallel conduct and attendant circumstances. 550 U.S. at 565. The two dissenting Justices took the majority to task, claiming that the "dichotomy between factual allegations and 'legal conclusions' is the stuff of a bygone era. *Id.* at 589 (Stevens, J., dissenting) (quoting Twombly, 550 U.S. at 564-65). The "legal conclusion" label could perhaps be argued with, but the Court's point was simply that the complaint's allegations of agreement were all based on an inference from other alleged facts, and that the issue for the Court was the legal sufficiency of that inference.

conduct as an explanation for defendants' parallel behavior."[30] Rather, the court noted that *Twombly* "specifically held that, to survive a motion to dismiss, plaintiffs need only 'enough factual matter (taken as true) to suggest that an agreement was made.'"[31] The court cited Professor Hovenkamp's treatise for the proposition that "the Supreme Court did *not* hold that the same standard applies to a complaint and a discovery record . . . . The 'plausibly suggesting' threshold for a conspiracy complaint remains considerably less than the 'tends to rule out the possibility' standard for summary judgment."[32]

The Supreme Court, however, did not expressly address the relationship between the standard by which a court should judge the adequacy of an inference of conspiracy at a motion to dismiss on the one hand and at summary judgment on the other. To Professor Hovenkamp's ear, "plausibly suggesting" is less demanding than "tending to rule out the possibility;" but it is perfectly coherent to say that factual allegations "plausibly suggest" a conspiracy if they "tend to rule out the possibility" of independent action. Both phrases point in the same direction. As Professor Hovenkamp notes, "[p]lus factors are needed to create an inference of conspiracy from suspicious parallel conduct when sufficient direct evidence is lacking."[33] It is trivially true that, if a plaintiff can make sufficient direct allegations of conspiracy, then the question whether the plaintiff has pleaded sufficient inferential allegations is beside the point. (It is likewise true that direct evidence of a conspiracy can make an inferential case unnecessary at summary judgment.) But if the plaintiff cannot plead direct allegations of conspiracy, the question is whether the direct factual allegations support the inference of conspiracy—that is, whether the plaintiff has "allege[d] those elements that it 'needs to prove'"[34]

When the Supreme Court applied the proper standard in *Twombly*, the analysis resembled the analysis that a court would undertake—albeit on a much more extensive and nuanced factual record—at summary judgment. The *Twombly* plaintiffs had alleged a conspiracy with two aspects—an agreement among incumbent telephone companies to refrain from competing in each others' territories and an agreement to frustrate the efforts of other new entrants to compete. The Supreme Court asked itself whether factual allegations of parallel conduct plausibly supported an inference of prior agreement in light of context, and found that they did not. With regard to non-entry, the defendants had ample reason to remain within their own territories and to pay heed to the "adage about him who lives by the sword."[35] With regard to frustrating new entrants, no conspiracy would be needed to encourage each defendant to protect its own turf.[36] In other words, defendants' conduct was perfectly understandable as the product of unilateral self-interest in the absence of agreement. Plaintiff could not explain why the inference of conspiracy made sense in light of the competing inference of unilateral conduct.

The *Starr* court—after emphasizing the perceived difference between the summary judgment standard and the motion to dismiss standard—evaluated the complaints allegations to determine whether the 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

[30] Starr, 529 F.3d at 325.
[31] *Id.*
[32] 2 AREEDA & HOVENKAMP § 307d1, at 118 (3d ed. 2007).
[33] *Id.* at 119.
[34] *Id.* (quoting Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 346 (2005)).
[35] 550 U.S. 547.
[36] *See Id.* at 566-67.

be independent action.'"[37] Again, the inference required—that the conduct and attendant circumstances are inconsistent with unilateral conduct—is the same as the inference required at summary judgment. Even for the Second Circuit, then, the difference is apparently in the strength of the inference, and that is a matter that is notoriously hard to capture in words.

VI. WHAT WAS MISSING

However one would measure the "plausibly suggesting" standard on a "strength of inference" scale, the critical point about inferences—as opposed to direct allegations—is that they can be explained. Unlike a direct allegation—which requires no logical explanation—an inferential allegation should be accepted only if the logic of the inference makes sense. That means that a plaintiff should be required to be clear about (1) the direct factual allegations from which the inference is being drawn and (2) what inference—exactly—the court is being asked to accept.

The problem with the *Starr* decision is that it failed to demand precision either with respect to factual premises or with respect to the conclusions drawn from them. The *Starr* opinion is quite vague about who did what when—and so is the complaint.[38] We learn that major record labels formed joint ventures; that the joint ventures imposed unpopular terms on purchasers of the music they sold; that the joint ventures had some apparent role in selling digital music to other vendors (though the role is unclear); that the defendants all charge a similar amount for music; that prices did not fall despite allegedly declining costs; and that a number of related and unrelated investigations were undertaken by federal and state law enforcement officials. Plaintiffs include other more specific nuggets and critical comments in the complaint as well. But plaintiffs never tell a clear, coherent story—complete with chronology—about the specific conduct and market facts that support their claims.

Just as important, it is simply not clear what the alleged agreement was supposed to have been. On the one hand, if plaintiffs' allegation is that the record companies fixed the prices they charge for songs, the complaint has little information about the actual prices charged, when the prices changed, and how those changes compared to previous pricing patterns. Mere similarity of prices would seem to provide no reason to infer a conspiracy. And the allegation that all of the record companies put similar restrictions on copying their music would also seem to do nothing to support an inference of unlawful agreement: if all of the companies had an interest in protecting their intellectual property, they would very likely tend to adopt similar methods of protecting that property (all of which would be open to observation).[39]

On the other hand, there is much in the complaint that suggests that the real focus of plaintiffs' allegations is the joint ventures that defendants formed in 2001.[40] But if the plaintiffs' claim is that the joint ventures themselves were illegal under the rule of reason, then all of the discussion of inference of conspiracy was surplusage. A joint venture always involves an agreement, and its activities are subject to scrutiny under Section 1. But then the question becomes, "what about the joint venture unreasonably restrained trade?" The court does not

[37] 592 F.3d at 323 (quoting Twombly, 550 U.S. at 557).

[38] *See* Second Consolidated Amended Complaint, In re Digital Music Antitrust Litigation, No. 1:06-md-01780-LAP (S.D.N.Y. filed June 13, 2007).

[39] That some record labels sought to promote their content through low-cost distribution with fewer restrictions is no more suspicious than the fact that some websites charge for content while others do not.

[40] 592 F.3d at 326. ("[A]lthough the district court below stated that plaintiffs did not challenge the joint ventures here, the complaint makes clear that plaintiffs do challenge the joint ventures.").

provide a clue.[41] It is true that the joint ventures provided an opportunity for the defendants to conspire. But the question remains—what conduct, specifically, was the result of prior agreement?

It is not unfair to demand such specificity and precision—to the contrary, it is the least a court should demand. The ability to launch antitrust litigation is a powerful economic weapon. Once a complaint survives a motion to dismiss in a major antitrust matter, the defendants will inevitably bear millions in costs, key management personnel will be subject to extended distractions, and defendants will shy away from efficient conduct. This is not to gainsay the benefits of private antitrust litigation: private suits and the threat of such suits provide a key deterrent for unlawful conduct. But the *Twombly* Court made clear that district courts play an important gate-keeping function at a motion to dismiss by sifting out unfounded inferential claims from those that have a sufficient factual basis to warrant the social costs of allowing the litigation to continue. Properly applied, that standard helps to ensure that the legal system maintains the balance between the real costs and real benefits of private antitrust litigation.

The *Starr* court, by signing off on the complaint at issue in that case, did the legal system a disservice. There is room to argue about how strong an inference of conspiracy should be required at a motion to dismiss. Whatever the standard, courts cannot apply it unless they demand precision in the pleading of underlying facts, and coherence in the pleading of the inferences drawn. The *Starr* opinion sends the message that no such precision or coherence is necessary, opening the door that the *Twombly* Court tried to close.

[41] The court suggested that the allegations of the complaint supported the claim that the joint ventures were unlawful shams that were simply a vehicle for price fixing. *Id.* at 326. But the plaintiffs seem to have disclaimed that theory. *See* Digital Music, 592 F. Supp. 2d at 441 n.8 (quoting plaintiffs' brief: "'[I]t is not the existence or creation of these joint ventures that form the basis of the Plaintiffs' allegations.'").