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Second Circuit Distinguishes *Twombly* and *Dagher* in Vacating Dismissal of Antitrust Challenge to Joint Ventures' Conduct

In vacating dismissal of a complaint, the United States Court of Appeals for the Second Circuit recently issued an opinion analyzing two key issues under antitrust law: (1) the standard for alleging an antitrust conspiracy claim under *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), and (2) the circumstances in which a joint venture's conduct can be exempt from Section 1 of the Sherman Act under *Texaco Inc. v. Dagher*, 547 U.S. 1 (2006). See *Starr v. Sony BMG Music Entertainment*, No. 08-5637, 2010 WL 99346 (2d Cir. Jan. 13, 2010).

With respect to the first question, the Second Circuit in *Starr* appears to be pushing back on the strict pleading standard adopted in *Twombly*. Although in many cases defendants should be able to point to *Starr's* unusual facts to distinguish it, the decision nevertheless adopts a standard that is arguably more plaintiff-friendly than used by some other courts, and may provide antitrust plaintiffs with greater guidance regarding how to plead claims to avoid dismissal.

As to the second question, the *Starr* case suggests that, at least in the Second Circuit, *Dagher* may not provide protection to defendants in rule of reason cases. The Supreme Court itself, however, may soon provide guidance regarding how *Dagher* should be applied when it decides *American Needle v. National Football League*, which was argued on January 13, 2010 – the same day the Second Circuit decided *Starr*.

Application of *Twombly*

Twombly, of course, held that, in order to survive a motion to dismiss, the factual allegations in the complaint must meet a "plausibility" requirement. In particular, the complaint must include "enough fact[s] to raise a reasonable expectation that discovery will reveal evidence of [an] illegal agreement." *Id.* at 556. Some other federal courts have interpreted *Twombly* (correctly, in our view) to require a plaintiff to plead enough facts to suggest that the defendants' conduct was contrary to their self interest if they were acting unilaterally, thus raising an inference of conspiracy. In *Starr*, however, the Second Circuit held that plaintiffs are not required to allege facts that "tend to exclude independent self-interested conduct as an explanation for defendants' parallel behavior." *Starr*, 2010 U.S.App. LEXIS 768, at *25. According to the Second Circuit,

that requirement applies only at the summary judgment stage. Nevertheless, the Second Circuit left some room for analysis at the motion to dismiss stage of whether defendants' conduct was in their independent self interest, holding that allegations of parallel conduct that could "just as well be independent action" are not sufficient to state a claim. *Id.* at *6, 9.

Plaintiffs in *Starr* alleged that the defendants agreed to fix the price of the music they sold online through joint ventures, pressplay (a joint venture of defendants Sony Corporation and Universal Music Group Recordings) and MusicNet (a joint venture of defendants Bertelsmann, Inc., Warner Music Group, Corp. and EMI). The Second Circuit found that plaintiffs' complaint succeeded where the one in *Twombly* failed because, "taken together," plaintiffs' allegations placed the defendants' 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." *Id.* at *6 (quoting *Twombly*, 550 U.S. at 557).

Some of the factual allegations relied on by the Second Circuit, however, appear to be conclusory, and similar to those rejected by other courts, including the Supreme Court in *Twombly*. For example, the court pointed to plaintiffs' allegation that the defendants agreed to launch joint ventures which charged "unreasonably high prices," and that the defendants did not reduce their prices despite a "dramatic" reduction in costs. *Id.* at *19. It is somewhat surprising that the Second Circuit would rely on such allegations, which appear to be the sort of generic allegations unsupported by specific facts that other courts have rejected as insufficient under *Twombly*. The Second Circuit also pointed to plaintiffs' allegation that the defendants controlled over 80% of digital music sold to end purchasers in the United States, *Id.* at *21, even though the Supreme Court in *Twombly* recognized that, in circumstances where there is such concentration, lawful parallel behavior is common. 550 U.S. at 553-54.

The Second Circuit did not, however, rely on these allegations alone; instead, it found plaintiffs' claim sufficient only when

"viewed in light of" the totality of plaintiffs' allegations, which arguably support a greater inference of collusion than the allegations in *Twombly*. Thus, for example, the Court found significant the fact that the CEO of one of the defendants allegedly said that one of the joint ventures was formed expressly as an effort to stop the "continuing devaluation of music" prices. *Id.* at *22. Moreover, the plaintiffs alleged that an industry commentator said that "no [consumer] in their right mind" would deal with the defendant ventures given their high prices and other restrictions on consumers, which the Second Circuit believed suggested that "some form of agreement among defendants would have been needed to render the enterprises profitable." *Id.* at *6. And all of the defendants allegedly refused to do business with the second largest internet music retailer, whose prices were not as high as the defendant ventures. These allegations distinguish *Starr* from many other Section 1 cases, although they may also provide a roadmap to plaintiffs regarding how to survive a *Twombly* motion in other cases.

Judge Newman issued a concurring opinion in *Starr*, which is noteworthy for his assertion that "it would be a serious mistake to think that the Court [in *Twombly*] has categorically rejected the availability of an inference of an unlawful [S]ection 1 agreement from parallel conduct." *Id.* at 11. He suggested that the mere pleading of parallel conduct will be sufficient to allege a Section 1 agreement in at least some circumstances. The majority of the panel, however, did not appear willing to adopt that standard, which would be inconsistent with decisions of many other federal courts – and arguably inconsistent with *Twombly* itself.

Even as the courts continue to interpret and apply *Twombly* – and some courts like the Second Circuit push back on the standard it adopted – it should also be noted that legislation has been proposed in Congress that would lessen the pleading burden on plaintiffs in all federal cases, including potentially returning to the prior standards under *Conley v. Gibson*. It is

unclear, however, whether Congress will adopt any such legislation.

Application of *Dagher*

The Second Circuit in *Starr* also held that the reasoning in *Texaco Inc. v. Dagher*, 547 U.S. 1 (2006) did not support dismissal of the plaintiffs' complaint. In *Dagher*, the Supreme Court dismissed claims challenging pricing decisions by a joint venture as *per se* unlawful, because – after the formation of the integrated venture – the co-venturers “did not compete with one another in the relevant market,” and were therefore a “single entity” for purposes of the alleged Section 1 claims. *Id.* at 5 – 6. Courts and commentators have generally recognized that characterization of a firm as a “single entity” makes it immune from either *per se* or rule of reason liability, because a single entity's conduct cannot be considered collective under Section 1. Accordingly, many commentators believe that *Dagher's* reasoning suggests that – at least for certain “core” practices – the conduct of joint ventures should be exempt from either a *per se* or rule of reason challenge, although the Court in *Dagher* had specifically addressed only *per se* claims.

The Second Circuit in *Starr*, however, rejected application of *Dagher* to the rule of reason claims at issue in that case, in part because *Dagher* dismissed only *per se* claims. Without saying so expressly, the Second Circuit appeared to reject the argument that *Dagher's* reasoning would also exempt a defendant from scrutiny under the rule of reason. This conclusion by the Second Circuit seems at odds with the generally recognized principle that characterization of a firm as a single entity makes

it immune from either *per se* or rule of reason scrutiny, so that the logic of *Dagher* should apply to both *per se* and rule of reason claims. In all events, the Supreme Court itself may soon clarify the scope of *Dagher*, since, as noted above, the same day that the Second Circuit decided *Starr*, the Supreme Court also heard oral argument in *American Needle v. National Football League*. The parties' arguments in *American Needle* address the circumstances in which joint ventures are single entities exempt from scrutiny under Section 1. The Supreme Court may accordingly take the opportunity to clarify application of *Dagher* to rule of reason claims.

The Second Circuit in *Starr* also held that *Dagher* was inapplicable because the plaintiffs alleged that the venture was merely a “puppet of the defendants,” and that the defendants used the ventures “to facilitate anticompetitive horizontal combinations.” It distinguished this from the situation in *Dagher*, where the plaintiffs did not challenge the existence of the venture. It also noted that the complaint contained allegations of conduct by the defendants outside their involvement in the joint ventures, making *Dagher* inapplicable.

In short, the Second Circuit's decision *Starr* will be relied on by some plaintiffs to attempt to avoid dismissal under *Twombly*, although many defendants will likely be able to distinguish it. And while the *Starr* decision also raises questions about the scope of the Supreme Court's decision in *Dagher*, the Supreme Court itself may clarify that issue soon when it decides the *American Needle* case.

If you have questions about any of these items, please contact your regular Sidley Austin LLP contact.

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