

## Outside Counsel

## Expert Analysis

# 'Twombly' and Parallel Conduct Claims in the Second Circuit

Even while the Supreme Court has clarified through *Ashcroft v. Iqbal* that the plausibility standard established in *Bell Atlantic v. Twombly* governs all civil pleadings subject to Rule 8(a)(2) of the Federal Rules of Civil Procedure, there remains uncertainty about how to apply that standard to antitrust parallel conduct claims, such as those alleged in *Twombly* itself. Nowhere could this uncertainty be more pronounced than within the U.S. Court of Appeals for the Second Circuit where both *Iqbal* and *Twombly* originated.<sup>1</sup>

Parallel conduct cases involve allegations of conspiracy or agreement among competitors in violation of §1 of the Sherman Act based on inferences rather than direct evidence. *Twombly* recounted a history of skepticism toward these claims inasmuch as "parallel conduct or interdependence" is "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>2</sup>

This hesitancy has meant that "[a]n antitrust conspiracy plaintiff with evidence showing nothing beyond parallel conduct is not entitled to a directed verdict" and that "proof of a §1 conspiracy must include evidence tending to exclude the possibility of independent action."<sup>3</sup> In 1986, the Supreme Court announced that the "tending to exclude" requirement also applies to plaintiffs at the summary judgment stage.<sup>4</sup>

*Twombly* presented the "antecedent question of what a plaintiff must plead in order to state a claim under §1 of the Sherman Act."<sup>5</sup> In other words, the Court sought to address the extent to which skepticism about parallel conduct claims factors into a motion to dismiss. The Court "[h]eld that stating such a claim requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made" meaning that showing "plausible grounds to infer an agreement...calls for enough facts to raise a reasonable expectation that discovery will reveal evidence of an illegal agreement."<sup>6</sup> How much factual matter is needed at the motion to dismiss phase, however, remains unclear.

Two recent parallel conduct cases set out a Second Circuit approach to this question that

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reads *Twombly* as establishing a unique standard applicable to motions to dismiss. In *Starr v. Sony*, the Second Circuit reversed the dismissal of a parallel conduct claim and made clear that the factual showing of agreement required on a motion to dismiss is considerably less than that required after discovery.<sup>7</sup> A subsequent Eastern District of New York case, *LaFlamme v. Societe Air France*, granted a *Twombly* dismissal even while relying on *Starr's* interpretation of *Twombly*.<sup>8</sup>

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### 'Context' Is Key

*Starr* concerned price-fixing allegations for digital music sold and distributed online. Defendants comprised 80 percent market share of the digital music market operated through joint ventures and licensing arrangements, allegedly used as vehicles for conspiratorial conduct. The complaint accused defendants of setting prices that were higher than independent labels and that were not reduced even as market costs diminished over time. Plaintiffs also alleged that defendants used most favored nations' clauses and side agreements to execute and conceal anticompetitive conduct.

The district court granted the motion to dismiss on *Twombly* grounds, concluding that plaintiffs had not pled sufficient factual matter "rais[ing] a suggestion of a preceding agreement."<sup>9</sup> Determining that plaintiffs alleged ambiguous circumstances of conspiracy, none of which showed defendants to be acting against independent economic self-

interest, the Court instructed that "*Twombly*... requires that they plead further facts tending to show conspiracy; 'facts' such as these that are just as consistent with independent action are insufficient as a matter of law."<sup>10</sup>

The Second Circuit reversed and held that the "tends to exclude" requirement does not apply at the motion to dismiss phase.<sup>11</sup> It explained that the "enough factual matter" showing on a motion to dismiss is "considerably less" than what is needed for a plaintiff to show after discovery where it must be demonstrated that a defendant's actions "tended to exclude independent self-interested conduct."<sup>12</sup> Rather, the Second Circuit posited, the "enough factual matter" must only demonstrate "a context that raises a suggestion of a preceding agreement."

A concurring opinion, authored by Judge Jon O. Newman, emphasized the "context" concern even more explicitly by stating that the complaint was dismissed in *Twombly* because of "the context in which the defendants' parallel conduct occurred."<sup>13</sup> According to Judge Newman, "the context in which the defendants' alleged parallel conduct occurred, amplified by specific factual allegations making plausible an inference of agreement, suffices to render the allegation of a §1 violation sufficient to withstand a motion to dismiss."<sup>14</sup> Judge Newman's concurrence harkens back to the opinion he authored for the Second Circuit in *Iqbal*. There, Judge Newman interpreted *Twombly* to be prescribing a "flexible" plausibility standard, "which obliges a pleader to amplify a claim with some factual allegations in those contexts where such amplification is needed."<sup>15</sup>

### 'Factually Suggestive'

In the aftermath of *Starr*, the focus on a motion to dismiss is whether the pleaded facts demonstrate context of an agreement even absent showing a defendant's conduct to be contrary to self interest. *LaFlamme* offers the first example of a district court employing this approach.

In *LaFlamme*, plaintiffs alleged that international air carriers conspired to fix fuel surcharges on transatlantic passenger flights. Defendants belonged to a trade association and global alliances where they discussed and agreed upon rates and fares subject to antitrust immunity received from the United States Department of Transportation (DOT). The alleged agreement was a resolution adopted by the defendants as part of trade association activity but one that had

not been approved of by the DOT. Defendants moved to dismiss under *Twombly*. After dismissing claims of direct conspiratorial behavior, the court analyzed the parallel conduct allegations in light of *Starr*.

Based on the majority and Judge Newman's concurrence in *Starr*, *LaFlamme* emphasized that showing "context" on a motion to dismiss does not require alleging facts that tend to exclude "independent self interested conduct as an explanation for defendants' parallel behavior."<sup>16</sup> *LaFlamme* understood *Starr* to mean that *Twombly* instituted a different standard for motions to dismiss, which entails showing a "factually suggestive" context involving some sort of anomalous behavior on the part of the defendants.<sup>17</sup> *LaFlamme* explained that *Twombly* identified the anomalous factual contexts that meet this standard. Excerpting footnote four in *Twombly*, *LaFlamme* wrote:

[T]he *Twombly* court catalogued various factual contexts which would create such an inference of conspiracy including: (i) "parallel behavior that would probably not result from chance, coincidence, independent responses to common stimuli, or mere interdependence unaided by advance understanding among the parties"; (ii) "conduct [that] indicates the sort of restricted freedom of action and sense of obligation that one generally associates with agreement"; and (iii) "complex and historically unprecedented changes in pricing structure made at the very same time by multiple competitors and made for no other discernible reason."<sup>18</sup>

While it was questionable whether defendants' pricing decisions in *LaFlamme* were, in fact, parallel, the court dismissed the claims even assuming parallelism precisely because the behavior did not fall within the scenarios described in *Twombly's* footnote four. The court found: "unlike the examples enumerated in *Twombly*, defendants' purportedly parallel behavior as alleged in the complaint is not of the type that 'would probably not result from... independent responses to common stimuli' nor does defendants' imposition of surcharges comprise 'complex and historically unprecedented changes in pricing structures...made for no other discernible reason.'"<sup>19</sup>

#### 'Twombly's' Footnote Four

Although substantiating a plausible parallel conduct claim on a motion to dismiss may require less of a showing than that needed later in litigation, it is not clear that the scenarios in footnote four of *Twombly* absolve showing that a defendant's conduct tends to exclude the possibility of independent self-interest. Indeed, the sources cited in footnote four do not appear to say as such.

For example, the first scenario in footnote four about parallel conduct "not result[ing] from chance, coincidence, independent responses to common stimuli or mere interdependence unaided by an advance understanding among the parties," comes from Professors Areeda and Hovenkamp's antitrust treatise. The quoted language is actually the definition the treatise ascribes to "unnatural parallelism," for which "it will be necessary to infer from the circumstances that parallel action

depends upon advance communication and understanding."<sup>20</sup>

At one point, the treatise characterizes circumstances of unnatural parallelism as occurring when defendants must act against independent self-interest, stating: "[t]o restate this point in a formulation already explored in ¶1415 (2d), a conspiracy may be inferred if a defendant's action would have been contrary to its independent self-interest in the absence of advance agreement."<sup>21</sup>

Likewise, scenario two is taken from a section of a law review article about parallel conduct that considers ways to infer agreement.<sup>22</sup> After reciting the facts of some well known cases, the article then states the language quoted by footnote four that "such conduct indicates the sort of restricted freedom of action and sense of obligation that one generally associates with agreement."<sup>23</sup> In the very next sentence, the article makes clear that "[i]t is true that in each of these examples, the conduct may be characterized as contrary to the defendants' independent economic interests."<sup>24</sup>

Finally, *Twombly* footnote four identified a third scenario "agree[d]" to by "the parties in th[at] case" concerning "'complex and historically unprecedented changes in pricing structure made at the very same time by multiple competitors, and made for no other discernible reason' would support a plausible inference of conspiracy." This scenario certainly cannot be meant to refer to a "factually suggestive" context of conspiracy that does not concern the "tends to exclude" standard. The cited petitioner's reply brief explicitly stated: "It is easy to point to circumstances that would 'tend to exclude' the possibility of unilateral action. Respondents propose one such example—'complex and historically unprecedented changes in pricing.'"<sup>25</sup>

In short, whether or not the tends to exclude standard applies at the motion to dismiss phase, the sources cited in *Twombly's* footnote four highlight that the footnote itself may not have been intended to address that point. Rather, it seems that footnote four simply identified "examples" of parallel conduct cases that have involved or could involve sufficient allegations of conspiracy without mentioning that these circumstances encompass conduct that was or would be against a defendant's independent self-interest.

The *Twombly* standard for motions to dismiss remains what is written in the text of the opinion itself, that the complaint must contain "enough factual matter (taken as true) to suggest that an agreement was made" which entails alleging "enough facts to raise a reasonable expectation that discovery will reveal evidence of illegal agreement."

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1. *Iqbal*, 129 S. Ct. 1937 (2009) reversed the Second Circuit decision published at 490 F.3d 143 (2d Cir. 2007). *Twombly*, 550 U.S. 544 (2007) reversed the Second Circuit decision published at 425 F.3d 99 (2d Cir. 2005).

2. *Twombly*, 550 U.S. at 554 (quoting 6 P. Areeda & H. Hovenkamp, *Antitrust Law* ¶1433a, p. 236 (2d ed. 2003) (hereinafter *Areeda & Hovenkamp*) ("The courts are nearly unanimous in saying that mere interdependent parallelism does not establish the contract, combination or conspiracy required by Sherman Act §1."))

3. *Twombly*, 550 U.S. at 554 (citing *Theatre Enterprises Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537 (1954) and *Monsanto Co. v. Spray-Rite Services Corp.*, 465 U.S. 752 (1984)).

4. *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

5. *Twombly*, 550 U.S. at 554-55.

6. *Id.* at 556.

7. 592 F.3d 314 (2d Cir. 2010).

8. No. 08 CV-1079 (KAM), 2010 WL 1292262 (EDNY April 5, 2010).

9. *In re Digital Music Antitrust Litigation*, 592 F. Supp.2d 435, 441-42 (SDNY 2008).

10. *Id.* at 445 (citing *Matsushita*, 475 U.S. at 588).

11. *Starr*, 592 F.3d at 321 and 325.

12. *Id.* at 325 (quoting 2 *Areeda & Hovenkamp* §307d1 (3d ed. 2007)).

13. *Id.* at 328 (Newman, J. Concurring) (emphasis in original).

14. Judge Newman justified the need for a concurrence that emphasized the context concern because of his "perplexity" with *Twombly* being read to impede parallel conduct claims. He wrote: "I believe it would be a serious mistake to think that the court has categorically rejected the availability of an inference of an unlawful §1 agreement from parallel conduct." *Id.* at 329.

15. *Iqbal v. Hasty*, 490 F.3d 143, 157-58 (2d Cir. 2007).

16. *LaFlamme* at 11 (quoting *Starr*, 592 F.3d at 325). In making this point, *LaFlamme* itself was not technically accurate when stating that "a plaintiff need not allege facts that fully exclude independent self-interested conduct." The relevant standard and the one that *Starr* declared inapplicable to motions to dismiss is one that tends to exclude independent self-interested conduct.

17. *LaFlamme* at 11.

18. *Id.*

19. *Id.* at 12 (citing *Twombly*, 550 U.S. 557 n.4).

20. *Areeda & Hovenkamp*, ¶1425, at 167-69.

21. *Id.* at 169.

22. Michael D. Blechman, *Conscious Parallelism, Signalling and Facilitating Devices: The Problem of Tacit Collusion Under the Antitrust Laws*, 24 N.Y.L.S. L. Rev. 881 (1979).

23. *Id.* at 899.

24. *Id.*

25. Reply Brief for Petitioners in *Bell Atlantic v. Twombly*, at 12.