UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re DIGITAL MUSIC ANTITRUST LITIGATION	:	MDL Docket No. 1780

DEFENDANTS' JOINT MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS AND TO STRIKE PORTIONS OF PLAINTIFFS' THIRD CONSOLIDATED AMENDED COMPLAINT

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Defendants submit this joint memorandum in support of their motion to dismiss portions of the Third Consolidated Amended Complaint ("TCAC") for failure to state a claim pursuant to Fed. R. Civ. P. 12(b)(6), and to strike portions of the TCAC pursuant to Rule 12(f).[1]

With minor exceptions, this motion already is fully briefed. Defendants previously moved to dismiss the nearly identical Second Consolidated Amended Complaint ("the SCAC") on various grounds and moved to strike the same portions. This Court granted the motion to dismiss, holding that plaintiffs had failed to satisfy the requirements of *Bell Atlantic Corp. v. Twombly*, 550 U.S. 554 (2007), and did not reach the additional grounds or the motion to strike. The Second Circuit subsequently reversed and remanded. On June 2, 2010, plaintiffs filed the TCAC, which is identical to the SCAC except for new material in paragraph 99 and the addition of paragraphs 146-153.

Defendants now renew their motion to dismiss and strike on the same grounds as before, with the exception of the *Twombly* argument, and incorporate by reference the briefs previously filed. *See* Docket Nos. 76, 78, 79, 82, 88, 89, 94, 95, 96, and 97.

Specifically, the grounds being reasserted for dismissal are as follows:

- *Plaintiffs' Claims Through February 1, 2005 Have Already Been Settled and Released*. *See* Docket No. 78 at pp. 17-20.

- *Plaintiffs' Claims Involving the Sale of Compact Discs Cannot Survive. See* Docket No. 78 at pp. 20-24.

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[1] This memorandum is submitted on behalf of all defendants: Bertelsmann, Inc.; Sony Music Entertainment; Sony Corporation of America; EMI Group North America Inc.; Capitol Records, LLC (doing business as EMI Music North America); Capitol-EMI Music, LLC; Virgin Records America, Inc.; Time Warner Inc.; UMG Recordings, Inc.; and Warner Music Group Corp. (collectively, "defendants").

● *Plaintiffs Lack Standing to Assert Claims on Behalf of Residents of Other States. See* Docket No. 78 at pp. 24-27.

● *Plaintiffs Ignore the Specific Pleading Requirements for Many of the State Statutes upon Which They Rely. See* Docket No. 78 at pp. 27-34.

● *Plaintiffs' Unjust Enrichment Claim Is Barred. See* Docket No. 78 at pp. 34-37.

● *Plaintiffs' Extraneous Allegations Must Be Stricken. See* Docket No. 78 at pp. 38-41 (The paragraphs of the SCAC referenced there are identical, in both content and paragraph number, to the paragraphs of the TCAC that defendants are now seeking to have stricken).

● *Plaintiffs' Have Failed to State a Claim Against the Parent Corporations Bertelsmann, Inc., Time Warner Inc., and Sony Corporation of America. See* Docket Nos. 76, 79, and 82.

In addition, defendants now address the new paragraphs 146-153 of the TCAC, which present claims under Illinois and New York law that did not appear in the SCAC. Those claims also should be dismissed, for the reasons described in the pages that follow.

I. Plaintiffs Have Failed to State a Claim for Violation of the Illinois Antitrust Act

A. Legal Standard Under Fed. R. Civ. P. 12(b)(6)

Rule 12(b)(6) of the Federal Rules of Civil Procedure provides that a defendant may move to dismiss a complaint for "failure to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6). "It has long been understood that a defendant may base such a motion on either or both of two grounds: (1) a challenge to the 'sufficiency of the pleading' under Rule 8(a)(2); or (2) a challenge to the legal cognizability of the claim." *Jackson v. Onondaga County*, 549 F. Supp. 2d 204, 211 & nn.15-16 (N.D.N.Y. 2008) (citing cases). This motion challenges

the legal cognizability of Count IV of the TCAC, which fails to state a claim upon which relief can be granted. Fed. R. Civ. P. 12(b)(6).

B. Plaintiffs Lack Standing To Bring A Claim Under the Illinois Antitrust Act, Which Prohibits All Persons Except the State Attorney General From Maintaining Class Actions On Behalf Of Indirect Purchasers

Paragraph 147 of the TCAC purports to amend the definition of "End Purchaser States" (at ¶ 44) to include the state of Illinois, and purports to amend the definition of the "End Purchaser Internet Music Damages" class to include "all persons or entities in Illinois meeting the definition set forth at ¶ 44 hereto." TCAC ¶ 147. Through these amendments, Plaintiffs seek damages on behalf of indirect purchasers for acts that are alleged to violate the Illinois Antitrust Act, 740 Ill. Comp. Stat. § 10/1 *et seq*. TCAC, ¶¶ 148-149. Section 7(2) of that Act, however, expressly bars indirect purchasers from pursuing class actions. 740 Ill. Comp. Stat. § 10/7(2). Accordingly, Plaintiffs lack standing to assert a violation of the Illinois Antitrust Act on behalf of a class of Illinois consumers, and their claims under the Act must be dismissed.

In the wake of the Supreme Court's holding in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), that only direct purchasers may recover antitrust damages under federal law, many states, including Illinois, enacted legislation to permit recovery by indirect purchasers. Accordingly, Section 7(2) of the Act expressly authorizes indirect purchasers to maintain an action for damages under the Act. 740 Ill. Comp. Stat. § 10/7(2) ("No provision of this Act shall deny any person who is an indirect purchaser the right to sue for damages."). At the same time, however, Section 7(2) further provides "that no person shall be authorized to maintain a class action in any court of this State for indirect purchasers asserting claims under this Act, with the sole exception of this State's Attorney General, who may maintain an action parens patriae as provided in this subsection." *Id.*

Both state and federal courts have prohibited indirect purchaser plaintiffs from maintaining class actions based on Section 7(2). *See, e.g.*, *In re Flonase Antitrust Litig.*, No. 08-CV-3301, 2010 U.S. Dist. LEXIS 4707, at *30-31 (E.D. Pa. Jan. 21, 2010) ("[T]he Act does not provide relief to indirect purchasers through class actions."); *Gaebler v. N. M. Potash Corp.*, 285 Ill. App. 3d 542, 544-45, 676 N.E.2d 228, 230 (Ill. App. Ct. 1996) (concluding that indirect purchaser class action was "necessarily precluded by section 7(2) of the Antitrust Act"); *Bobrowicz v. City of Chicago*, 168 Ill. App. 3d 227, 236-37, 522 N.E.2d 663, 669 (Ill. App. Ct. 1988) (affirming dismissal of a indirect purchaser class action suit , holding that "[t]he statute clearly mandates that such an action be brought by the Attorney General"). Plaintiffs' claim under the Illinois Antitrust Act in this action must fail for the same reason.

C. *Shady Grove Orthopedic Associates v. Allstate Insurance Co.* Does Not Allow Plaintiffs to Maintain A Class Action Under the Illinois Antitrust Act

Plaintiffs have asserted, without any analysis, that the Supreme Court's decision in *Shady Grove Orthopedic Associates, P.A. v. Allstate Insurance Co.*, 130 S. Ct. 1431, 176 L.Ed.2d 311 (2010) permits them to allege a claim for violations of the Illinois Antitrust Act on behalf of indirect purchasers. Pls.' Memo. Of Supp. Auth., Docket No. 125, at 6. They are wrong. *Shady Grove* does not permit Plaintiffs to pursue this claim.

In *Shady Grove*, the Supreme Court considered whether a New York law that prohibits class actions in suits seeking penalties or statutory minimum damages precluded a federal district court exercising diversity jurisdiction from entertaining a class action under Fed. R. Civ. P. 23. 103 U.S. at 1436. A majority of the Supreme Court concluded that the plaintiff's suit could proceed as a class action. Nevertheless, the proposition that Rule 23 may be applied "in all jurisdictions, with respect to all claims, regardless of its incidental effect upon state created

rights," *id.* at 1444 (Scalia, J., plurality), failed to command a majority of the Court and therefore is not the law.

Justice Stevens, concurring in part and concurring in the judgment, cast the deciding vote on which the Court's majority depended. He found that the New York law at issue embodied a *procedural* rule that is not part of New York's substantive law and was therefore supplanted by Rule 23. *Id.* at 1448 (Stevens, J., concurring). Under his opinion, "[w]hen a federal rule appears to abridge, enlarge, or modify a substantive right, federal courts must consider whether the rule can reasonably be interpreted to avoid that impermissible result." *Id*. at 1452. "[W]hen such a 'saving' construction is not possible . . . , federal courts cannot apply the rule." *Id*. (citations omitted). Thus, where a state law is *substantive*, as the Illinois Antitrust Act clearly is, its prohibition against class actions remains in force after *Shady Grove*.

1. **Justice Stevens's Concurring Opinion Controls Future Applications of *Shady Grove* Under the "Narrowest Grounds" Test**

Under the "narrowest grounds test," the Supreme Court has held that "[w]hen a fragmented Court decides a case and no single rationale explaining the result enjoys the assent of five Justices, 'the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds . . . .'" *Marks v. United States*, 430 U.S. 188, 193 (1977) (quoting *Gregg v. Georgia*, 428 U.S. 153, 169 n.15 (1976)); *see also Texas v. Brown*, 460 U.S. 730, 737 (1983) (holding that the discussion of a contested issue in a plurality opinion is "not a binding precedent" if it "has never been expressly adopted by a majority of this court"); *DeStefano v. Emergency Housing Group, Inc.*, 247 F.3d 397, 419 (2d Cir. 2001) (following Justice O'Connor's concurring opinion, which was narrower than the plurality because it utilized established legal standards rather than creating a new standard).

The "narrowest grounds" language from *Marks* has been construed by the Second Circuit "as referring to the ground that is most nearly confined to the precise fact situation before the Court, rather than to a ground that states more general rules." *United States v. Martino*, 664 F.2d 860, 872-73 (2d Cir. 1981). The Second Circuit found support for this construction "in the fact that the Supreme Court itself has generally regarded the narrowest ground as the rationale offered in support of the result that would affect or control the fewest cases in the future." *Id.* at 873 (citation and internal quotation marks omitted). Here, Justice Stevens's concurring opinion is "more narrow than the plurality's and therefore constitutes the holding of the Court." *Lurie v. Wittner*, 228 F.3d 113, 130 (2d Cir. 2000).

Shady Grove must thus be confined to the precise fact situation before this Court. Five Justices expressly disagreed with the plurality's categorical application of Rule 23, which would apply that rule in all putative class actions without regard to the substantive or procedural nature or purpose of the affected state law. Justice Stevens's opinion, which specifically concluded that Rule 23 cannot be applied to override a substantive state law that prohibits class actions, thus represents the holding of the Court and governs the application of *Shady Grove* to this case.[2]

2. **Applying Rule 23 To Count IV Would Violate the Rules Enabling Act**

The Supreme Court has long-recognized the principle that federal courts sitting in diversity "apply state substantive law and federal procedural law." *Hanna v. Plumer*, 380 U.S. 460, 465 (1965). The Rules Enabling Act instructs that federal rules cannot "abridge, enlarge or modify any substantive right," 28 U.S.C. § 2072(b), which means that federal rules cannot displace a State's definition of its own rights or remedies. *See Sibbach v. Wilson & Co.*, 312

[2] Indeed, Justice Stevens sided with the dissenting opinion in agreeing that "there are some state procedural rules that federal courts must apply in diversity cases because they function as a part of the State's definition of substantive rights and remedies." *Shady Grove*, 130 S. Ct. at 1448 (Stevens, J., concurring).

U.S. 1, 13-14 (1941) (reasoning that "the phrase 'substantive rights'" embraces only those state rights that are sought to be enforced in the judicial proceedings). Thus, whether a federal rule of procedure displaces state law "turns on whether the state law is actually part of a State's framework of substantive rights or remedies." *Shady Grove*, 130 S. Ct. at 1449 (Stevens, J., concurring) (citations omitted). "[W]ere federal courts to ignore those portions of substantive state law that operate as procedural devices, it could in many instances limit the ways that sovereign States may define their rights and remedies." *Id.* at 1450.

Because the Rules Enabling Act requires that federal rules "not abridge, enlarge or modify any substantive right," 28 U.S.C. § 2072(b), "an application of a federal rule that effectively abridges, enlarges, or modifies a state-created right or remedy violates [the Enabling Act]." *Shady Grove*, 130 S. Ct. at 1451. Under the narrowest holding of *Shady Grove*, which this Court is bound to follow, Rule 23 cannot apply to Count IV because its application would "abridge, enlarge, or modify" the substantive rights and remedies created by the Illinois Antitrust Act, thereby violating the Rules Enabling Act.

The Illinois statute provides "that no person shall be authorized to maintain a class action in any court of this State for indirect purchasers asserting claims under this Act, with the sole exception of this State's Attorney General, who may maintain an action parens patriae as provided in this subsection." 740 Ill. Comp. Stat. § 10/7(2). This state law obviously conflicts with Rule 23, which entitles *any* plaintiff whose suit meets the rule's requirements to pursue a claim as a class action. *Shady Grove*, 130 S. Ct. at 1437. But it is equally clear that the Illinois statute is a substantive law. The same subsection of the Act that confers upon indirect purchasers the right to sue under the Act limits that right to actions brought in their individual capacities. *See* 740 Ill. Comp. Stat. § 10/7(2). The prohibition against private plaintiff class

actions is part and parcel of the substantive rights that the Illinois Legislature established under the Act.

Unlike the New York statute at issue in *Shady Grove*, Section 7(2) applies exclusively to claims brought under the Illinois Antitrust Act, 740 Ill. Comp. Stat. § 10/1 *et seq.*, and does not apply to claims based on federal law or the law of any other State. Justice Stevens deemed the New York law at issue in *Shady Grove* to be procedural because its text "expressly and unambiguously applies not only to claims based on New York law but also to claims based on federal law or the law of any other State." 130 S. Ct. at 1457. By contrast, because Section 7(2) of the Illinois Act directs which "civil actions and remedies are authorized under the Act," this statute plainly constitutes the substantive antitrust law of the State of Illinois and, indeed, is embodied within the right of action itself. It is well established that a state law authorizing a cause of action is substantive in nature. *See, e.g.*, *Cantor Fitzgerald Inc. v. Lutnick*, 313 F.3d 704, 710 (2d Cir. 2002) (holding that state law governing the commencement of a limitations period is "substantive" and must govern in diversity cases); *Tanker Mgmt., Inc. v. Brunson*, 918 F.2d 1524, 1527 (11th Cir. 1990) ("In a diversity action, the court looks to the substantive law which creates the cause of action[.]").

Furthermore, the legislative history of Section 7(2) makes clear that the Illinois Legislature crafted this provision with the intention of granting individual indirect purchasers a right to sue under the Illinois Antitrust Act, but to vest the right to maintain a class action only with the State's Attorney General. 740 Ill. Comp. Stat. § 10/7(2). Prior to the amendment of the Illinois Antitrust Act in 1981 to expressly authorize indirect purchaser suits, indirect purchasers were prohibited from bringing suit under the rule of *Illinois Brick*. This "*Illinois Brick* repealer" statute therefore reflects a conscious policy calibration by the Illinois Legislature to both

authorize and circumscribe the substantive rights of indirect purchasers in view of federal law. The prohibition on consumer class actions asserted by indirect purchasers therefore cannot be understood as merely procedural, as it is "intimately bound up in the scope of a substantive right or remedy." *Shady Grove*, 130 S. Ct. at 1458.

II. Plaintiffs Failed to State a Claim for Violation of New York's Donnelly Act

As discussed in defendants' June 11 response to plaintiffs' submission of supplementary authority (*see* Docket No. 128 at 6), plaintiffs' newly asserted claim under the Donnelly Act, New York's antitrust statute, is also fatally flawed and must be dismissed. Putting aside the Supreme Court's recent decision in *Shady Grove*, courts in this District and beyond have confirmed that "federal antitrust laws preempt the Donnelly Act where the alleged conduct principally affects interstate commerce." *Conergy AG v. MEMC Electronic Materials, Inc.*, 651 F. Supp. 2d 51, 61, n.83 (S.D.N.Y. 2009) (collecting cases); *see also H-Quotient, Inc. v. Knight Trading Group, Inc.*, No. 03 Civ. 5889, 2005 WL 323750, at *4-5 (S.D.N.Y. Feb. 9, 2005) (finding a Donnelly Act claim preempted by federal antitrust law given that plaintiff had not "put forth any specific allegations in its pleadings of impact on intrastate commerce"); *In re Wiring Device Antitrust Litig.*, 498 F. Supp. 79, 82 (E.D.N.Y. 1980) ("Where, as here, all defendants are unquestionably engaged in interstate commerce, those who are damaged from an alleged restraint of trade find a remedy in the federal, not the state, antitrust laws"); *accord Two Queens, Inc. v. Scoza*, 745 N.Y.S. 2d 517, 519 (1st Dep't. 2002) (explaining that "[w]here the conduct complained of principally affects interstate commerce, with little or no impact on local or intrastate commerce, it is clear that Federal antitrust laws operate to preempt the field . . . .").

Plaintiffs cannot deny that the conduct they allege principally affects interstate commerce rather than New York commerce. Nor can plaintiffs escape from their repeated refrain that

defendants' conduct occurred "throughout the United States." TCAC ¶¶ 38, 40, 56-57, 127. Nor can plaintiffs hide from the fact that they fail to allege any nexus or connection between the conduct alleged and the State of New York, or any specific state for that matter. In sum, plaintiffs' newly asserted Donnelly Act claim is preempted by federal antitrust laws and thus must be dismissed.

CONCLUSION

For these reasons, and for the reasons described in the prior briefs, defendants respectfully submit that the Court should grant defendants' joint motion to dismiss in its entirety, with prejudice, and strike the specified portions of the TCAC.

DATED: June 23, 2010

Respectfully submitted,

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