Bell Atlantic Corp. v. Twombly – The Supreme Court Tightens Pleading Standards for Antitrust Conspiracy and Beyond

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INTRODUCTION

On May 21, 2007, the United States Supreme Court issued an important decision pertaining to the pleading standards in an antitrust action under Section 1 of the Sherman Act, 15 U.S.C. § 1. In Bell Atlantic Corp. v. Twombly, No. 05-1126, the Supreme Court reversed the judgment of the Court of Appeals for the Second Circuit, 425 F.3d 99 (2d Cir. 2005), and held in a 7-2 decision that to satisfy the pleading requirements of Rule 8 of the Federal Rules of Civil Procedure, and survive a motion to dismiss pursuant to Rule 12(b)(6) for failure to state a claim upon which relief may be granted in a § 1 case, an allegation of parallel conduct and a bare assertion of an agreement will not suffice. The Court required “plausible grounds to infer an agreement” in violation of Section 1, and determined that stating such “plausible grounds” requires “enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement.”

The decision is likely to have an impact well beyond the antitrust context. The Court took head on what has for decades been the primary formulation of the pleading standard on a motion to dismiss in federal and many state courts. That formulation – as every defense lawyer has seen quoted in innumerable oppositions filed by plaintiffs – is 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.” Conley v. Gibson, 355 U.S. 41, 45-46 (1957). The Supreme Court in Twombly stated that this language has been “questioned, criticized, and explained away long enough,” and that it “is best forgotten as an incomplete, negative gloss on an accepted pleading standard.” Referring to the Dickens character, the Court expressed concern that any other approach allows plaintiffs to pursue cases based on nothing more than “Mr. Micawber’s optimism.” The Court was concerned that parties are subjected to costly discovery, which plaintiffs use both as a lever to increase the settlement value of cases and to seek support for claims even where one has not been pleaded. Twombly should become a significant tool for defendants in combating such tactics.

Section 1 of the Sherman Act prohibits contracts, combinations or conspiracies in restraint of trade or commerce. Because unilateral action cannot violate § 1, a hotly contested issue in § 1 claims is whether the challenged conduct resulted from concerted action – an agreement or conspiracy. If direct evidence of a conspiracy – such as a recorded conversation in the proverbial smoke-filled room – is not available, plaintiffs are required to plead facts from which a conspiracy properly can be inferred.

One way that plaintiffs have attempted in the past to plead concerted action without direct evidence is by alleging parallel conduct, where competitors in an industry have acted in the same or similar fashion. The problem with that approach is that parallel business conduct, where one or more companies adopt the practices of their competitors, does not, standing alone, violate the antitrust laws. Lower courts, such as the district court in Twombly, have therefore held that dismissal is appropriate when a plaintiff fails to plead so-called “plus factors” – facts tending to exclude the possibility that the conduct was the result of lawful activities – when a § 1 claim is based on parallel conduct. In Twombly, however, the Second Circuit held that pleading plus factors is not required under the circumstances of the case.
The proper pleading standard in antitrust actions has taken on critical importance in recent years, as the cost and burden of discovery in such cases can be enormous and can cause significant disruption to the ongoing operations of a business or an industry. Without fully developed factual allegations, this burden may be imposed on defendants who are swept into litigation alleging a widespread – even industry-wide – conspiracy without facts which, if true, would show each defendant’s alleged role in the conspiracy and provide notice of the charges that must be defended.

BACKGROUND

The Twombly case arose in the context of the Telecommunications Act of 1996, which was intended to promote competition in local telephone service markets. The Telecommunications Act required Incumbent Local Exchange Carriers (ILECs) to open local telephone and Internet service, which had been previously provided by government-sanctioned regional monopolies, to competition from Competitive Local Exchange Carriers (CLECs). ILECs, in exchange, were allowed to compete for long-distance service and local telephone service customers in territories traditionally serviced by other ILECs.

Plaintiffs, representatives of a putative class of subscribers of local telephone or high-speed Internet service, alleged that the ILECs violated § 1 by conspiring to thwart efforts of CLECs to enter their respective local telephone markets and by agreeing not to compete with other ILECs to provide local telephone service in each other’s territories. Plaintiffs alleged no facts showing that defendants reached any agreement, but instead alleged parallel conduct by the ILECs.

Specifically, plaintiffs relied primarily on allegations that ILECs were not attempting to expand into each other’s markets, even though the areas they serviced often were not contiguous and were in some instances entirely surrounded by their competitors’ territories. While this conduct could be entirely consistent with unilateral behavior, plaintiffs alleged that defendants’ decisions not to move into adjacent local phone service markets constituted anomalous parallel conduct that would be unlikely in the absence of a conspiracy not to compete, and that the conspiracy was motivated by each ILEC’s desire to maintain a monopoly in its territory. Plaintiffs also pointed to a statement made by the CEO of one of the ILECs that competing in the territory of another ILEC “might be a good way to turn a quick dollar but that doesn’t make it right.”

THE DISTRICT COURT DECISION

The district court dismissed the complaint, concluding that pleading parallel conduct, without pleading plus factors, is insufficient for purposes of Rule 12(b)(6). The district court noted that parallel conduct is often legitimate and therefore does not violate the antitrust laws.

The court also recognized that, under existing precedent, to defeat summary judgment a plaintiff would be required to demonstrate that the parallel conduct resulted from an agreement, and that a plaintiff can satisfy that standard by establishing at least one plus factor tending to exclude independent self-interest as an explanation for defendants’ parallel behavior. The court reasoned that because parallel conduct alone does not violate § 1, plus factors must be pleaded in order to state a substantive element of the claim upon which relief could be granted.

Further, the court reasoned that pleading plus factors is necessary to give defendants notice of plaintiffs’ theory of the conspiracy and enable defendants to defend the claim. The court concluded that plaintiffs failed to state a viable § 1 claim because all businesses are expected, acting on their own, to resist rivals’ efforts to take their customers, and there is nothing suspicious about a company’s decision not to enter a new line of business. The court held that no conspiracy could be inferred from that conduct, and that plaintiffs failed to allege any other facts to support an inference of conspiracy.

THE SECOND CIRCUIT DECISION

The Second Circuit vacated the judgment of the district court, concluding that the district court applied the wrong pleading standard when it required the plaintiffs to plead plus factors and concluded that the plaintiffs’ allegations were sufficient to give the defendants fair notice of the claim and its grounds. The circuit court stated that antitrust claims are not subject to the heightened pleading requirements of Rule 9(b), and that Rule 8 requires only that the complaint contain “a short and plain statement” of the claim showing that the pleader is entitled to relief to provide defendants with fair notice of the basis for the complaint and enable them to answer and prepare for trial.
Although the Second Circuit acknowledged that parallel conduct could just as easily be legitimate unilateral business conduct, it nevertheless held that the inquiry regarding plus factors is limited to the summary judgment stage because plus factors are evidence of conspiracy, and evidence need not be pleaded under Rule 8. The circuit court held that, at the pleading stage, the factual predicate pleaded for a § 1 claim need only include conspiracy among the realm of “plausible possibilities,” and that pleading facts that indicate parallel conduct can state a plausible conspiracy.

The Second Circuit concluded that dismissal under Rule 12(b)(6) required a court to find that there is no set of facts that would permit a plaintiff to demonstrate that the particular parallel conduct asserted was the product of collusion rather than coincidence.

THE SUPREME COURT DECISION

In reversing the Second Circuit, the Supreme Court began its analysis by acknowledging that a showing of parallel business behavior is admissible circumstantial evidence from which an agreement may be inferred. However, it reiterated that such parallel conduct alone is insufficient to establish an agreement or itself constitute a Sherman Act offense, concluding that it is consistent with conspiracy but just as much in line with rational and competitive business strategy unilaterally prompted by common perceptions of the market.

The Court acknowledged that, under Rule 8, a complaint does not need detailed factual allegations, but concluded that a plaintiff’s obligation to provide the “grounds” of his or her “entitle[ment] to relief” requires factual allegations that must be enough to raise a right to relief above the speculative level on the assumption that all of the complaint’s allegations are true.

In the antitrust context, the Court noted that a parallel conduct allegation gets a § 1 complaint close to stating a claim, but without some further factual enhancement it stops short of the line between possibility and plausibility. “Hence, when allegations of parallel conduct are set out in order to make a § 1 claim, they must be placed in a context that raises a suggestion of a preceding agreement, not merely parallel conduct that could just as well be independent action. The need at the pleading stage for allegations plausibly suggesting (not merely consistent with) agreement reflects the threshold requirement of Rule 8(a)(2) . . . .”

This “plausibility requirement” serves the practical purpose of preventing a plaintiff with a largely groundless claim from using costly discovery to increase the settlement value of the case. The Court specifically addressed the expense of discovery in antitrust actions, noting that the potential expense was obvious in the Twombly case where the plaintiffs represented a putative class of at least 90 percent of subscribers of local telephone or high-speed Internet service against the largest telecommunications companies in the country for unspecified instances of antitrust violations that occurred over a seven-year period. The Court was not persuaded by the argument that judicial supervision could limit abuse of the discovery process.

The Court agreed with the district court that plaintiffs’ claim of conspiracy in Twombly was based on parallel conduct, and not an independent allegation of an agreement among ILECs. The Court also agreed that nothing in the complaint suggests that the ILECs’ resistance to CLECs was anything more than “the natural, unilateral reaction of each ILEC intent on keeping its regional dominance.” Also, the Court ruled that the ILECs’ reluctance to enter each other’s markets was not suggestive of conspiracy because there was an alternative explanation, specifically that the ILECs would concentrate on the market segment that they formerly dominated as monopolies, expecting their competitors to do the same thing.

The Court in Twombly was not persuaded by plaintiffs’ argument that its decision would be contrary to Swierkiewicz v. Sorema N.A., 534 U.S. 506 (2002), which held that a “complaint in an employment discrimination lawsuit [need] not contain specific facts establishing a prima facie case of discrimination under the framework set forth in McDonnell Douglas Corp. v. Green, 411 U.S. 792 (1973).” In Swierkiewicz, the Supreme Court reversed on the grounds that the circuit court had impermissibly applied what amounted to a heightened pleading standard by requiring that the plaintiff allege “specific facts” beyond those necessary to state his claim and the grounds showing entitlement to relief. In Twombly, the Court distinguished Swierkiewicz by stating that “we do not require heightened fact pleading of specifics, but only enough facts to state a claim for relief that is plausible on its face. Because the plaintiffs here have not nudged their claims across the line from conceivable to plausible, their complaint must be dismissed.”
The *Twombly* decision criticized the Second Circuit’s reliance on a frequently quoted passage set forth in the seminal case of *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957), which states 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.” The Court concluded that the Second Circuit may have read this passage in isolation in formulating its understanding of the proper pleading standard for a § 1 claim. As Justice Stevens, who was joined in part by Justice Ginsburg, pointed out in dissent, the *Conley* passage has been relied on for 50 years by federal courts and has served as the model for the law in many states. The Court, however, rejected an interpretation of *Conley’s* “no set of facts” language that would permit a complaint to survive a motion to dismiss whenever the pleadings left open the possibility that a plaintiff might later establish some set of undisclosed facts to support recovery. The Court listed criticisms of the “no set of facts” language as a literal pleading standard, and characterized the passage as an “incomplete, negative gloss” of an accepted standard: “once a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint.” The Court stated that the Conley “no set of facts” language “has earned its retirement.”

**IMPACT OF THE DECISION**

By requiring that an antitrust conspiracy complaint must allege facts sufficient to provide “plausible grounds to infer an agreement,” as opposed to mere parallel competitor or industry action, the *Twombly* decision may provide companies swept up in widespread antitrust litigation with a strong basis for seeking dismissal of conclusory pleadings. In addition, because there is no statutory stay of discovery in antitrust litigation while a motion to dismiss is being considered, this decision may provide grounds for more courts to stay discovery pending a decision on a motion to dismiss, so that the burden and substantial expense of antitrust discovery may be avoided, or at least postponed, until it is determined that a complaint is viable. Moreover, because the Supreme Court “retired” the longstanding Conley “no set of facts” standard used by federal courts and many state courts in assessing motions to dismiss generally, the *Twombly* decision may give rise to closer scrutiny of complaints and support efforts to stay or avoid costly discovery in a variety of cases outside of the antitrust context.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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