UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re DIGITAL MUSIC ANTITRUST LITIGATION	:	MDL Docket No. 1780 (LAP)
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DEFENDANT TIME WARNER'S SUPPLEMENTAL MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS PLAINTIFFS' SECOND CONSOLIDATED AMENDED COMPLAINT

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Defendant Time Warner Inc. ("Time Warner") respectfully submits this supplemental memorandum of law in support of Defendants' July 30, 2007 motion to dismiss plaintiffs' Second Consolidated Amended Complaint ("Compl." or "Complaint"), pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. Time Warner is filing this supplemental memorandum in order to emphasize arguments that are unique to it, and which independently require that plaintiffs' claims against Time Warner be dismissed entirely. Time Warner also joins Defendants' July 30, 2007 Joint Memorandum of Law in Support of Motion to Dismiss and to Strike Portions of Plaintiffs' Second Consolidated Amended Complaint (the "Joint Memorandum for Defendants"), which sets forth the grounds on which plaintiffs' claims against all defendants should be dismissed.

PRELIMINARY STATEMENT

The Complaint purports to allege an antitrust conspiracy, among Digital Music wholesalers, to fix and maintain the price of Digital Music. (See, e.g., Compl. ¶¶ 2-4.) It names Time Warner as a defendant. Yet, according to plaintiffs' own allegations, Time Warner is not a Digital Music wholesaler and was not a direct participant in the alleged conspiracy to fix Digital Music prices. (Id. ¶¶ 25-26, 65-72.) Faced with those dispositive facts, and unable to name Time Warner as a defendant based on its own actions, plaintiffs have attempted to manufacture a claim against Time Warner based on allegations related to its former subsidiary, Warner Music Group ("WMG"), and (possibly, although it is unclear if such an allegation is even being made) its current subsidiary, America Online, Inc. ("AOL").

The allegations in the Complaint are insufficient to state a claim against Time Warner as a matter of law. First, plaintiffs cannot impose liability on Time Warner

merely because it was the parent company of WMG, or is currently the parent of AOL. (See infra § I.) Second, even if Time Warner could be held liable for the acts of its current or former subsidiaries, the Complaint fails to state an underlying claim against WMG or AOL. (See infra § II.) Because of those failings (as well as others set forth in the Joint Memorandum for Defendants), plaintiffs' claims against Time Warner must be dismissed in their entirety.

BACKGROUND

Throughout the evolution of plaintiffs' complaint—the full history of which is detailed in the Joint Memorandum for Defendants (at 3-7)—its allegations with respect to Time Warner have been woefully deficient. Plaintiffs' First Consolidated Amended Complaint sought to allege antitrust liability against Time Warner on the basis of only a single paragraph, which referenced the retail sales activities of Time Warner's current subsidiary, AOL. (First Amended Consolidated Complaint ¶ 58 ("Defendant Time Warner sells and has sold Internet Music to consumers directly on its online store AOL Music Now, and sells CDs directly to consumers using AOL Music and through other channels.").)

Pursuant to Case Management Order No. 3, which required defendants to inform plaintiffs of the deficiencies in the First Consolidated Amended Complaint, Time Warner wrote a letter to plaintiffs on May 14, 2007 (the "May 14 Letter") explaining that it could not be held liable based solely on its parent-subsidiary relationship with AOL, and that, in any event, the First Amended Consolidated Complaint failed to state a claim against AOL under the pleading standard set forth by the Second Circuit in its Twombly decision. Those arguments were further strengthened when the United States Supreme Court reversed the Second Circuit, and held that an antitrust complaint must allege, at the

very least, the "specific time, place, [and] person involved in the alleged conspiracies" and that the allegations must contain a "plausible suggestion" of a preceding agreement. Bell Atl. Corp. v. Twombly, 550 U.S. ___, 127 S.Ct. 1955, 1970-71 & n.10 (2007).

On June 13, 2007 plaintiffs filed their Second Amended Consolidated Complaint. Rather than expanding their allegation relating to AOL to address the noted deficiencies, plaintiffs appear to be claiming a new theory of liability for Time Warner—this time, based on its former parent-subsidiary relationship with WMG. Plaintiffs' new theory simply asserts (once again, in a single paragraph) that "Time Warner is liable for antitrust violations of Defendant Warner Music Group ('WMG') from January 1, 1999 to the date it transferred ownership to the WMG Investor Group".[1] (Compl. ¶ 26.) At the same time, the new Complaint retains the same single, passing reference to the sale of Digital Music by AOL (now in ¶ 65).[2] As set forth more fully below, both theories are subject to the same fundamental flaws.

ARGUMENT

As set forth more fully in the Joint Memorandum for Defendants (at 7 – 17), the Supreme Court recently announced that a complaint purporting to assert an antitrust conspiracy must allege "factual matter" sufficient to plausibly suggest the existence of a preceding agreement. Twombly, 127 S.Ct. at 1965-66. In reaching that

[1] Because those WMG-based allegations were not made in the First Amended Consolidated Complaint, Time Warner did not address them in its May 14 Letter.

[2] It is unclear whether plaintiffs are attempting to assert liability against Time Warner based on AOL's retail activities, or how they even would do so, and we have tried to confirm with plaintiffs whether they make that claim. Because plaintiffs have not clarified the significance of the AOL reference remaining in the Complaint, we go on to explain below why any AOL-based claim, if it is asserted here, must fail and should be dismissed.

decision, the Court recognized that the pleading standard set forth in Twombly was needed in antitrust conspiracy cases in large part because "the threat of discovery expense will push cost-conscious defendants to settle even anemic cases before [a decision on the merits can be reached]". Id. at 1967. Thus, the Court reasoned, "it is only by taking care to require allegations that reach the level suggesting conspiracy that we can hope to avoid the potentially enormous expense of discovery in cases with no reasonably founded hope [of marshalling a supportable § 1 claim]". Id. (internal quotation marks omitted). Plaintiffs' attempt to name Time Warner as a defendant in this litigation flies in the face of this fundamental policy. Plaintiffs have alleged no facts against Time Warner directly, but nevertheless seek to make it part of this case in a transparent attempt to use the burden and expense of discovery as leverage to obtain a quick settlement. As set forth below, however, the Complaint falls well short of the pleading standard required by Twombly; indeed, it is precisely the type of "abuse" that the Court's Twombly decision was intended to prevent. Id.

I. PLAINTIFFS FAIL TO STATE A CLAIM AGAINST TIME WARNER BASED ON THE ACTS OF ITS SUBSIDIARIES.

As an initial matter, it is well-settled that a parent corporation generally cannot be held liable for the acts of its subsidiaries. E.g., United States v. Bestfoods, 524 U.S. 51, 61 (1998) ("It is a general principle of corporate law deeply ingrained in our economic and legal system that a parent corporation . . . is not liable for the acts of its subsidiaries." (internal quotation marks omitted)). Indeed, in both New York and Delaware (and elsewhere)[3], a parent corporation cannot be found liable solely because it

[3] Time Warner is incorporated in Delaware, but its principal place of business is New York. Under New York's choice of law rules, the law of the state in which a corporation

owns a subsidiary that is alleged to have committed unlawful acts. Phoenix Canada Oil Co. v. Texaco, Inc., 658 F. Supp. 1061, 1084-85 (D. Del. 1987) (mere fact of ownership "does not make a subsidiary the agent of its parent" for the purposes of assigning liability); Billy v. Consol. Mach. Tool Corp., 51 N.Y.2d 152, 163 (N.Y. 1980) ("[L]iability can never be predicated solely upon the fact of a parent corporation's ownership of a controlling interest in the shares of its subsidiary."); Rosenberg v. Home Box Office, Inc., Slip Op., No. 601924/05 (N.Y. Sup. Ct. Feb. 8, 2006) (attached hereto as Ex. A) (dismissing claims against Time Warner because it could not be held liable for allegedly wrongful acts of its wholly owned subsidiary). Instead, a parent corporation can be liable for the acts of its subsidiaries only when a plaintiff successfully "pierces the corporate veil" by showing (1) that the parent so dominated and controlled the subsidiary that the companies "operated as a single economic entity"; and (2) that an "overall element of injustice or unfairness [was] present". Fletcher v. Atex, Inc., 68 F.3d 1451, 1457 (2d. Cir. 1995) (applying Delaware law).[4]

Plaintiffs do not even attempt to allege facts sufficient to meet that high threshold here with respect to WMG or AOL—namely, that Time Warner exercised

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is incorporated governs questions of parent/subsidiary liability. See Fletcher v. Atex, Inc., 68 F.3d 1451, 1456 (2d Cir. 1995). However, several New York courts have nevertheless applied New York law to the issue. See, e.g., Quinn v. Thomas H. Lee Co., 61 F.Supp.2d 13, 20-21 (S.D.N.Y. 1999) ("The parties do not dispute the application of New York law [to issue of parent/subsidiary liability]."). Because Delaware and New York law are similar, we cite both.

[4] Delaware courts interpret the "injustice or unfairness" element to require a showing of "[f]raud or something like it" before the corporate veil can be pierced. See, e.g., Mobil Oil Corp. v. Linear Films, Inc., 718 F. Supp. 260, 268 (D. Del. 1989). Furthermore, "the fraud or similar injustice [must] be found in the defendants' use of the corporate form". In re Foxmeyer Corp., 290 B.R. 229, 236 (D. Del. 2003) (internal quotation marks omitted). In other words, "[t]he underlying cause of action [alleged in the complaint cannot] supply the necessary fraud or injustice". Mobil Oil, 718 F. Supp. at 268.

complete domination and control over its subsidiaries' day-to-day business activities. Instead, plaintiffs, even after having nearly 12 months to come up with their Consolidated Complaint, base their claims against Time Warner on the single fact that Time Warner used to own WMG (¶ 26). And, if plaintiffs even attempt to assert AOL-based claims against Time Warner, they attempt to do so merely because Time Warner currently owns AOL. Such allegations are plainly deficient as a matter of law. See, e.g., Phoenix Canada Oil, 658 F. Supp. at 1084-85; Billy, 51 N.Y.2d at 163.

Moreover, there is no allegation that the corporate form was used by Time Warner to commit "a fraud or something like it". To the contrary, while the Complaint does purport to allege that WMG participated in a price-fixing conspiracy, plaintiffs have failed to allege that Time Warner directed WMG to become involved with that alleged conspiracy. Instead, plaintiffs specifically allege that WMG acted as an independent entity. (See Compl. ¶¶ 67, 72.) With respect to plaintiffs' AOL-based claims, there are no allegations that AOL engaged in any wrongdoing at all, nor are there any allegations that AOL was a Digital Music wholesaler. In any event, there certainly are no allegations (with respect to WMG or AOL) that the corporate form was used to perpetrate a fraud separate from the alleged price-fixing conspiracy, as is required by Delaware law. See, e.g., Mobil Oil, 718 F. Supp. at 268-69. Plaintiffs' allegations are thus insufficient to hold Time Warner liable for the acts of AOL or WMG.

II. IN ANY EVENT, PLAINTIFFS HAVE FAILED TO STATE AN UNDERLYING CLAIM AGAINST WMG OR AOL.

Even assuming that plaintiffs had alleged facts sufficient to hold Time Warner liable for the acts of its subsidiaries, the Complaint must nevertheless be

dismissed because plaintiffs have failed to state an underlying claim against either WMG or AOL.

For the reasons set forth in the Joint Memorandum for Defendants, which is incorporated herein by reference, plaintiffs have failed to state a claim against WMG. Because the Complaint fails to state, and cannot state, a plausible antitrust conspiracy against WMG, there is no basis for such a claim against Time Warner—even assuming Time Warner could be held liable for WMG's conduct, which it cannot.

Likewise, the Complaint fails to state a claim against AOL. The Complaint is devoid of any allegation that AOL was a participant in the purported antitrust conspiracy—indeed, the Complaint does not even name AOL as a defendant. As noted previously, the Complaint makes only a single passing reference to the fact that AOL sold Digital Music to consumers. (Compl. ¶ 65.) The Supreme Court's Twombly ruling undeniably requires far more than that. See Twombly, 127 S.Ct. at 1965-74.

Finally, even if the Complaint somehow could be read to allege that AOL participated in a conspiracy to fix Digital Music prices, those allegations would still be deficient because such a theory is not "plausible". The gravamen of the Consolidated Complaint is that Digital Music wholesalers engaged in a conspiracy to charge Digital Music retailers higher prices for Digital Music. (See, e.g., Compl. ¶¶ 99-102.) The alleged result was a "wholesale price floor" of 70 cents that retailers, such as AOL, were forced to pay. (Id. ¶ 100.) Indeed, according to plaintiffs' own allegations, AOL was a named target of the wholesalers' alleged price-fixing scheme. (Id. ¶ 86 (according to plaintiffs, the alleged conspirators believed the conspiracy was necessary because "[i]f you allow an AOL . . . to use music to promote [its] own business model . . . [it] can

advantage [itself] on the back of the music industry in a way which continues to devalue music").) It is not plausible that AOL would join such a conspiracy. As a result, plaintiffs have failed to state a claim against AOL. See, e.g., Twombly, 127 S.Ct. at 1965 (stating that "plausible grounds to infer an agreement [to conspire]" must exist).

CONCLUSION

For the foregoing reasons, the Court should dismiss with prejudice plaintiffs' claims against Time Warner for failure to state a claim upon which relief can be granted, pursuant to Fed. R. Civ. P. 12(b)(6).

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