TABLE OF CONTENTS

PAGE

TABLE OF AUTHORITIES

CASES **PAGE**

CASES **PAGE**

CASES **PAGE**

CASES **PAGE**

STATUTES AND RULES **PAGE**

REGULATIONS **PAGE**

TREATISES **PAGE**

JURISDICTIONAL STATEMENT

This is an appeal from the Order and final Judgment of the United States District Court for the Northern District of New York (Honorable David N. Hurd), dated and entered the 29th day of September, 2005, which granted Defendants' motions to dismiss the Complaint (A-296, A-316). The Court dismissed with prejudice the First, Seventh and Eighth causes of action stating federal claims, and dismissed without prejudice the remaining causes of action stating state law claims.

Plaintiffs-Appellants ("Plaintiffs") asserted jurisdiction in the District Court based on 15 U.S.C.A. §§ 15 and 26, 28 U.S.C.A §§ 1331, 1337, 1343 and 1367.

Appellate jurisdiction is based on 28 U.S.C.A. § 1291 in that this appeal is from a final Judgment of the United States District Court for the Northern District of New York that disposed of all claims with respect to all parties.

STATEMENT OF ISSUES

1. Whether the District Court erred in dismissing with prejudice the antitrust claims in Plaintiffs' initial Complaint on the grounds, *inter alia*, that Plaintiffs did not adequately plead a correct relevant market.

2. Whether the District Court erred in dismissing the copyright claims in

Plaintiffs' initial Complaint on the grounds, *inter alia*, that the Court essentially made findings of fact as to the term of a non-exclusive copyright license granted as part of a one-year service contract.

3. Whether the District Court abused its discretion in dismissing Plaintiffs' initial Complaint with prejudice, without granting leave to Plaintiffs to replead.

STATEMENT OF CASE

In their first -- and only -- Complaint, Plaintiffs described an unusual arrangement involving Defendant-Appellee New York State Office of Children and Family Services ("OCFS"), which oversees private foster care agencies ("Private Foster Agencies") in New York State, and Defendant-Appellee Cornell University ("Cornell"). The Complaint alleged that with Cornell's participation, OCFS, by its adverse regulatory actions and threats of detrimental licensing actions, for many years has prevented all the Private Foster Agencies in New York State from contracting with Plaintiffs -- or any other vendors of restraint training -- to train their staff. The Complaint contended that instead, these Private Foster Agencies were and continue to be required -- and even coerced -- by OCFS to use the restraint training program owned and administered by Cornell, to the exclusion of all others.

Plaintiffs asserted claims under the Sherman Act, Sections One and Two, alleging injury to competition in that, as a result of the anticompetitive conduct, Cornell is charging, and OCFS is paying, more than four times the price Cornell charges its other customers for the same training. Plaintiffs also alleged antitrust injury, seeking damages and injunctive relief because they have been prevented from contracting with Private Foster Agencies that sought to use them as their provider of choice of restraint training.

Under New York law, the autonomous Private Foster Agencies have sole responsibility for the administration of their foster care homes, including choosing the training program that will best serve their foster children and staff. OCFS nevertheless engaged in anti-competitive coercion by misusing its regulatory authority to approve the agencies' "restraint policy" (including "plans" for restraint training) *only* if such "policy" included using Cornell's training program.

Defendants below moved to dismiss under Fed. R. Civ. P. 12(b)(6) and successfully persuaded the District Court that the Complaint failed to allege an adequate "relevant market" in which the impact of Defendants' restraint of trade misconduct (under Section One of the Sherman Act) and monopolization activity (under Section Two) could be judged actionable. OCFS and Cornell also sought the protection of antitrust immunity under the state action doctrine, a defense as to

which the Court expressed serious doubt, but did not rule upon.

Even though Defendants agreed that the Complaint "may be broadly and liberally construed to alleged [sic] anticompetitive conduct" (Docket No. 51, p. 15), and that a dismissal without leave to amend is only appropriate "in extraordinary circumstances" (Docket No. 51, p. 10), the District Court dismissed the antitrust claims with prejudice (A-296, A-316).

The Complaint also stated federal copyright claims, alleging that certain New York State agencies and their employees infringed upon Plaintiffs' copyrighted training materials. As to the copyright claims, the District Court engaged in an unusual level of fact-finding in determining the effective term of a written, but non-integrated, agreement. Despite an express expiration date, the Court found no copyright violation by Defendants, notwithstanding allegations of their continued copying of Plaintiffs' copyrighted training materials beyond the expiration date. The District Court dismissed the copyright claims, also with prejudice (A-296, A-316).

The District Court's decision dismissing the antitrust claims in Plaintiffs' Complaint with prejudice under Rule 12(b)(6), on the basis of a perceived inadequacy of the pleaded relevant market, is highly unusual and greatly disfavored. As to the copyright claims, the District Court's interpretation of the

contract at the pleading stage was inconsistent with the very contractual documents presented.

Appellants seek a vacatur of the judgment below, together with a remand to the District Court for the purpose of granting Plaintiffs leave to file an Amended Complaint.

STATEMENT OF FACTS

A. The Allegations in the Complaint (A-25 - A-45)[1]

1. The Plaintiffs

[1] The allegations in the Complaint are admittedly somewhat sparse and, in places, not entirely clear. The Complaint's allegations were supplemented by various documents submitted by Defendants with their motions to dismiss. We freely refer to these supplemental materials and any regulatory material to elaborate on the nature of the Complaint. *See* OCFS's Principal Memo., Docket No. 60, p. 8 (agreeing that public records of an administrative agency may be judicially noticed in connection with a Rule 12(b)(6) motion). *See also Kramer v. Time Warner Inc.*, 937 F.2d 767, 773 (2d Cir. 1991) (permitting factual matters not incorporated in a complaint to be considered on a motion to dismiss under Rule 12(b)(6) if they are proper for judicial notice).

Plaintiff Bruce Chapman ("Chapman") is the president of Plaintiff Handle With Care Behavior Management System, Inc. ("HWC") (¶¶ 3-4).[2] He is the author and copyright owner of a series of manuals and audio visual materials on the topic of crisis intervention, including physical restraint, as well as the owner of all derivative rights associated with the manuals and videos (¶¶ 43-45). Using these materials, Chapman has been involved in providing training in crisis intervention, including physical restraint, since the 1980s (¶¶ 27-28, 50-51).[3] Since approximately 1998, Chapman has providing training through HWC, a corporation of which Chapman is president and sole owner (¶¶ 4, 27-28, 50).[4]

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[2] All "¶" references are to the Complaint, unless otherwise noted.

[3] Chapman is also the holder of a patent for an apparatus and method for safely maintaining a restraining hold on a person. Patent Reg. Nos. 6360749, 6273091.

[4] The Complaint used various phrases for the type of training provided to the Private Foster Agencies, *e.g.*, "use of force program" (¶ 36), "behavior management" (¶ 36), "crisis intervention" (¶ 36) and "restraint training " (¶ 90). The regulations define "physical restraint"

Training in physical restraint techniques is part of general "crisis intervention" training programs (¶¶ 4, 36, 90).

The first Chapman copyright, obtained on June 7, 1984, is for a manual entitled, "Handle with Care - A Revolutionary Approach to Behavior Management" (¶ 44). Derivative works include a performance-based (live) training program, updated manuals and numerous video tapes (¶ 44). Chapman has also copyrighted all significant updates of these materials. Copyright notifications were affixed to all materials (¶¶ 43-45).

In 1997, HWC was hired by Defendant The New York Division for Youth ("DFY") to train the staff of residential facilities for juvenile delinquents in a "safe use of force [restraint] program," including physical restraint techniques (¶¶ 27-28, 50). Although Chapman and HWC were solicited and hired by DFY, the predecessor to OCFS, to provide restraint training to state-owned juvenile

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as "the use of staff to hold a child in order to contain acute physical behavior." 18 N.Y.C.R.R. § 441.17(a)(3). Hereafter, for simplicity, this activity will be denominated as "restraint" or "physical restraint," the training as "restraint training," and a Private Foster Agency's relevant policy as its "restraint policy." Regulations also call for training in methods of reducing or preventing the need for the use of restraint. The combined program of prevention and restraint is sometimes generally called "crisis intervention" (¶ 90).

delinquent facilities, OCFS has prevented Private Foster Agencies in New York State from using HWC -- or any training providers other than Cornell -- to provide restraint training to their staffs (¶¶ 34-38, 71-73, 86-91).

2. The Defendants

The Complaint names three categories of Defendants: (1) several New York State agencies, principally OCFS and DFY, as well as several of their employees (collectively, the "State Defendants" or "OCFS") (¶¶ 5-10); (2) Cornell and several related institutions and entities, as well as several Cornell employees (collectively, the "Cornell Defendants" or "Cornell") (¶¶ 11-19); and (3) Hillside Children's Center, a corporation, and several of its owners and employees (the "Hillside Defendants") (¶¶ 20-22).

DFY, until 1998, was the agency that operated state-owned correctional facilities for juvenile delinquents throughout New York (¶¶ 5, 23-24). Defendant the New York State Department of Social Services ("DSS"), until 1998, was responsible for the approval and regulation of Private Foster Agencies (¶¶ 6, 23). In 1998, both DFY and a portion of DSS were merged into OCFS (¶¶ 7, 23, 31, 82). In 1998, OCFS, a sub-agency of the newly-created New York State Department of Family Assistance, assumed responsibility for overseeing Private

Foster Agencies (¶¶ 7, 23).[5] OCFS also assumed the functions of DFY, which, as noted above, had contracted in 1997 with Chapman to train DFY staff in Chapman's (and HWC's) physical restraint program (¶¶ 7, 23, 50, 82). As DFY's successor, OCFS continued to use and copy copyrighted materials created by Chapman even after the contract expired (¶ 46-47, 50-53).

In the 1980s, Cornell also developed a restraint training program, calling it "Therapeutic Crisis Intervention" ("TCI") (¶¶ 35, 87; A-48, A-124). Like Chapman's and HWC's program, TCI includes training in physical restraint (¶¶ 35, 87, 90; A-95 - A-102, A-124 - A-136). The TCI program is owned by Cornell; however, OCFS has an unlimited right to use Cornell's program and materials to train staff of Private Foster Agencies within New York State (¶¶ 35, 87, 90; Docket No. 51, p. 4). Cornell, with Defendant The New York State College of Human Ecology at Cornell University ("CHE"), markets the TCI program in New York State and elsewhere (¶¶ 91-92).

[5] The Complaint used various terms for these "private foster agencies," such as "child care providers" (¶ 23), "private child care providers" (¶ 31) and "residential treatment centers" (¶ 83). They are defined by statute and regulation as "voluntary authorized agencies." N.Y. Soc. Serv. Law § 371(10)(a) and (c). For simplicity, they are herein referred to as Private Foster Agencies.

3. HWC's 1997 Agreement with DFY

Part of DFY's responsibilities for the care of juvenile delinquents in state custody included training its staff in techniques to physically restrain juveniles under appropriate circumstances, such as when a juvenile posed a threat to his own safety, other juveniles or DFY staff (¶ 24). DFY also created a "use of force policy" governing when physical restraint could be used (¶ 25).

Between 1994 and 1996, serious mental and physical injuries -- including two deaths -- resulted from the use of physical restraint by DFY staff (¶¶ 26, 58; Docket No. 67, pp. 4-5). Thereafter, in 1997, upon examining the merits and success of HWC's training program, DFY retained HWC to train DFY staff in HWC's proprietary program, including physical restraint techniques (¶¶ 27, 50, 59).[6]

As part of this 1997 agreement, HWC trained DFY staff and also licensed DFY to use and reproduce HWC's copyrighted training materials, so that HWC-trained and HWC-certified DFY staff members could, in turn, train other

[6] DFY had previously hired Chapman to provide similar restraint training for DFY in 1987 (A-158 - A-162). Chapman was the sole proprietor of his training business, which by 1997 did business under the name "Handle With Care" (A-178). HWC was incorporated in 1998, and most of Chapman's intellectual property was subsequently transferred or licensed to HWC.

DFY staff in HWC's restraint program (¶¶ 28, 50-52). Pursuant to this agreement, in April 1997, Chapman provided twelve days of training to DFY staff, including training and certifying staff members as instructors in HWC's restraint program, and also provided written and audio visual materials (¶¶ 50-52). The 1997 agreement had an initial term of four months, with an option to extend for two additional four-month periods, totaling a one year period in all (¶¶ 28, 51-52, 61-63, 66). Furthermore, each DFY staff member trained in HWC's restraint program acknowledged in writing that the staff member was only permitted to train others in HWC's program during the pendency of that one-year period (¶¶ 61-63; A-181).

Notwithstanding the above-described terms of the parties' agreement, after the one-year period ended in 1998, DFY -- now OCFS -- "misappropriated HWC's property, program and techniques" by continuing to copy HWC's materials and train in HWC's program (¶¶ 29-30, 46-47, 53-54).

4. The Autonomy of the Private Foster Agencies and OCFS's Regulatory Oversight

Statutes and regulations governing Private Foster Agencies[7] afford

[7] Pursuant to both New York Social Service Law ("NY-SSL") §§ 371(10)(a) and (c) and 18 N.Y.C.R.R. § 441.2(b), "Voluntary Authorized Agency" means "any agency, association, corporation, institution, society or other organization which is incorporated or organized under the laws of New York with corporate power or empowered by law to care for, to place or to board out children." Such Agencies, referred to as Private Foster Agencies herein, are approved and supervised by OCFS. NY-SSL § 462; 18 N.Y.C.R.R. §§ 477.4, 482.3. *See generally* 18 N.Y.C.R.R. Ch. II, sub. C. Any private corporation that includes as one of its corporate purposes

such agencies a substantial amount of autonomy. N.Y. Soc. Serv. Law ("NY-SSL") § 460-a; 18 NYCRR §§ 441.3, 482.3. As for the sensitive area of restraint policy and related training, OCFS merely requires that Private Foster Agencies submit their restraint policies to OCFS for approval (¶¶ 82-84). 18 N.Y.C.R.R. § 441.17.

Regulations mandate that the "board of directors or other governing board" of a Private Foster Agency "shall manage the affairs of such agency in accordance with applicable [law]." 18 N.Y.C.R.R. § 441.3(a)(1). The Agency's "chief executive officer" ("CEO") shall "be responsible to the governing board for the proper administration of the agency . . .." 18 N.Y.C.R.R. § 441.3(a)(4)(i). Ultimately, it is the board of the Private Foster Agency that is expressly charged with "assur[ing] the proper care of children for whom such agency is responsible." 18 N.Y.C.R.R. § 441.3(a)(4)(iii). The responsibilities of the CEO of the agency -- that is, *not* OCFS -- include the duty to "direct, evaluate and coordinate all aspects of an agency's program," including "staff development *and training.*" 18 N.Y.C.R.R. § 441.3(c)(1)(emphasis added).

OCFS is required, *inter alia*, to ensure that the staff of Private Foster Agencies receives training in "safety and security procedures . . . [and] techniques

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providing foster care must obtain written approval by OCFS before filing its certificate of incorporation. NY-SSL § 460-a; 18 N.Y.C.R.R. §§ 477.1, 477.4.

of . . . child management including crisis intervention . . .." NY-SSL § 462. As noted, OCFS has promulgated regulations with respect to the duration and nature of such training. 18 N.Y.C.R.R. § 441.17(h). A Private Foster Agency, in order to use any physical restraint on a child in its care, must first submit its restraint policy to OCFS, including its plan for training its staff in the use of restraint. 18 N.Y.C.R.R. § 441.17(c)-(d)(4)(i)-(ii). Each member of the agency's staff who is involved in the use of restraint must complete a minimum amount of training "in the agency's policy" on several subjects, including "methods of applying restraint and the rules which must be observed in so doing." 18 N.Y.C.R.R. § 441.17(h)(1)(iv).

There is no provision of law requiring -- or even permitting -- OCFS to ***mandate*** the use by Private Foster Agencies of any particular source of training, including outside vendors of restraint training.

5. OCFS's Anticompetitive Actions Regarding the Restraint Policies of Private Foster Agencies

In 1998, OCFS assumed responsibility for the supervision of Private Foster Agencies in New York State (¶¶ 31, 82). However, without regulatory authority to manage the affairs of the Private Foster Agencies beyond mere approval authority pursuant to 18 N.Y.C.R.R. § 441.17(c), OCFS, with the "participation" of Cornell, has "systematically refus[ed]" to allow the Agencies to select their own restraint training vendors (¶¶ 34, 86, 88-90). OCFS's compulsion

of Private Foster Agencies to use Cornell's TCI program is described as "illegal" in the Complaint because it gives Cornell and OCFS a "monopoly situation within the State of New York" by disallowing Private Foster Agencies the freedom to contract with HWC or any other vendor of restraint training (¶¶ 36, 38, 90).[8]

OCFS has, under the threat of adverse regulatory and licensing actions, compelled all Private Foster Agencies within New York State to use only Cornell's TCI program (¶¶ 88-89), and, accordingly, to engage in a concerted refusal to deal with HWC or other vendors of restraint training (¶¶ 70-74, 90). As a result, Private Foster Agencies expressing an interest in using HWC's (and others') programs were coerced by OCFS into *not* using HWC (¶¶ 71-73).

OCFS has also indicated directly *to HWC* that OCFS would *simply not permit* HWC (or any vendor other than Cornell) to provide restraint training to the Private Foster Agencies (¶¶ 73, 88, 89; Complaint in *Qui Tam* action, described in note 9, *infra*, ¶¶ 111-120). Specifically, OCFS reminded HWC that, although Private Foster Agencies are free to negotiate with HWC for training programs, OCFS would ultimately refuse to approve any such arrangement pursuant to

[8] Counsel concedes that the Complaint, which was not prepared by undersigned counsel, was not terribly detailed nor articulate, particularly in delineating the various theories of liability under Sherman Act §§ 1 and 2.

nothing more than the self-styled mandate of 18 N.Y.C.R.R. § 441.17(c), which provides that "an authorized agency shall not use any method of restraint unless it has submitted its restraint policy to [OCFS] and such policy has been approved in writing by [OCFS]" (¶¶ 84, 86, 88).

Put another way, OCFS has created an environment whereby foster care agencies "*can only use TCI as their use of force training provider or risk their license and ability to do business within the State of New York*" (¶ 88; emphasis added). In the face of regulations that give Private Foster Agencies the right to select their own restraint training provider (18 N.Y.C.R.R. § 441.3(c)(1)), OCFS has even "told [Private Foster Agencies] that the only approved restraint training vendor is TCI" and that the Agencies "can not contract with [HWC] *or any other restraint trainer vendor* for services or risk their license and ability to do business within the State of New York" (¶ 89; emphasis added). OCFS's actions, in conjunction with Cornell and CHE, have indeed created a "monopoly control" over the restraint training services provided to and purchased by Private Foster Agencies in New York State (¶ 90).

Plaintiffs' Complaint specifically alleges that some Private Foster Agencies have been rebuffed by OCFS in their efforts to contract with HWC and vendors of restraint training other than Cornell (¶¶ 71-72, 89; Complaint in *Qui*

Tam action, described in note 9, *infra*, ¶ 117). The anti-competitive effect of this activity on this market (in which Private Foster Agencies in New York select restraint training vendors) is not illusory (¶¶ 89-90). The Complaint alleges that this improper arrangement between OCFS and Cornell has enabled Cornell to bill New York State over four times the amount Cornell charges its non-New York State clients for the ***same TCI training*** (¶¶ 40, 91-92).[9] This arrangement has also suppressed quality competition, as well as price competition (A-174 - A-176; A-253 - A-257; http://www.aichhorn.org/aichhome2.html).

6. The Copyright Infringement

Plaintiffs gave notice to OCFS that its activities constitute copyright

[9] Most of this excessive cost has not been paid by New York State, but by the United States ("the Government"). *See* Amended Complaint in *United States of America ex rel. Chapman v. Cornell University, et al.*, 1:04-CV-1505 (N.D.N.Y. 2005), brought under the *qui tam* provisions of the False Claims Act, 31 U.S.C.A. §§ 3729 *et seq*. The principal allegations of the *Qui Tam* action, which is brought solely in favor of the Government, are that Cornell and OCFS submitted false claims by, *inter alia*, improperly obtaining reimbursement for the costs of TCI training under Title IV-E of the Social Security Act, and also violated federal regulations requiring adherence to competitive pricing requirements for using outside vendors such as Cornell. The *Qui Tam* action and the Complaint under review in this appeal involve different plaintiffs, different claims and different damages.

infringement (¶¶ 47, 67-68). Nevertheless, OCFS has continued, without license, assignment or permission, to reproduce Plaintiffs' copyrighted materials without compensating Plaintiffs (¶¶ 48, 53-54). Specifically, DFY -- now OCFS -- has continued to reproduce Plaintiffs' written and audio visual materials, provided pursuant to the contract the parties entered into in 1997 and which expired in 1998 (¶¶ 53-54).

B. The Motions to Dismiss[10]

1. Antitrust

OCFS asserted that the antitrust claims are "facially deficient" in that the Complaint fails to plead "antitrust standing" and "antitrust injury" (Docket No. 60, p. 14). OCFS also claimed that Plaintiffs did not "properly" plead the existence of an antitrust conspiracy (*Id.*). As is typical in antitrust cases, Defendants also claimed that the only possible relevant market in which the alleged misconduct is to be judged is large -- even international -- and that, therefore, the Complaint does not sufficiently allege injury to competition (Docket No. 60, pp. 6-7). OCFS made this argument by referring to, and unfairly melding, different paragraphs of the Complaint -- some directed at defining the market at issue, and others at setting forth the impact of the antitrust misconduct on interstate

[10] As Plaintiffs' state law claims were dismissed without prejudice (A-315; A-317), this

commerce (¶¶ 38, 74, 93 and 95).

Focusing on the allegation of joint activity as a basis for liability under Section One of the Sherman Act, OCFS next claimed that there were insufficient facts alleged to plead a conspiracy or joint activity in violation of Section One (Docket No. 60, p. 14).

Cornell emphasized, notwithstanding its submission of extensive factual material, that its motion for dismissal "relies exclusively on the legal insufficiency of plaintiffs' complaint . . ." (Docket No. 51, p. 10). Cornell also properly, and importantly, recognized that dismissal of complaints *without leave to amend* should only take place "in extraordinary circumstances . . ." (Docket No. 51, p. 10). Cornell even tellingly suggested that the Complaint "may be broadly and liberally construed to alleged [sic] anticompetitive conduct by the Cornell defendants . . ." (Docket No. 51, p. 15).

2. <u>Immunity</u>

OCFS and Cornell claimed "state action immunity," with the State acting pursuant to a "clearly articulated and affirmatively expressed state policy" (Docket No. 51, p. 15; Docket No. 60, p. 23). Interestingly, while OCFS claimed that it could not divine the market for "crisis intervention services," it had little

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section of the brief only addresses Defendants' motions to dismiss the federal claims.

problem articulating exactly what its activities were in this "market," insofar as necessary to assert its immunity claim: "In exercising its governmental functions, OCFS requires that private child care providers and residential treatment centers submit for OCFS' [*sic*] approval their use of force policies when those private child care providers and residential treatment centers initially apply for licenses, and every two years thereafter" (Docket No. 60, p. 23).

Cornell, though admittedly a private university (A-47 - A-48), also claimed state action immunity, alleging that this immunity doctrine extends to it because of "active state supervision of TCI and the other programs as regards their budgeting, staffing, and training curriculum" (Docket No. 51, pp. 13-15).[11]

3. <u>Copyright</u>

In its challenge to Plaintiffs' copyright claims, OCFS submitted an affidavit by its counsel, Douglas S. Goglia, Esq., annexing agreements and correspondence from OCFS and DFY (A-155 - A-181; Goglia Aff., Exs. A-E).

Cornell likewise appended as exhibits to the Affirmation of its counsel, Nelson E. Roth, Esq., factual materials relating to the origins of Cornell's TCI program, even going so far as to create a comparison chart with aspects of HWC's

[11] Cornell submitted a 1994 "Memorandum of Agreement" ("MOA") between Cornell and OCFS, contending that it was thereby cloaked in state action immunity by virtue of its "relationship" with OCFS (A-141 - A-154).

1984 "Behavior Management System Manual" (A-46 - A-154 ; Roth Aff., Exhibits A-F).

C. The Decision Below

Oral argument took place on February 25, 2005 (A-264 - A-295), and on September 29, 2005, the District Court issued a memorandum decision and order, reported at 227 F.R.D. 175 (N.D.N.Y. 2005) (A-296 - A-315).

The Court accepted that Plaintiffs alleged violations of both Sections One and Two of the Sherman Act, including restraint of trade, monopolization and conspiracy to monopolize (A-299).

In analyzing the Complaint, the District Court made the following observations:

> This action was prompted in part by an apparent policy change at OCFS wherein OCFS now *refuses to allow agencies to submit use of force policies other than the policy promulgated by TCI*. *Id.* at ¶¶ 34, 36. This policy change, allegedly attributable to OCFS, Cornell, the College and TCI, "insure[s] that the State's program *has exclusive access to the market*." *Id.* at ¶ 73. "OCFS has created an environment whereby private child care providers *can only use TCI as their use of force training provider* or risk their license and ability to do business within the State of New York." *Id.* at ¶ 88. This *precludes plaintiffs and other vendors from the marketplace* and creates a TCI monopoly in providing child restraint training services. *Id.* at ¶ 90.

(A-302 - A-303; emphasis added).

> Later in the decision, the Court wrote:
>
> > In short, plaintiffs allege that the Cornell defendants developed the TCI program which the state defendants *require child care providers* to purchase. Thus, these defendants have participated or acquiesced in a plan whereby TCI obtained a monopoly over the right to train private child care providers in New York State. (Complaint at ¶ 95.)

(A-306; emphasis added).

> For purposes of the motion, the Court also
>
> > presumed that *OCFS refuses to grant approval of physical restraint programs other than TCI. OCFS* therefore effectively *exercises the child care providers' market choice in service providers*.

(A-312; emphasis added).

Notwithstanding the District Court's own above-quoted references to *collective conduct* by Defendants and "preclu[sion of] plaintiffs and other vendors *from the marketplace*" (A-303; emphasis added), as well as the fact that the Private Foster Agencies are the purchasers (*i.e.*, the "*child care providers' market choice*" (A-312; emphasis added)), the District Court nevertheless characterized the entirety of Plaintiffs' antitrust allegations as only setting forth "illegal exclusive contracting"

by OCFS (A-312).[12]

[12] Thus, the Court also found that "the product market has been defined [by Plaintiffs] to include only the purchases of OCFS" (A-312). And, still elsewhere, wrote that "[a]ny anticompetitive effect resulting from allegedly biased purchasing decisions in the market must reflect the total demand for restraint services as a whole, *not just OCFS's demand*" (A-313).

Thus, although Plaintiffs alleged a market consisting of supplying restraint training to New York Private Foster Agencies (called "providers" in the Court's decision (A-312)), the Court focused only on *OCFS* as the buyer, not the Private Foster Agencies. For example, the Court concluded that Plaintiffs' market definition "is not a proper antitrust market as it is defined in terms of *the purchase(s) of a single -buyer, OCFS*" (A-312; emphasis added).[13] Elsewhere, the Court again characterized the market impacted by the alleged misconduct as "*the purchases of OCFS*" (A-313; emphasis added). Still elsewhere, the Court, again viewing OCFS as a "purchaser," wrote that "OCFS, as a participant or consumer in the restraint services market, has simply entered into an *exclusive contract* with Cornell defendants" (A-313; emphasis added). Furthermore, the Court referred to *OCFS* (*i.e.*, not the Private Foster Agencies) as a "consumer in the restraint services market" (A-313) and stated that "the product market has been defined to include only the *purchases of OCFS*" (A-313; emphasis added).

The Court made the above findings despite the Complaint's allegations that the Private Foster Agencies are the buyers of restraint training, not OCFS itself (¶ 88-89). OCFS regulations confirm this. 18 N.Y.C.R.R. § 441.3(c).

[13] The Court relied on an extemporaneous statement made by Plaintiffs' then counsel during oral argument to the effect that the market was "the OCFS market" (A-313).

Indeed, the District Court was obviously struggling with the difficult challenge of identifying the market because it relied, in the section of the opinion discussing the relevant *geographic* market, on Plaintiffs' own description of Private Foster Agencies as the real "consumers of training services" (A-314), finding too "constrained" Plaintiffs' definition of the geographic market as "child care providers [in New York State]" (A-314) (meaning New York Private Foster Agencies).[14] Elsewhere, however, the Court itself described the market as consisting of "OCFS child care providers" (A-313).

With respect to the Defendants' state action immunity defense, the Court held:

> In the instant case, it is not necessary to delve into the complex and murky analysis of whether or not the state exercises sufficient control over the agency for it to be deemed an arm of the state or the intended scope of the legislative regulatory authority conferred on agency.

(A-309; footnotes omitted).

Judge Hurd dismissed all of Plaintiffs' federal claims with prejudice, dismissed the state law claims without prejudice, and ordered immediate entry of

[14] One source of confusion, even for counsel, has been that while DFY directly "operates" juvenile detention facilities, OCFS only "supervises" Private Foster Agencies in their provision of foster care (A-300).

judgment (A-315). This appeal ensued.

SUMMARY OF ARGUMENT

The essence of Plaintiffs' Sherman Act Section One claims is that Cornell and OCFS have combined to force all the Private Foster Agencies in New York to refuse to deal with any restraint training providers except Cornell, thus excluding all vendors of restraint training from the market of the Agencies, as buyers of restraint training (¶¶ 71, 88-90). Furthermore, the anticompetitive conduct of Cornell and OCFS also essentially falls into the category of actions forbidden by Section Two, including a conspiracy to monopolize and monopolization.

While Plaintiffs readily concede that their initial Complaint was not a model of clarity and was even unartful, it nevertheless gave sufficient notice of serious violations of the antitrust laws by Cornell and OCFS to withstand a motion to dismiss. And it most certainly did so in sufficient detail to avoid a dismissal with prejudice. Indeed, "construed as a whole," *Linens of Europe, Inc. v. Best Manufacturing, Inc.*, 2004 WL 2071689 (S.D.N.Y. Sep. 16, 2004), citing *Yoder v. Orthomolecular Nutrition Institute Inc.*, 751 F.2d 555, 562 (2d Cir. 1985), the Complaint adequately put the Defendants on notice of their antitrust claims.

There is no heightened pleading requirement for antitrust complaints. *Twombly v. Bell Atlantic Corp.*, 425 F.3d 99, 107 (2d Cir. 2005). Moreover, the decision below bears similarity to the dismissal with prejudice (but of an already-amended complaint) in *Discon Inc. v. Nynex Corp.,* 93 F.3d 1055, 1059 (2d Cir. 1996), *reversed on other grounds, Nynex Corp. v. Discon, Inc.,* 525 U.S. 128, 119 S.Ct. 493 (1998), where the Second Circuit held, "In this case, we believe that the District Court may have been misled by a poorly drafted complaint into categorizing the arrangement as one that is presumptively legal."[15]

ARGUMENT

POINT I

THE COMPLAINT SUFFICIENTLY GAVE NOTICE OF ALLEGED VIOLATIONS OF SECTION ONE OF

[15] The Second Circuit in *Discon* proceeded to find that the complaint, even though already once amended and then dismissed with prejudice, "states a cause of action under Section One of the Sherman Act, though under a *different legal theory than the one articulated by Discon*." 93 F.3d at 1059 (emphasis added). Although the Second Circuit was reversed on its substantive ruling regarding antitrust liability, the Supreme Court did not question this Court's duty to analyze antitrust complaints such that they may "properly be understood to allege arrangements that might be shown to be unlawful . . .." *Id*.

THE SHERMAN ACT

This Court:

> review[s] *de novo* the dismissal of a complaint for failure to state a claim, accepting as true all facts alleged in the complaint and drawing all inferences in favor of the plaintiff. *Todd v. Exxon Corp.*, 275 F.3d 191, 197 (2d Cir. 2001). "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.'" *Id.* at 197-98 (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957)). "At the pleading stage . . . the issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Eternity Global Master Fund Ltd. v. Morgan Guar. Trust Co. of N.Y.*, 375 F.3d 168, 177 (2d Cir. 2004) (citation, brackets, and internal quotation marks omitted).

Twombly, *supra*, 425 F.3d at 106.

At the outset, we emphasize that the District Court misread Plaintiffs' relevant market allegations and engaged in an analysis that both misapprehended the relationship among Defendants, Plaintiffs (and other vendors of restraint training) and Private Foster Agencies. Therefore, the dismissal, at the pleading stage, was premature. The District Court did not even appreciate the allegations of the Complaint insofar as they characterized the Private Foster Agencies as the buyers (¶¶ 38, 71, 72, 89) -- not OCFS. As the District Court grounded its dismissal solely on its relevant market analysis, we begin with a review of that

subject.

A. Relevant Market

The Complaint alleges that the relevant market is "training services to New York State child care providers" (called "Private Foster Agencies" herein) (¶¶ 90, 91, 95). The District Court rejected this market definition, stating that "the agreement must be evaluated in terms of the restraint services market as a whole" (A-313). The District Court elaborated on this by stating:

> The market for physical restraint programs includes social service agencies, law enforcement agencies, correctional facilities, educational institutions, and even airlines. Some portion of the program consists of behavior management techniques which may or may not be distinguishable from use of force techniques. It is also apparent that the restraint techniques are not strictly applicable to children.

(A-313).

In essence, the District Court found that the relevant market alleged was "under-inclusive." *See Todd v. Exxon*, 275 F. 3d 191, 202-207 (2nd Cir. 2001). *Todd*, however, makes clear that a motion to dismiss should not be granted where the market alleged is "plausible." 275 F.3d at 195, 203. Judge Baer recently

reaffirmed *Todd*'s mandate:

> To survive a motion to dismiss, a plaintiff need only allege a "plausible" market. *Hack v. President and Fellows of Yale Coll.*, 237 F.3d 81, 86 (2d Cir. 2000) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962)).

New York Jets LLC v. Cablevision Sys. Corp., 2005 U.S. Dist. LEXIS 23763, 2005 WL 2649330, *5 (S.D.N.Y. Oct. 17, 2005). The District Court below made no mention of *Todd* or *Jets* in its opinion and has ignored their teachings.

The market alleged in the Complaint -- "training services to New York State child care providers" (¶¶ 88-90) -- is not an implausible relevant market. It is evident that the New York-licensed Private Foster Agencies, as buyers of restraint training services, have requirements and strictures that are different from other participants in some larger "restraint training market" (¶¶ 82-84, 89, 91-92).

Indeed, this is clear from the regulatory regime itself. On the *sellers' side* of the alleged relevant market, *i.e.*, those entities that wish to fulfill the Private Foster Agencies' need for obtaining restraint training for their staffs, OCFS has an "approval" role: it must approve the restraint policy of each Private Foster Agency, including its selection of a vendor of this restraint training. 18 N.Y.C.R.R. § 441.17. *See also* "Statement of Facts," *supra*, Point A.4. (As alleged, of course, instead of approving each Agency's restraint policy on the merits, OCFS has chosen

to *insist* that each Private Foster Agency choose only Cornell as its restraint trainer, thus making its "approval" role an improper "mandatory selection" role (¶¶ 86, 88-89).)

However, OCFS's role and, in effect, power over the market for this training, does not end with its authority to *de facto* select the training vendor. For on the *buyers' side* of the relevant market, OCFS also plays an important role: it approves the very existence of a Private Foster Agency. First, as to a new agency, OCFS, as a pre-condition to the Agency's filing its very certificate of incorporation -- its "birth certificate," as it were -- must "approve" the Private Foster Agency as a candidate to provide this social service. NY-SSL § 460-a. *See also* "Statement of Facts," *supra*, Point A.4. Second, OCFS has ongoing authority to visit, inspect and supervise the Private Foster Agencies. *E.g.*, 18 N.Y.C.R.R. § 441.2(b). Moreover, Private Foster Agencies are limited to New York corporations or associations. *Id.* *See also* NY-SSL § 460-a.[16]

[16] These aspects of the regulatory environment depict the geographic market as well.

Few cases under the Sherman Act deal with such a regulatory regime that so strongly affects both sides of a market, here the market for the service of providing restraint training to Private Foster Agencies in New York State. The regulatory strictures described above, as far as is known, are unique to these Private Foster Agencies (¶¶ 82-84, 89, 91-92). And the definition of the relevant market should reflect that uniqueness. *See Lockheed Martin Corp. v. Boeing Co.*, 390 F. Supp.2d 1073, 1079 n.6 (D. Fla. 2005) (noting that "regulatory barriers" bolster a relevant market finding). *Accord United States v. Rockford Memorial Corp*., 717 F. Supp. 1251, 1281 (D. Ill. 1990), *aff'd* 898 F.2d 1278 (7th Cir. 1990) (finding that regulatory barriers to entry were significant factors in defining the relevant market).[17]

Thus, the potential purchasers of the training here at issue are the variety of Private Foster Agencies (¶¶ 38, 70, 89) -- and not OCFS itself, as the Court below concluded: "This is not a proper antitrust market as it is defined in terms of the purchase(s) of a single -buyer, OCFS" (A-312). The fact that OCFS participated in the conspiracy does not render it the sole purchaser, as the Court concluded.

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[17] "To the extent that regulation limits substitution, it may define the extent of the market." P. Areeda & H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 572 (2004)(hereinafter "Areeda").

The District Court's incorrect formulation of the relevant market may be freely reviewed on appeal as a matter of law, and it has long been held that "because market definition is a deeply fact-intensive inquiry, courts hesitate to grant motions to dismiss for failure to plead a relevant product market." *Todd*, *supra*, 275 F.3d at 199-200.

The propriety of the relevant market alleged is also amply demonstrated by the fact that the prices charged and paid in this market are significantly higher than in other markets, probably because of the availability of the Federal reimbursement program which renders the buyers less price sensitive (¶¶ 40, 91-92, 96-97). The buyers (the New York Private Foster Agencies) are also distinct because all are subject to regulation by New York State (¶¶ 84, 86). The actual suppliers (Cornell, acting with OCFS's assistance) and potential suppliers (HWC and others) in this market are also specialized because the regulatory requirements imposed on them are distinct from those in other markets. The factual predicates for these differences are discussed in further detail in the following sections, which discuss the nature of the antitrust violations.

B. Antitrust Misconduct

The anti-competitive nature of Defendants' restraint is manifest from the allegations that all actual or potential competitors of TCI are excluded from the

market (¶ 89). At the pleading stage, the District Court must accept the allegations as true, but it did not, ruling "it is not possible to evaluate the effect of the OCFS and TCI arrangement on other service providers or consumers" (A-313).

In the OCFS-Cornell environment, the Complaint makes clear that OCFS has used its regulatory power -- without any apparent effort to review the merits of any prospective vendor of restraint training to Private Foster Agencies -- to coerce their selection of Cornell's TCI program to the exclusion of all others (¶¶ 83, 86, 88-90).

OCFS does not assert any reasonable economic benefit, such as a cost savings, in engaging in this coercive practice. In fact, there may well be an *unreasonable* incentive to OCFS in that OCFS, while insisting on Cornell's expensive training program, does not pay for most of it (¶ 92). Instead, OCFS seeks and obtains, as part of a federal *entitlement* program under Title IV-E of the Social Security Act, as much as 75% of the cost of Cornell's TCI training from the Government. By using the pre-existing CHE "facilities and administrative" overhead, OCFS helps Cornell reap substantial monies for CHE and for itself, as CHE's administrator (¶¶ 91-92).[18]

[18] Complaint, ¶¶ 14, 35. *See also Qui Tam* Complaint, discussed *supra*, n. 9, at ¶¶ 98-102, 122. Federal reimbursement may itself be a factor in determining a discrete relevant market and would even strongly support the inference that there is a separate pricing environment. Availability of reimbursement tends to affect prices.

Indeed, given the strong financial incentive OCFS has for maximizing federal reimbursement or grant money for such activities, the Complaint, "construed as a whole," can be read to assert a claim that OCFS is a market participant, with Cornell using it as its agent, or even co-conspirator (¶¶ 88-89, 91-92). Behind this aggressive abuse of its power, OCFS (and Cornell) have as their aim *higher prices* for the training, *not market prices* (¶¶ 91-92). In such a case, the antitrust misconduct is manifest.

Moreover, the anti-competitive effect of threatened adverse licensing actions by OCFS, unless the Private Foster Agencies accepted Cornell's TCI training program, is manifest. Therefore, contrary to the District Court's conclusion, it is here *not* "'impossible for a court to assess the anticompetitive effect of [the] challenged practices'" (A-311; citing *Re-Alco Industries, Inc. v. National Center for Health Educ., Inc.*, 812 F.Supp. 387, 392 (S.D.N.Y. 1993)).

1. <u>Suppression of Quality Competition</u>

To the extent the Cornell Defendants endeavored to legitimize their TCI program by submitting exhibits attesting to the professionalism of its training staff (A-103 - A-123), this cannot overcome, certainly at this stage of the litigation, HWC's claims that certain Private Foster Agencies have been unimpressed with the quality of TCI training and have sought instead to engage HWC (and other vendors)

to provide restraint training in place of Cornell (¶¶ 71-72).

The exclusion of HWC and the other vendors certainly indicates a serious restraint on competition in the quality of the training (¶¶ 71-72, 88-89), even before reaching the issue of the *price* of the training (¶¶ 40, 91).[19] Indeed, OCFS's interference with -- and outright prohibition of -- a Private Foster Agency's selection of HWC and others as providers of restraint training, notwithstanding the desire of various Agencies to do so, is a patent restraint on competition (¶¶ 71, 72, 89).

That there can be a substantial variation in quality among the different providers of this training is manifest from an exhibit attached to the Hillside Defendants' January 18, 2005 Reply Declaration of David Bagley in Further Support of Hillside Defendants' Motion to Dismiss or for Summary Judgment (A-227 - A-230). Exhibit E thereto, at A-252-A-257, is a February 12, 2003 article from *New York Teacher* attesting to the selection by New York State United Teachers of HWC's restraint training program over others because "it met more of the needs expressed during focus groups" (A-256). It is represented that TCI competed for this training contract.

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[19] Price is the "central nervous system of the economy," *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 226 n.59, 60 S.Ct. 811, 845, 84 L. Ed. 1129 (1940), and an agreement that "interfere[s] with the setting of price by free market forces" is illegal on its face. *United States v. Container Corp.*, 393 U.S. 333, 337, 89 S. Ct. 510, 512, 21 L. Ed. 2d 526 (1969).

A diminution in the quality of TCI training, from lack of competition, is also manifest from Exhibit C to the October 5, 2004 Affidavit of Nelson E. Roth, Esq., counsel for the Cornell Defendants, showing that Cornell no longer teaches a single-person restraint technique (A-78 - A-102). By their submissions below, Defendants acknowledged that HWC continues to train in this technique (A-61 - A-66; A-253 - A-257), which is important to and sought by Private Foster Agencies (¶¶ 71, 72).

2. Impact on Prices

Turning to price, the strong inference from the Complaint is that Cornell's price is higher than that which HWC and the other vendors charge. But even more dramatic evidence that Cornell's enjoyment of exclusive status as the restraint trainer for the Private Foster Agencies has a significant impact on pricing is that Cornell, with OCFS's approval, is charging a multiple of "4 to 10 times" *more than it charges its own other buyers for the same service* (¶¶ 40, 91, 97).[20] Moreover, as noted, there is no procedure in place by which OCFS can make any judgment on the quality of TCI training as compared with other programs. The "selection" by the Private Foster Agencies of Cornell and its TCI program has been

[20] This allegation was plainly made (¶ 91). Moreover, details of how Cornell accomplished this are set forth in the *Qui Tam* Complaint, Section V.C, ¶¶ 155-173 *et passim*. The multiple may ultimately not be as great as ten, but it is substantial.

fixed for at least twelve years (A-141 - A-154). Nothing in the ongoing, and apparently unending (*see Qui Tam* complaint ¶¶ 111-13), exclusion by OCFS of other vendors in favor of Cornell can be said to be "procompetitive."

The District Court held that OCFS was the "buyer" and, like any other buyer, could switch suppliers without violating Section One (A-312). Under the regulatory regime presented, however, OCFS, a regulatory "approver," was *not* the buyer. Rather, the various Private Foster Agencies were the buyers (¶¶ 71, 88-89). Some confusion may have resulted from the fact that, while the Private Foster Agencies are the buyers of restraint training, they are not *autonomous* buyers -- free to choose TCI, on the one hand, *or* HWC and others, on the other hand, based on quality and price (¶¶ 71, 88-89). To the contrary, Cornell -- the seller of its TCI program -- has acted with OCFS to force all the Private Foster Agencies in New York State to buy its program (¶¶ 36, 86-90). This essentially makes OCFS itself an agent -- or co-conspirator -- of Cornell in "selling" the TCI program by the compulsion of its regulatory fiat (without any hint that it has made any determination "on the merits" of the quality of the various programs).

3. Antitrust Liability

Given this factual scenario, several traditional theories of antitrust liability on which to peg Defendants' obviously anticompetitive conduct are

applicable. And certainly, this "complaint may properly be understood to allege arrangements that might be shown to be unlawful." *Discon*, *supra*, 93 F.3d at 1059.

We start with the cautionary language of then-Chief Judge Newman in *Discon*, where he observed:

> This appeal typifies one of the primary difficulties in the judicial application of antitrust law. Under Section One of the Sherman Act, courts are asked to categorize various complex commercial arrangements into a rigid legal taxonomy, *e.g.,* horizontal restraint, vertical restraint, price-fixing, market division, concerted refusal to deal, and so on. This initial categorization is often outcome-determinative. Under one category, the arrangement may be *per se* illegal, while under another, it may be found permissible under the rule of reason. Due to the complexity of modern business transactions, however, courts often find that commercial arrangements can be classified *theoretically under a number of different categories*. *See Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 8, 99 S.Ct. 1551, 1556, 60 L.Ed.2d 1 (1979) ("[E]asy labels do not always supply ready answers.").

Id. (emphasis added).

With Judge Newman's sympathetic viewpoint in mind, this Complaint could ultimately lead to strong evidence of: (1) collective (or "concerted") refusal to deal (by OCFS and Cornell) with HWC and other vendors who are Cornell's competitors; (2) conspiracy with a licensor (OCFS) to eliminate competitors (HWC and others); (3) vertical price-fixing by OCFS with Cornell, by virtue of their

control of the market of Private Foster Agencies; and (4) conspiracy and monopolization.

While these theories, or some of them, might fall into a *per se* category, we believe that for purposes of analyzing the anticompetitive nature of Defendants' conduct the market properly can be viewed to take account of the actual anticompetitive effect of the misconduct. As noted, in a regulatory setting, where entry into the market is controlled by the regulating agency (as it is here, by OCFS's requisite "approval," even at the certificate of incorporation stage, of a new Private Foster Agency), the regulated market can be the "relevant" market for purposes of evaluating the misconduct. Indeed, to define a relevant product market, one must look at how buyers view the products in question. *See Westman Commission Co. v. Hobart Int'l, Inc.*, 796 F.2d 1216, 1220 (10th Cir. 1986) ("Any definition of a line of commerce which ignores the buyers and focuses on what the sellers do, or theoretically can do, is not meaningful.") (quoting *United States v. Bethlehem Steel Corp.*, 168 F. Supp. 576, 592 (S.D.N.Y. 1958)); *Federal Trade Commission v. Cardinal Health, Inc.*, 12 F. Supp.2d 34, 46 (D.D.C. 1998) ("The relevant market consists of all of the products that the Defendant's *customers view as substitutes* to those supplied by the Defendants.") (emphasis added). In this sense, the Private Foster Agencies need restraint trainers and, for quality and price

reasons, should be able to choose HWC or another vendor. But HWC and the other vendors can only become "substitutes" when approved by the very Defendants in this antitrust action.[21]

Actions brought under the federal antitrust laws involving conduct by states or by regulatory authorities of states are not common, and the facts presented by such cases do not always or easily fall within the traditional parameters of antitrust liability as developed by the courts. That said, the elements of liability on the part of states and their agencies for anticompetitive actions have become relatively clear. Thus, conspiracy with a licensing authority to eliminate a competitor may also result in an antitrust transgression. *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 706, 82 S.Ct. 1404, 1414 (1962).

The error of the District Court's dismissal with prejudice can be seen from its own reliance on *Evac, LLC v. Pataki*, 89 F. Supp.2d 250 (N.D.N.Y. 2000) (A-314). In *Evac*, the District Court dismissed a complaint alleging that the state providing emergency helicopter ambulance service for *free* was a restraint of trade. The court found little merit in that allegation, in that any evacuee or person in need

[21] Even in unregulated markets, the servicing of one, narrow product line can be the relevant market. *Eastman Kodak Co. v. Image Technical Service, Inc.,* 504 U.S. 451, 482, 112 S. Ct. 2072, 2090 (1992).

of emergency medical services requiring use of a helicopter could purchase that service from another vendor, should he so choose. However, analogizing *Evac* to the instant case, it would be as though the state *required* use of its designated helicopter service (here the mandated use of Cornell's TCI program), but *forbade* potential customers from hiring any *other* helicopter services (here, the exclusion of HWC and other restraint training vendors).

In the case at bar, the buyers (Private Foster Agencies) are not being allowed to choose their suppliers (¶ 71). The Private Foster Agencies are being forced to use Cornell in order to do business in New York (¶¶ 36, 86-90). Plaintiffs' claims are not those of a single vendor ousted by an exclusive contract of a state agency with one of its competitors. Instead, this is a case where a horizontal array of multiple purchasers (Private Foster Agencies) is being unlawfully prohibited from purchasing services it is legally entitled to purchase. 18 N.Y.C.R.R. § 441.3(c).

POINT II

THE DISTRICT COURT ERRED IN DISMISSING THE SHERMAN ACT SECTION TWO CLAIM

No elaborate separate analysis is needed to show how the misconduct described above is also actionable under Section Two of the Sherman Act.

Monopoly power is the "power to control prices or exclude competition" in the relevant market. *United States v. E.I. DuPont DeNemours & Co*., 351 U.S. 377, 391, 76 S.Ct. 994, 1005, 100 L. Ed. 1264 (1956). While it is something more than the market power that is a prerequisite to liability under Section One, *see Digidyne Corp. v. Data General Corp.*, 734 F.2d 336, 1339-41 (9th Cir. 1984), it is present here in abundance because the relevant market analysis has merit.

Clearly, the abuse of the regulatory process by OCFS in favor of Cornell gave them monopoly power, which they continue to use to exclude restraint training vendors from being available to the Private Foster Agencies (¶¶ 89-90). Their combined effort makes them liable for conspiracy to monopolize and monopolization (¶¶ 95-98). Thus, in *Surgical Care Center of Hammond, L.C. v. Hospital Service District No. 1 of Tangipahoa Parish*, 171 F.3rd 231, 232 (5th Cir. 1999), the Fifth Circuit *en banc* reversed a panel's prior affirmance of a dismissal of an antitrust complaint, finding that:

> The complaint . . . outlined the implementing path of the [defendant's] effort [to extend its monopoly], marked by various anticompetitive acts. These acts included pressuring five of the seven largest managed care plans in the market into contracts calculated to exclude St. Luke's from the market for outpatient surgical care. Specifically, North Oaks allegedly used its monopoly power to ensure that its contracts with the plans included provisions for exclusivity and tying, in violation of the Sherman Act.

POINT III

THE DEFENDANTS ARE NOT IMMUNE AND, IN ANY EVENT, THIS ISSUE SHOULD BE ADDRESSED BY THE DISTRICT COURT ON REMAND

As the Supreme Court held, "[t]he national policy in favor of competition cannot be thwarted by casting . . . a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement." *Cal. Ret'l Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 106, 100 S.Ct. 937, 63 L. Ed.2d 233 (1980) (quoted in *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d. 205, 222 (2d Cir. 2004)). The same, of course, is true of any antitrust misconduct.

The District Court addressed the defense of state action immunity, claimed by Cornell as well as OCFS. While stopping a bit short of a "holding," the Court rightly doubted whether Defendants could meet the tests of being an arm of the state (certainly not true for Cornell and unlikely as to OCFS), or of carrying out anticompetitive practices that are somehow authorized by the state, the latter test requiring "a more searching analysis" (A-307- A-310).

We respectfully suggest that, given the scant record below, the issue of immunity be addressed by the District Court on remand.

POINT IV

EVEN IF THIS COURT FINDS PLAINTIFFS' ANTITRUST ALLEGATIONS WANTING, A REMAND WITH LEAVE TO REPLEAD IS THE ONLY REMEDY CONSISTENT WITH THE FEDERAL RULES AND THE APPLICABLE STANDARD

Based on the arguments in this Brief, Plaintiffs submit that their Complaint was sufficient to withstand the dismissal motions aimed at them below, especially given that there is no heightened pleading standard for antitrust cases. While there may be a dispute about the overall precision and clarity of the Complaint, one thing is clear beyond peradventure of doubt: motions to dismiss with prejudice are almost *never* granted when such motions are filed against plaintiffs' *first* complaint, and no motion is granted with prejudice in such circumstances without a finding that any further pleading would be "futile" -- a finding not made here.

The obvious starting point for granting leave to Plaintiffs to replead is Fed. R. Civ. P. 15(a), holding that such "leave shall be freely given when justice so requires." In its decision below, the District Court gave no explanation for why leave to replead was not given. Indeed, the Court did not engage in any discussion of the standard for a dismissal with prejudice.

Antitrust complaints, with sometimes difficult relevant market questions, easily present circumstances under which leave to replead, at least

once,[22] should be granted. Final dismissals in such instances "should be granted very sparingly." *Todd*, *supra*, 275 F.3d at 198. The reason for this caution in ending an antitrust case too early is that the "'proof is largely in the hands of the alleged conspirators . . ..'" *Hospital Building Co. v. Trustees of Rex Hospital*, 425 U.S. 738, 746-47, 96 S.Ct. 1848 (1976), quoting *Poller v. Columbia Broadcasting System, Inc.*, 368 U.S. 464, 473, 82 S.Ct. 486 (1962).

[22] *See, e.g.*, *Discon*, *supra*, 93 F.3d at 1059 (reversing dismissal of amended complaint with prejudice because "poorly drafted" complaint "may properly be understood to allege arrangements that *might be shown* to be unlawful" even under different theories than plaintiff had advanced) (emphasis added).

Accordingly, however much this Court delves into the OCFS-Cornell arrangement on this appeal, Plaintiffs should be entitled, at the very least, to replead their claims in an amended complaint.[23]

POINT V

THE DISTRICT COURT ERRED IN DISMISSING PLAINTIFFS' COPYRIGHT CLAIMS

A. Background

In 1997, DFY and Chapman entered into an agreement for the provision of training to DFY staff in restraint techniques (the "Agreement") (A-163-A-171).[24] The Agreement commenced May 1, 1997 and contained a termination date of August 31, 1997 (A-163). Pursuant to the Agreement, Chapman provided to DFY copyrighted training materials, including manuals and audio visual materials, which DFY was given permission to reproduce (A-164).

The Agreement was entered into after a catastrophic injury, and subsequent death, of a child in DFY's care resulted in a 1996 action against DFY

[23] The same leave to replead should also be granted as to Plaintiffs' copyright claims.

[24] The same parties entered into a similar agreement, of three months' duration, on January 1, 1988 (A-157 - A-162). That agreement is not at issue in this case.

and its Commissioner, alleging, among other claims, failure to train on the proper use of restraint (¶¶ 26, 58). *See Jackson v. Johnson,* 118 F. Supp.2d 278 (N.D.N.Y. 2000) (Hurd, J.).

DFY, in its Request for Bid, asked for "rights to reproduce any and all materials" (A-179). DFY also specified a four-month term for the proposed agreement, with the option to extend it for two additional four-month terms (A-179). Chapman's subsequent handwritten bid offered "preparation & delivery of 12 days of training for approximately 120 trainers," including the "right to reproduce all materials & ***option to extend***" (A-179; emphasis added).[25] Chapman's handwritten bid was submitted on the Request for Bid form generated by the New York State Executive Department, Division for Youth, and resulted in the 1997 Agreement, which was ***drafted by DFY***, as explained in more detail below.

The Agreement specified that Chapman "acknowledges and agrees that the Division has the right to reproduce all training materials" (A-164: Section II.C) and that the Agreement would "end August 31, 1997" (A-163: Section I). A further provision specified that the Agreement "may be extended for two (2) additional four (4) month periods from the termination date of August 31, 1997 upon the same

[25] If Chapman thought the license to reproduce his materials was perpetual, there would be no reason for him to handwrite "with option to extend" (A-179).

terms and conditions" (A-166 - A-167: Section IV.J). The Agreement was never extended.

As a supplement to the Agreement, and to further clarify its terms, Chapman drafted a "Handle With Care Program Participant Release From Responsibility Agreement" (hereinafter "DFY Trainer Agreement"), specifying that the HWC certification obtained by each DFY trainer pursuant to the Agreement expired after one year (A-181).[26] Every DFY trainer who became certified in HWC's program signed the DFY Trainer Agreement, including DFY's Director of Training, Margaret Davis (*Id.*).

Plaintiffs' Complaint alleged that DFY (now OCFS) continued to reproduce Plaintiff's training materials beyond the expiration date of the Agreement, and has continued to permit Division Trainers to train DFY staff in

[26] To the extent the certification to train (lasting one year) includes, implicitly, a right to "reproduce" HWC's copyrighted materials, then Defendants could argue that the right to reproduce continued, as to the certified trainers, for one year, although Plaintiffs' position is that the right to reproduce ended with the expiration date of the Agreement. Such discrepancies among the documents executed by the parties indicate that ambiguities existed which could only properly be resolved by evaluating documents and testimony extrinsic to the Agreement, particularly because the Agreement had no integration clause.

HWC's program beyond the expiration date of the Agreement (¶¶ 53-54).

B. The District Court's "Findings of Fact"

As noted, in evaluating a motion to dismiss under Rule 12(b)(6), the District Court must "accept the facts alleged in the complaint as true and draw all reasonable inferences in favor of the plaintiff." *Broder v. Cablevision Sys. Corp.*, 418 F.3d 187, 196 (2d Cir. 2005) (citing *Freedom Holdings*, *supra*, 357 F.3d at 216). A complaint should not be dismissed unless it appears to a certainty that plaintiff is entitled to no relief under any statement of facts which could be proved in support of the claim. *Eternity Global Master Fund Ltd. v. Morgan Guar. Trust Co. of N.Y.*, 375 F.3d 168, 176-177 (2d Cir. 2004). Furthermore, on such a motion, the District Court should resolve any contractual ambiguities in favor of the plaintiff. *Subaru Distributors Corp. v. Subaru of America, Inc.*, 425 F.3d 119, 122 (2d Cir. 2005). Finally, in deciding a Rule 12(b)(6) motion to dismiss a breach of contract claim, the Court's role is not to resolve ambiguities in the language of the contract. *DKR Capital, Inc. v. AIG Int'l W. Broadway Fund, Ltd.*, 2003 U.S.Dist. LEXIS 17498, 2003 WL 22283836 at *4 (S.D.N.Y. Oct. 2, 2003).

The District Court based its dismissal with prejudice of Plaintiff's copyright claims on the following findings of fact, all of which are contradicted by the allegations in the Complaint:

> Despite plaintiffs' repeated assertions, the [Agreement] simply does not contain a provision limiting this license to use the materials to one-year *or any other duration of time*. The [Agreement], drafted by Chapman, is clear and unambiguous. Plaintiffs do not argue that it suffers any legal defect or otherwise attack the validity of the [A]greement. Plaintiffs never assert that any other representations were made or agreed upon extraneous to the [Agreement].

(A-305; emphasis added).

First, the maximum one-year potential duration of the Agreement (A-163) (including the two potential extension periods provided for in Section IV.J (A-166)) applied to each term therein -- including the license Chapman granted DFY to copy his copyrighted materials (A-164) and train its staff in HWC's program (A-181). The District Court erroneously found Plaintiffs' allegations concerning the one-year duration of the license granted to DFY pursuant to the Agreement untenable as a matter of law (A-305).

Second, the District Court incorrectly -- and (again) in direct conflict with the allegations in the Complaint (¶ 61) -- found that the Agreement was "drafted by Chapman" (A-305).

Third, the Court made an unsupported finding that the Agreement was "clear and unambiguous" on its face, despite the obvious discrepancy and alleged

resultant ambiguity regarding the Agreement's duration (A-305).[27] Again, the Agreement itself contains no integration clause.

These findings are clearly controverted by Plaintiffs' allegations in their Complaint (¶ 51) and, thus, were wholly inappropriate for the District Court to make at the pleading stage. This Court should reinstate the Complaint and remand to the District Court with a direction that the Agreement, and DFY's license to use HWC's program and program materials, expired on August 31, 1997 or, at the latest, April 30, 1998, or at least that the question presents a triable issue.

C. There Is No Basis For The District Court's Finding that the License Granted to DFY to Reproduce Chapman's Training Materials Was Not Limited to the Term of the Agreement

Plaintiffs unquestionably satisfied the basic pleading requirements of a copyright infringement claim by alleging that: 1) they own a valid copyright in an original work; and 2) the State Defendants copied such work. *See Feist Publications, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340, 361, 111 S.Ct. 1282 (1991); *Matthew Bender & Co., Inc. v. West Publishing Co.*, 158 F.3d 674, 679 (2d Cir. 1998). In its decision, the District Court noted that "[i]t is not disputed that the

[27] Plaintiffs objected to the documents submitted by OCFS that were not incorporated or relied upon in the Complaint, such as the 1988 agreement between the parties described in note 24, *supra*, and correspondence related thereto (A-212, A-262-A-263).

state defendants copied [Plaintiffs'] materials" (A-304). Accordingly, the District Court should not have dismissed the copyright claims at the pleading stage. Certainly, the District Court was premature in finding that Plaintiffs "have not *demonstrated* a limitation on defendants[']s non-exclusive license to reproduce [Plaintiffs' training] materials" (A-306; emphasis added).

Plaintiffs alleged that the Agreement granted DFY a non-exclusive right to reproduce the subject training materials for the duration of the Agreement (¶¶ 50-51). There is simply no basis for the District Court's interpretation that a contract with clearly defined commencement (May 1, 1997) and termination (August 31, 1997) points (A-163) should not be so limited as against both parties to it.

In reaching its decision, the District Court focused only on the specific license clause contained in Section II.C giving DFY the right to reproduce all training materials (A-164), without taking into account the equally clearly defined temporal limitation in Section I which states that the Agreement shall commence "May 1, 1997 and end August 31, 1997" (A-163). To read Section II without taking into account the term of the Agreement creates an internal conflict within the Agreement.

This reading also goes against cannons of contract construction

whereby "a court should not 'adopt an interpretation' which will operate to leave a 'provision of a contract . . . without force and effect.'" *Laba v. Carey*, 29 N.Y.2d 302, 308, 277 N.E.2d 641, 327 N.Y.S.2d 613 (1971) (internal citations omitted). *See also Eighth Ave. Coach Corp. v. City of New York*, 286 N.Y. 84, 88, 35 N.E.2d 907, 909 (1941) (citing as a "fundamental canon of construction" that a "contract must be read as a whole in order to determine its purpose and intent, and that single clauses cannot be construed by taking them out of their context and giving them an interpretation apart from the contract of which they are a part"); *Fleischman v. Furgueson,* 223 N.Y. 235, 239, 119 N.E. 400, 401 (1918) ("In construing a contract the whole instrument must be considered and from such consideration a conclusion reached as to what the parties intended to do or sought to accomplish."). It is well-settled that a written contract must be read as a whole and every part interpreted with reference to the whole, with preference given to reasonable interpretations. *W.W.W. Associates, Inc. v. Giancontieri,* 77 N.Y.2d 157, 162-163 (1990).

The court relied on *Graham v. James*, 144 F.3d 229, 236 (2d Cir. 1998) for the proposition that "'[a] copyright owner who grants a nonexclusive license to use his copyrighted materials waives his right to sue the licensee for copyright infringement'" (A-304; bracketed material in original). However, this rule is inapplicable here because DFY's right to reproduce HWC's copyrighted

material *expired* at the expiration date of the Agreement. *See Kamakazi Music Corp. v. Robbins Music Corp.*, 684 F.2d 228, 230 (2d Cir. 1982).

Moreover, courts are reluctant to interpret any contract so as to infer a perpetual duration of a transfer or license of a copyright without specific contractual language to that effect. *See United States Surgical Corporation v. Oregon Medical & Surgical Specialties, Inc.*, 497 F. Supp. 68, 71 (S.D.N.Y. 1980) (refusing to infer a perpetual obligation even where a contract did not contain a specific temporal limit); *Boyle v. Readers Subscription, Inc.*, 481 F. Supp. 156, 158 (S.D.N.Y. 1979). If the parties intend that the obligation be perpetual, they must expressly say so. *Warner-Lambert Pharmaceutical Co., v. John J. Reynolds, Inc.*, 178 F.Supp. 655, 661 (S.D.N.Y. 1959). Thus DFY's license to copy Plaintiffs' materials expired on August 31, 1997 (A-163).

Finally, the District Court erred by attributing the drafting of the Agreement to Chapman (A-305). The Complaint clearly alleged that the Agreement was drafted by DFY (¶ 61). Factual allegations contained in the Complaint must be accepted as true. *Courtenay Communs. Corp. v. Hall*, 334 F.3d 210, 213 (2d Cir. 2003). Even a cursory examination of the Agreement reveals that it was drafted by DFY, as it contains non-negotiable, boilerplate "Standard Clauses For All New York State Contracts," and was even prepared on "Form DFY-3103

(Rev 4/92)" (A-169 - A-171). Moreover, the District Court acknowledged that Margaret Davis, DFY's Director of Training, "worked on the terms of the [A]greement" (A-301).

New York contract law follows the rule that ambiguities in contracts are generally construed against the drafter. *Sheppard v. Beerman*, 18 F.3d 147, 150 (2d Cir. 1994); *Jacobson v. Sassower*, 66 N.Y.2d 991, 993 (1985). Plaintiffs alleged that the expiration date in Section I of the Agreement was not ambiguous, and applied to all other provisions of the Agreement, such as DFY's obligation to continue to pay for training. Nevertheless, should the District Court have considered the term of the license ambiguous, it should not have dismissed the Complaint, and instead should have afforded Plaintiffs' allegations every favorable inference, given the fact that Plaintiffs alleged that DFY drafted the Agreement (¶ 61). Only Plaintiffs merit favorable inferences and constructions on a motion to dismiss. *Sheppard*, 18 F.3d at 150.

CONCLUSION

For the foregoing reasons, the decision of the District Court should be reversed, its judgment vacated and the matter remanded to the District Court for the purpose of granting leave to Plaintiffs-Appellants to replead their claims in an

amended complaint.

Dated: New York, NY
July 10 , 2006

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 11,767 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using WordPerfect in Times New Roman 14-Point type.

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