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WHITE PAPER

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Insights from the Supreme Court's *Apple v. Pepper* Antitrust Decision

In May 2019, the U.S. Supreme Court issued a 5–4 decision in *Apple v. Pepper*, one of the Court's most significant antitrust rulings of the last several years. In a majority opinion authored by Justice Kavanaugh, the Court held that iPhone owners who purchased software applications ("apps") from Apple's App Store are "direct purchasers" and therefore have standing to sue Apple for alleged monopolization of an aftermarket for iPhone apps.

The *Apple* opinion narrows the so-called *Illinois Brick* defense, expands opportunities for private antitrust litigation, and warrants careful assessment by retailers, distributors, and companies operating electronic marketplaces. While some companies might consider restructuring distribution arrangements to mitigate increased exposure from this decision, such restructuring could undercut an efficient business model.

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BACKGROUND FACTS

Every iPhone has a connection to the "App Store," which is the only place an iPhone owner can purchase apps, due to Apple's contractual and technological restrictions. The App Store has available more than two million apps, most developed by third parties. While some apps in the App Store are free, others are sold for a price, which is set by the app developer. When an iPhone owner purchases a third-party app from the App Store, Apple collects the purchase price, allows the owner to download the app, and, pursuant to agreement with the app developer, sends 70 percent of the price to the developer. Apple keeps 30 percent as a commission.

ROAD TO THE SUPREME COURT

In 2011, four iPhone owners filed a putative antitrust class action against Apple in federal court in California. The plaintiffs purport to represent a class of all consumers who had purchased an iPhone app. The plaintiffs allege Apple has monopoly power in an aftermarket for iPhone apps. They allege that, by making its App Store the only place to purchase apps and by charging a 30 percent commission on App Store sales, Apple forced iPhone owners to pay above-competitive prices for apps they purchased.

Apple moved to dismiss, arguing that plaintiffs are "indirect purchasers" and therefore lack standing under *Illinois Brick Co. v. Illinois* (1977), which held that "only the overcharged direct purchaser, and not others in the chain of manufacturer or distribution," may sue under federal antitrust law for overcharges. Apple argued that, even though Apple collects payment from iPhone owners for App Store sales (keeping its 30 percent commission), the "economic reality" is that iPhone owners actually purchase the apps from the app developers themselves. This is so, Apple reasoned, because each developer sets its App Store price, deciding whether to "pass on" the 30 percent commission it agreed to pay Apple.

The district court accepted this argument, finding that plaintiffs were "indirect purchasers" suing for "pass on" damages that are barred by *Illinois Brick*. But the Ninth Circuit later reversed, holding that plaintiffs were "direct purchasers" with antitrust standing, because Apple sold iPhone apps directly to plaintiffs. Apple appealed to the U.S. Supreme Court.

SUPREME COURT'S DECISION

In the opinion authored by Justice Kavanaugh and joined by Justices Ginsburg, Breyer, Sotomayor, and Kagan, the Court affirmed the Ninth Circuit judgment: "It is undisputed that the iPhone owners bought the apps directly from Apple. Therefore, under *Illinois Brick*, the iPhone owners were direct purchasers who may sue Apple for alleged monopolization."

The Court explained that this "straightforward conclusion" follows from both the antitrust statute itself and the *Illinois Brick* decision. The text of Clayton Act § 4 permits "any person" injured by an antitrust violation to sue for damages, language suggesting that antitrust standing should be interpreted broadly. Then *Illinois Brick* incorporated "principles of proximate cause into § 4 [and] established a bright-line rule that authorizes suits by *direct* purchasers but bars suits by *indirect* purchasers." Applying that framework, the Court considered the lack of any "intermediary" between Apple and iPhone owners to be "dispositive" to determine plaintiffs here are "direct" purchasers:

> Unlike in *Illinois Brick*, the iPhone owners are not consumers at the bottom of a vertical distribution chain who are attempting to sue manufacturers at the top of the chain. There is no intermediary in the distribution chain between Apple and the consumer. The iPhone owners purchase apps directly from the retailer Apple, who is the alleged antitrust violator. The iPhone owners pay the alleged overcharge directly to Apple. The absence of an intermediary is dispositive.

The majority saw this conclusion as consistent with three rationales that support the *Illinois Brick* doctrine. According to the majority, the decision: (i) facilitates more effective enforcement of the antitrust laws, by not narrowing the set of plaintiffs that have standing to sue; (ii) does not require courts to engage in unusually complicated calculations to apportion damages among different levels of purchasers; and (iii) does not threaten duplicative damages against antitrust defendants. As to the third rationale, the majority explained that this is "not a case where multiple parties at different levels of a distribution chain are trying to all recover the same passed-through overcharge." The iPhone owners, if successful, "will be entitled to the full amount of the unlawful overcharge that they paid to Apple," while the overcharge "has not been passed on by anyone to anyone."

It did not matter that "Apple's alleged anticompetitive conduct may leave Apple subject to multiple suits by different plaintiffs." *Illinois Brick* does not bar such a scenario: "A retailer who is both a monopolist and a monopsonist may be liable to two different classes of plaintiffs—both to downstream consumers and to upstream suppliers … The two suits would rely on fundamentally different theories of harm and would not assert dueling claims to a 'common fund.'" That is, app purchasers have standing to pursue a monopolization claim against Apple as the App Store app seller, while app developers would have standing to pursue any monopsonization claim against Apple as a wholesale app reseller.

In reaching its decision, the Court rejected Apple's indirect purchaser theory. According to Apple, *Illinois Brick* allows consumers to sue only the party who sets the retail price." But in the majority's view, this theory contradicts the plain language of Clayton Act § 4 as well as the "longstanding bright-line rule" of *Illinois Brick*. Further, a "who sets the price" rule would "draw an arbitrary and unprincipled line among retailers based on their financial arrangements with their manufacturers or suppliers" and therefore would "provide a roadmap for monopolistic retailers to structure transactions with manufacturers or suppliers so as to evade antitrust claims by consumers."

DISSENT

Justice Gorsuch wrote the dissent for the four Justices who saw iPhone owners as purchasing directly from app developers and therefore lacking standing to sue Apple for the commission overcharge. The dissent argued that *Illinois Brick* "held that an antitrust plaintiff can't sue a defendant for overcharging someone else who might (or might not) have passed on all (or some) of the overcharge to him," and that this case presents "exactly the kind of 'pass-on theory' *Illinois Brick* rejected." In the dissent's view, the majority "had recast *Illinois Brick* as a rule forbidding only suits where the plaintiff does not contract directly with the defendant" and thereby "replaces a rule of proximate cause and economic reality with an easily manipulated and formalistic rule of contractual privity."

KEY TAKEAWAYS

More Antitrust Litigation to Come

The Court's ruling will create more private antitrust litigation. While the Court did not follow the recommendation of 31 states as *amici* to overturn *Illinois Brick* completely and thus allow all indirect purchaser actions, the Court did narrow the scope of the *Illinois Brick* defense. Going forward, in assessing whether a plaintiff is a direct or indirect purchaser under federal antitrust law, courts no longer will rely on who sets the price or how a retailer structures its financial arrangements with upstream suppliers. Instead, if there is an intermediary between a seller and buyer, the buyer is an indirect purchaser barred from seeking antitrust damages; if there is no intermediary, the buyer is a direct purchaser who may sue for damages.

While this ruling will not affect the merits of any individual claim, it limits the ability of defendants to challenge the standing of some downstream customers. Indeed, the *Apple* decision is generally contrary to the prior leading case on this issue—*Campos v. Ticketmaster* (8th Cir. 1998)—where consumers of concert tickets alleged that Ticketmaster monopolized a market for ticket distribution services and imposed supracompetitive service fees that consumers paid Ticketmaster. The Eighth Circuit held that the concert venues that hired Ticketmaster to distribute tickets in exchange for the service fees at issue were the "direct purchasers," and that the consumer plaintiffs therefore were "indirect purchasers" suing for pass-on damages barred by *Illinois Brick*. However, even under the *Campos* rule, "indirect purchasers" had (and will continue to have) standing to bring state law antitrust claims in the many states that, by statute or court decision, have declined to follow *Illinois Brick*.

Liberal vs. Conservative

In his first antitrust case since joining the Court, Justice Kavanaugh sided with the Court's liberal wing. Some commentators have concluded there now is a pro-plaintiff, pro-enforcement majority for the Court's antitrust cases. This notion likely is overblown, particularly given Justice Kavanaugh's emphasis on the text of Clayton Act § 4, which permits "any person" injured by an antitrust violation to sue for damages. Indeed,

Justice Kavanaugh noted that "to the extent *Illinois Brick* leaves any ambiguity about whether a direct purchaser may sue an antitrust violator, we should resolve that ambiguity in the direction of the statutory text." This emphasis on statutory text reflects Justice Kavanaugh's anticipated conservative judicial philosophy and—despite his disagreement with the Court's other conservatives on how to apply a "longstanding" precedent "incorporating principles of proximate cause" into the statute—should not suggest a freewheeling expansion of substantive antitrust liability.

Mitigating Antitrust Risk

Retailers, distributors, and companies operating electronic marketplaces should review the *Apple* decision with counsel to assess the most efficient way to structure distribution agreements while mitigating antitrust risk. This is especially true for companies with significant market positions that—as is common for online travel agencies, online ticket agents, and certain online retail platforms—do not set the price for the products they distribute.

Such a company should consider steps to make clear that it is not making a "sale" to the customer, including: (i) having the sale agreement run between the supplier and end-customer and (ii) not collecting the payment from the end-customer. As Justice Gorsuch explained in the dissent, "the Court's test turns on who happens to be in privity of contract with whom," and that "to evade the Court's test, all Apple must do is amend its contracts. Instead of collecting payments for apps sold in the App Store and remitting the balance (less its commission) to developers, Apple can simply specify that consumers' payments will flow the other way: directly to the developers, who will then remit commissions to Apple."

Challenges to Restructuring Distribution

There are two main challenges with such restructuring. First, it may undercut business efficiency. Depending on the facts, the cost of such restructuring may outweigh the increase in potential antitrust exposure from this decision. Second, the majority did not specifically endorse Justice Gorsuch's proposed workaround. As such, end-customers still could litigate whether they have standing against the distributor, citing the Court's criticism of upstream "financial arrangements" designed to "thwart effective antitrust enforcement." However, if it is clear that the distributor has not made a "sale" to the end-customer—no privity of contract, no collection of payment—the end-customer should not be deemed a "direct purchaser" with standing to bring a federal antitrust claim for damages under *Apple* or *Illinois Brick*.

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