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Illinois Brick After *Apple v. Pepper*

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ON MAY 13, 2019, THE SUPREME Court issued its opinion in *Apple v. Pepper*.[1] The Court had an opportunity to overhaul the *Illinois Brick* rule, which dictates that only the first or direct purchaser, rather than subsequent or indirect purchasers, may recover damages from an antitrust violator.[2] The Court could have followed the Antitrust Modernization Committee's suggestion to allow both direct and indirect purchaser suits for the same conduct.[3] The Court also had a chance to explain how longstanding antitrust doctrines apply to technology platforms.

The Court declined those opportunities. Instead, in an opinion authored by Justice Kavanaugh, the Court applied the *Illinois Brick* rule and concluded that iPhone owners qualified as direct purchasers because they purchased apps directly from Apple.[4] The opinion did not purport to alter *Illinois Brick* in any way or suggest that old antitrust rules needed to be re-shaped to fit the "tech" economy. Nor did Justice Kavanaugh think the question was even that hard, writing that the "straightforward" conclusion that iPhone owners may sue flowed from the simple fact that they bought the apps directly from Apple.

Justice Gorsuch, joined by Chief Justice Roberts, Justice Thomas, and Justice Alito, agreed that the decision should have been easy, but they said it should have gone the other way.[5] The dissent warned that the Court let a "pass-on case proceed" and faulted the Court for overruling *Illinois Brick* without saying so. The dissent also speculated that it was possible that app developers would sue Apple for the same conduct. And, after that opinion, that is exactly what happened. A group of app developers subsequently sued Apple for antitrust violations, and both cases are pending before the same judge in the Northern District of California.[6] Thus, despite the majority's desire for finality and certainty, it appears that there are more developments and questions to come.

Apple v. Pepper

As a refresher, in 2011, a group of iPhone owners sued Apple claiming the company had monopolized the market for the sale of software applications ("apps") and unlawfully used its monopoly power to charge consumers supracompetitive prices.[7] Apple sells apps to iPhone owners through the App Store. Apple creates some of its own apps, but most are created by independent developers, who contract with Apple to sell their apps through the App Store. App developers set the sales price for their apps, as long as the price ends in $0.99. In return for making their apps available on the App Store, the developers pay Apple a commission of 30 percent of the retail price for each app sale. Plaintiffs allege that "via the App Store, Apple locks iPhone owners 'into buying apps only from Apple and paying Apple's 30% fee, even if' the iPhone owners wish 'to buy apps elsewhere or pay less.'"[8]

Apple moved to dismiss the complaint, claiming that under *Illinois Brick* the iPhone owners had no standing to sue because they were not "direct purchasers" from Apple. The district court sided with Apple and held that the plaintiffs were not "direct purchasers" from Apple because the app developers, not Apple, set the prices for apps.[9] The Ninth Circuit reversed and concluded that the iPhone owners did have standing to sue as direct purchasers because they purchased their apps directly from Apple. *Illinois Brick* bars suits from purchasers two or more steps removed in a vertical distribution chain, while the iPhone owners purchased directly from Apple, the alleged monopolist.[10] The Supreme Court affirmed the Ninth Circuit's holding with the "straightforward conclusion" that "[i]t 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."[11]

Justice Kavanaugh began by looking to the specific wording of the antitrust laws and past precedent. He focused on Section 4 of the Clayton, which states that "*any person* who shall be injured . . . by reason of anything forbidden in the antitrust laws may sue."[12] He explained that this "broad" language "readily covers" consumers who purchase goods or services from a monopolist at supra-competitive prices.[13] Kavanaugh also cited *Kansas v. UtiliCorp United Inc.*[14] to illustrate that the Court has "consistently stated" that direct purchasers have standing to bring suit against the antitrust violators. *Illinois Brick* established a bright-line rule authorizing suits by direct purchasers but barring suits by indirect purchasers, and the Court showed no interest in refining or straying from this distinction.[15] The Court acknowledged that 30 states and the District of Columbia filed an amicus brief supporting the plaintiffs and arguing that *Illinois Brick* should be overruled, allowing indirect purchasers to sue antitrust violators. The Court wrote, however, that it had "no occasion to consider that argument for overruling *Illinois Brick*" in light of its holding for the plaintiffs.[16] (As set forth below, however, Justice Gorsuch thinks the Court did overrule *Illinois Brick* in practice).

The Court then applied the *Illinois Brick* rule and distinguished the indirect purchasers in *Illinois Brick* from Plaintiffs: "unlike in *Illinois Brick*, the iPhone owners are not con-

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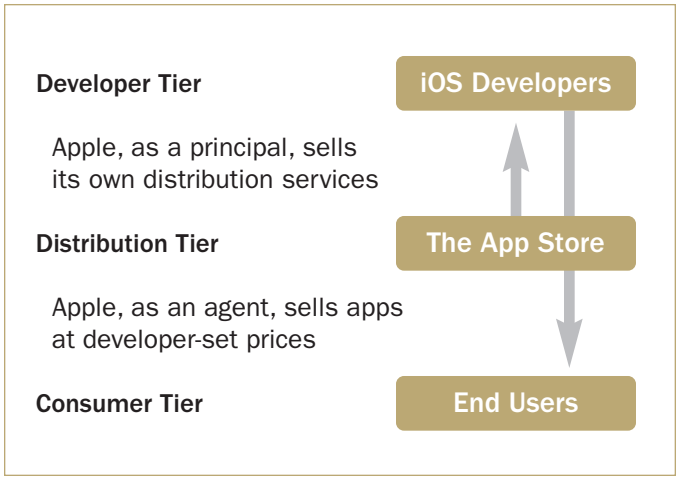
sumers at the bottom of a vertical distribution chain."[17] The Court found that there is no intermediary between the consumers and the antitrust violator. Rather, the iPhone owners purchase apps directly from the alleged antitrust violator, Apple, and pay the alleged 30 percent overcharge directly to Apple.

In the third and final section of the opinion, the Court dispensed with Apple's argument that *Illinois Brick* allows consumers to sue only the party that sets the retail price. According to Apple, the "who sets the price" theory would allow consumers to sue the party that sets the retail price, whether or not that party sells the good or service directly to the injured party.[18] First, the Court looked back to Section 4 of the Clayton Act, which "affords injured parties a right to sue under the antitrust laws," and to past precedent in *Illinois Brick*, which "was not based on an economic theory about who set the price."[19] The Court rephrased the rule in *Illinois Brick* to plainly state that "when there is no intermediary between the purchaser and the antitrust violator, the purchaser may sue," and lauded the bright-line rule for ensuring effective and efficient litigation in antitrust suits.[20]

The Court wrote that Apple's "who sets the price" theory would "draw an arbitrary and unprincipled line" based on arrangements retailers make with their suppliers and manufacturers.[21] To illustrate, the Court provided examples of two retail pricing models: the markup model and the commission pricing model. In the markup model, a hypothetical monopolistic retailer would pay $6 to a manufacturer and then charge consumers $10 for the product, keeping $4 as profit. In the commission pricing model, the retailer would pay nothing to the manufacturer but agree with the manufacturer to sell the product for $10, keep 40 percent of the sales price, and remit $6 back to the manufacturer.[22] The Court wrote that Apple's "who sets the price" theory would allow consumers to sue the retailer in the markup model but not in the commission model.[23] The Court criticized Apple's theory, stating that it "does not make a lot of sense, other than as a way to gerrymander Apple out of this and similar lawsuits."[24] The Court explained that Apple's proposed rule would elevate form over substance because a consumer's standing to sue would depend on the retailer's arrangement with a manufacturer or supplier rather than whether the consumer was forced to pay a higher price due to a monopolistic retailer's actions.[25] Further, the Court pointed out that Apple's theory would give a roadmap for monopolistic retailers to structure the transaction with manufacturers such that the retailer could avoid setting a price and thereby escape antitrust liability.[26]

Apple had argued that the three reasons the Court identified in *Illinois Brick* for adopting the direct-purchaser rule apply to this case, but the Court found the opposite—the three reasons actually cut in favor of the Plaintiffs. *Illinois Brick* listed three reasons for barring suits from indirect purchasers: "(1) facilitating more effective enforcement of antitrust laws; (2) avoiding complicated damages calculations; and (3) eliminating duplicative damages against antitrust defendants."[27] First, Apple's proposal to allow only upstream app developers, and not the downstream iPhone owners, to sue Apple would "leav[e] consumers at the mercy of monopolistic retailers simply because upstream suppliers could *also* sue the retailers."[28] This contradicts the longstanding goals of consumer protection and effective private enforcement of the antitrust laws. Second, Apple claims that allowing iPhone owners to sue would lead to complicated damages calculations. The Court dismissed this argument: "*Illinois Brick* is not a get-out-of-court-free card" that alleged monopolists can throw out whenever damages calculations may be complicated.[29]

Finally, the Court addressed Apple's claim that allowing iPhone owners to sue would subject Apple to duplicative damages claims from the app developers and from the iPhone owners over the same pot of money. Under the Court's reasoning that iPhone consumers are indeed direct purchasers from Apple, this was not a case where parties at different levels of the distribution chain are all trying to claim they were injured by the same pass-through overcharge levied by the entity at the top of the chain.[30] In effect, the Court dismissed Apple's view of the transactions between app developers, iPhone owners, and Apple, which was depicted in Apple's brief[31]:



In the Court's view, Apple is an intermediary in the distribution chain between app developers and iPhone owners. And "[a] retailer who is both a monopolist and a monopsonist may be liable to different classes of plaintiffs . . . when the retailer's unlawful conduct affects both the downstream and upstream markets."[32] The Court acknowledged that upstream app developers may also sue Apple, but the app developers would rely on a different theory of harm from the iPhone consumers: the app developers would be seeking lost profits they could have earned in a competitive market, and the iPhone consumers are seeking damages based on the price they could have paid in a competitive market.[33] In conclusion, the Court held that the iPhone owners have stand-

ing to sue Apple because they are direct purchasers from the alleged monopolist.

Justice Gorsuch authored the dissenting opinion. The majority characterized their decision as simply the obvious result of applying the *Illinois Brick* rule. The dissent, on the other hand, claimed that the majority has "recast[] *Illinois Brick* as a rule forbidding only suits where the plaintiff does not contract directly with the defendant."[34] The dissent explained that *Illinois Brick* and its predecessor *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*,[35] which held that an antitrust defendant may not avoid damages by claiming that any supracompetive prices were passed on to consumers, were grounded in the common law concept of proximate cause: "[U]nder ancient rules of proximate cause, the 'general tendency of the law, in regard to damages at least, is to not go beyond the first step.'"[36]

In the dissent's view, the app developers are the parties directly injured by Apple's 30 percent commission. If the commission is shown to be a monopolistic overcharge, then the app developers would be the party injured by it. The iPhone owners are only injured if the app developers are able to pass on the overcharge by raising prices for the apps.[37] While the majority accused Apple of putting form over substance, the dissent claims that the Court did the same by ignoring "the traditional proximate cause question where the alleged overcharge is first (and thus surely) felt."[38] The dissent noted that Apple could evade the Court's test by merely amending its contracts so that consumers pay app developers directly, and the app developers remit commissions to Apple.[39]

The theme of Justice Gorsuch's dissent was that antitrust rules should provide for certainty, even if that does not lead to complete antitrust justice. He praised *Illinois Brick* as a rule of "proximate cause and economic reality" which—"whatever its flaws"—was "far more sensible" than the "easily manipulated and formalistic" rule imposed by the majority.[40] He recognized that indirect purchasers no doubt are injured by anticompetitive conduct but warned of the immense practical difficulties of sorting out the injury for each level of indirect purchaser. He warned that "courts will have to divvy up the commissions Apple collected between the developers and the consumers. To do that, they'll have to figure out which party bore what portion of the overcharge in every purchase. And if the developers bring suit separately from the consumers, Apple might be at risk of duplicative damages awards totaling more than the full amount it collected in commissions."[41]

Recent Developments: The App Developers Bring Suit

As the dissent predicted, upstream app developers filed a complaint against Apple on June 4, 2019.[42] The plaintiffs and app developers Donald R. Cameron and Pure Sweat Basketball, Inc. filed a class action complaint alleging that Apple violated the Sherman Act and the California Unfair Competition Law by maintaining an "abusive monopoly in iOS app/in-app distribution services."[43] The plaintiffs claim that Apple attained monopoly power over the market for iPhone-compatible apps by refusing to permit anyone else to distribute apps to iPhone users. Apple exercises its allegedly monopolistic power by charging a 30 percent commission on the sale of paid apps and in-app products along with a $99 annual fee from developers who sell their products through the App Store.[44] The commission and annual fee have allegedly deterred potential app developers from designing and programming iPhone apps, which leads to less output and fewer distribution transactions. The app developer plaintiffs then complain that there are so many apps in the App Store, "huge numbers of apps necessarily get lost" because they are "buried among the 2 million+ available apps."[45] Apple's alleged monopoly over distribution of iPhone apps is preventing competitors from setting up their own app stores that could feature more apps. In the alternative, the app developers accused Apple of improperly attaining and exercising monopsony power over the buy-side market as the sole retailer of iPhone-compatible apps.[46]

[T]he issue of overlapping damages claims looms. Apple is facing the precise predicament Justice Gorsuch warned about—the threat of duplicative damages for the same conduct.

Unsurprisingly, the app developer plaintiffs cite to Apple's past filings in *Apple v. Pepper* for evidence. The complaint cites to Apple's briefs filed with the Ninth Circuit and Supreme Court to state that Apple has admitted that "developers are direct purchasers of distribution services from Apple."[47] The app developer plaintiffs point to Apple's claim that "the developer is also the first person to bear the alleged overcharge on the allegedly monopolized service," and developers are "the first party that directly pays an overcharge" and "the party injured in his business or property."[48] And the app developer plaintiffs cite to the Court's decision in *Apple v. Pepper* acknowledging that upstream app developers might also sue Apple on a different theory of harm from the iPhone owner plaintiffs.[49]

Then, on June 28, 2019, another app developer suit was filed. This suit also cited *Apple v. Pepper* as determining that app developers have standing to sue.[50]

What's Next?

In June 2019, the Ninth Circuit refused consumers' request to reassign the case from Judge Yvonne Gonzalez Rogers, who had initially dismissed the case for lack of standing.[51] On August 22, 2019, Judge Rogers granted Apple's request to relate the consumer case and the app developer cases on grounds that the matters are "underlined by the same oper-

ative facts—Apple's alleged monopolization of the distribution and sale of iPhone apps."[52]

The focus for now is on the merits of the claims. Apple's answer in *Pepper* asserts the procompetitive effects of the App Store and contests any antitrust liability. The answer also emphasizes that the Supreme Court's decision said nothing about the merits of plaintiffs' antitrust claims. Apple, in fact, asserts that "on the merits, Plaintiffs' complaint defies the Supreme Court's repeated admonition that the federal antitrust laws cannot be wielded to chill innovation and procompetitive conduct, such as Apple's."[53]

But the issue of overlapping damages claims looms. Apple is facing the precise predicament Justice Gorsuch warned about—the threat of duplicative damages for the same conduct. It seems quite possible therefore that the Ninth Circuit, and maybe even the Supreme Court, will be forced to revisit the same issues in the next few years.

In fact, Deputy Assistant Attorney General Michael Murray gave a speech on September 25, 2019, in which he concluded that the Supreme Court's decision only "nominally reaffirmed" *Illinois Brick* and in fact "laid" the "foundation" for "a subsequent case overturning *Illinois Brick*."[54] He argues that the decision's focus on the sparse text of the Sherman Act and Clayton Act allows longstanding precedent to be cast aside. He also speculates that the decision will allow "clever antitrust counsel" to restructure relationships so at to avoid privity and the potential resulting liability.

Both sides in *Apple v. Pepper* speculated about the impact of the decision on the future of direct purchaser litigation. The parties are currently living in that future, and, for now, it is just as messy as Justice Gorsuch predicted. ■

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1 Apple Inc. v. Pepper, 139 S. Ct. 1514 (2019).

2 Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

3 Antitrust Modernization Comm'n, Report and Recommendations 271 (2007), http://govinfo.library.unt.edu/amc/report_recommendation/toc.htm.

4 In a pre-opinion article in this magazine, author Ryan Sandrock set forth six possible opinions: (1) *Illinois Brick* Overruled; (2) Technology Platform Opinion; (3) Plaintiffs Win, *Illinois Brick* Stands; (4) Plaintiffs Win, *Illinois Brick* Explained; and (5) Apple Wins, *Illinois Brick* Stands, Apple Wins, *Illinois Brick* Explained. The Court's opinion fits into the third category: application of *Illinois Brick* in favor of plaintiffs, focused on transactional proximity, but which raises the question about whether app developers also have standing. Ryan M. Sandrock, Apple v. Pepper *and the Future of the Direct Purchaser Enforcement Regime*, Antitrust, Spring 2019, at 6.

5 Apple Inc. v. Pepper, 139 S. Ct. 1514, 1525 (2019) (Gorsuch, J., dissenting).

6 Class Action Complaint and Complaint for the Violation of the Sherman Act and California Unfair Competition Law, Cameron v. Apple Inc., No. 5:19-cv-03074-WHA (N.D. Cal. June 4, 2019) [hereinafter Complaint, Cameron v. Apple].

7 *Apple*, 139 S. Ct. at 1519.

8 *Id.* (quoting App. to Pet. for Cert. 53a).

9 *Id.* at 1519.

10 *Id.* at 1519–20 (citing *In re* Apple iPhone Antitrust Litig., 846 F.3d 313, 323–24 (9th Cir. 2017)).

11 *Id.* at 1520.

12 *Id.*

13 *Id.*

14 497 U.S. 199 (1990).

15 *Apple*, 139 S. Ct. at 1520.

16 *Id.* at 1521 n.2.

17 *Id.* at 1521.

18 *Id.* 1521–22.

19 *Id.* at 1522.

20 *Id.*

21 *Id.*

22 *Id.*

23 *Id.*

24 *Id.* at 1522–23.

25 *Id.* at 1523.

26 *Id.* at 1523–24.

27 *Id.* at 1524.

28 *Id.*

29 *Id.*

30 *Id.* at 1524–25.

31 Petitioner's Brief at 8, Apple Inc. v. Pepper, No. 17-204 (filed Aug. 10, 2018).

32 *Apple*, 139 S. Ct. at 1525.

33 *Id.*

34 *Apple*, 139 S. Ct. at 1526 (Gorsuch, J., dissenting).

35 392 U.S. 481 (1968).

36 *Apple*, 139 S. Ct. at 1526 (Gorsuch, J., dissenting) (quoting *Hanover Shoe*, 392 U.S. at 490, n.8).

37 *Id.* at 1528 (Gorsuch, J., dissenting).

38 *Id.* at 1529 (Gorsuch, J., dissenting).

39 *Id.* at 1530 (Gorsuch, J., dissenting).

40 *Id.* at 1526 (Gorsuch, J., dissenting).

41 *Id*. at 1529 (Gorsuch, J., dissenting).

42 Complaint, Cameron v. Apple, *supra* note 6.

43 *Id.* at 4.

44 *Id.* at 5.

45 *Id.* at 6.

46 *Id.* at 6–7.

47 *Id.* at 16 nn.38–39 ("Apps developers have standing under *Illinois Brick* to argue whatever they want *because they are direct purchasers of distribution services from Apple* . . . .").

48 Complaint, Cameron v. Apple, *supra* note 6, at 34–35.

49 *Id.* at 36 (citing Apple Inc. v. Pepper, 139 S. Ct. 1514, 1525 (2019)).

50 Class Action Complaint and Complaint for the Violation of the Sherman Act, Sermons v. Apple Inc., No. 5:19-cv-03796 (N.D. Cal. June 28, 2019).

51 Order, *In re* Apple iPhone Antitrust Litig., No. 14-15000 (9th Cir. July 16, 2019).

52 Order Granting Administrative Motions to Relate Cases, Pepper v. Apple Inc., No. 11-cv-06714-YGR (N.D. Cal. Aug. 22, 2019).

53 Answer, Pepper v. Apple Inc., No. 11-cv-06714-YGR (N.D. Cal. July 30, 2019).

54 Deputy Assistant Attorney General Michael Murray Delivers Remarks at the United States Council for International Business Competition Committee Meeting (Sept. 25, 2019), https://www.justice.gov/opa/speech/deputy-assistant-attorney-general-michael-murray-delivers-remarks-united-states-council.