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ANTITRUST TRADE AND PRACTICE

Expert Analysis

Potential Outcomes of 'Apple v. Pepper'

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On Nov. 26, 2018, the U.S. Supreme Court heard oral argument in a potentially landmark antitrust case: *Apple v. Pepper*, 846 F.3d 313 (9th Cir. 2017), cert. granted, 138 S. Ct. 2647 (2018) (No. 17-204). Respondents Pepper and a putative class of similarly situated iPhone owners are suing Apple for monopolizing, or attempting to monopolize, the market for iPhone applications ("apps"). Respondents seek treble damages under §4 of the Clayton Act. In 2013, the Northern District of California granted Apple's motion to dismiss the case, concluding that "any injury to plaintiffs is an indirect effect resulting from the software developers' own costs," and thus the plaintiffs were barred from bringing suit under the *Illinois Brick* doctrine. In 2017, the Ninth Circuit reversed and remanded, holding that plaintiffs are direct purchasers and therefore have standing to sue. In June 2018, the Supreme Court granted Apple's petition for writ of certiorari.

Indirect Purchaser Precedent

While §4 provides treble damages for *any* party "injured in his business or property by reason of anything forbidden in the antitrust laws," 15 U.S.C. §15(a), the Supreme Court has narrowed the interpretation of the statute in a trilogy of cases. First, in *Hanover Shoe v. United Shoe Machinery*, 392 U.S. 481 (1968), the defendant argued that the plaintiff passed on the defendant's allegedly illegal overcharge to its customers and thus suffered no injury. The court rejected this defense, holding that generally, antitrust violators may not use a pass-on defense to limit a plaintiff's recovery.

> All four potential Supreme Court decisions in 'Apple v. Pepper' come with varying implications.

The court expanded upon its interpretation of §4 in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). There, the state of Illinois sued Illinois Brick and 10 other concrete block manufacturers, arguing that they fixed the prices of concrete blocks, in violation of the Sherman Act. The state of Illinois alleged that it was injured because it paid more for construction projects than it would have with competitive concrete block prices. The concrete block manufacturers argued that any injury was indirect because they sold concrete blocks to masonry contractors, who submitted bids to general contractors, who then submitted bids to customers for construction projects. Expanding upon *Hanover Shoe*'s prohibition of the "defensive" pass on-theory, the court held that the State of Illinois, as an indirect purchaser, could not use an "offensive" pass-on theory to sue the concrete block manufacturers under §4. The overcharged *direct* purchaser (here, the masonry contractors) is the *only* party "injured in his business or property" within the meaning of §4.

Lastly, in *Kansas v. Utilicorp United*, 497 U.S. 199 (1990), the court held that when suppliers overcharge a public utility, which then passes the overcharge to its customers, only the utility company has a cause of action as the sole party who "suffered injury" within the meaning of §4. The court analogized the factual scenario to *Illinois Brick*, such that the consumers have the status of indirect purchasers and are not "the immediate buyers from the alleged antitrust violators." Id. at 207.

Arguments in 'Apple v. Pepper'

In *Apple v. Pepper*, respondents are purchasers of Apple's iPhones and iPhone apps through Apple's App

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Store. They argue that Apple monopolized and attempted to monopolize the iPhone app market by prohibiting app developers from selling iPhone apps anywhere other than through the App Store and by discouraging iPhone users from downloading unapproved apps. Respondents claim that they purchase apps *directly* from Apple's App Store, and that Apple gives 70 percent of the price to the app developers while retaining the remaining 30 percent of the price as a commission. They further assert that Apple's ability to demand a 30 percent commission from app developers demonstrates that Apple is charging a monopoly rent and that consumers would be charged lower prices for iPhone apps in a competitive market. Respondents also assert that their antitrust claim is not derivative of the app developers' potential claims against Apple, which are entirely different: "As suppliers of apps—not purchasers—they would be suing Apple as a monopsonist rather than as a monopolist, and their claims presumably would rest on the allegation that Apple's restraints cause them to earn lower profits."

In response, Apple argues that the respondents are *indirect* purchasers whose federal antitrust claims against it are barred by *Illinois Brick*. Apple describes the App Store as an "agency-based, two-sided marketplace, for connecting developers and consumers," where "Apple, as a principal, sells its own distribution services to iOS Developers. Apple, as an agent, sells apps at developer-set prices." Any consumers' injury, Apple asserts, occurs only if the app developers themselves raise prices in response to Apple's commission. Apple stresses that this damages theory "depends on precisely the sort of 'pass through' theory of harm that *Illinois Brick* is designed to prohibit" and "would invite duplicative recoveries."

Potential Outcomes

In deciding this case, the Supreme Court likely will render one of four decisions: (1) respondents are indirect purchasers whose claims are barred by *Illinois Brick*; (2) respondents are indirect purchasers, but the court remands the case so that the lower court may consider whether any of the exceptions to *Illinois Brick* apply; (3) respondents are indirect purchasers, but the court overturns *Illinois Brick*, allowing respondents to have standing; or (4) respondents are not indirect purchasers and therefore their claims are not governed by *Illinois Brick*.

Based on the Justices' questions during oral argument, only Chief Justice Roberts seemed to favor the first scenario. He pushed respondents' counsel to explain how permitting the lawsuit would not result in duplicative recoveries, conveying uncertainty that respondents would seek different damages than the app developers. Noting that there can be only one "monopoly rent," he questioned whether respondents were in fact direct purchasers.

The American Antitrust Institute (AAI) noted several potential negative consequences if respondents' suit is barred by *Illinois Brick*. First, AAI claimed it would result in underenforcement of the antitrust laws because app consumers, rather than app developers, are best suited to bring litigation under these circumstances: "[I]t is unlikely that [app developers]'s would challenge a distribution monopoly. They are, by definition, beholden to the monopolist to distribute their product, and some of them may benefit from the monopoly." Justice Breyer reiterated this concern during oral argument, noting that none of the tens of thousands of app developers have sued Apple for the alleged monopolistic behavior.

The AAI also raised a concern that barring respondents' suit could enable platform companies to shield themselves from antitrust liability based on mere structural formalities. It argued, "if Apple employed a wholesale model, consumers clearly would have standing to recover from Apple the overcharge paid for apps, and developers would have standing to recover their lost profits resulting from lower wholesale prices or reduced sales … . Nothing in economics or antitrust law suggests that a different *Illinois Brick* rule should apply to the use of an agency pricing model." The AAI thus cautioned that a decision barring suits against "agents" of app developers—as Apple currently describes its contractual relationship—could result in platform companies structuring contracts in a way that allows mere formalities to dictate who is and is not subject to suit.

Alternatively, the court could decide that although the respondents are "indirect purchasers," one of the exceptions to *Illinois Brick* applies. The court in *Illinois Brick* noted two possible exceptions: (1) "the pre-existing cost-plus contract" where "in setting the price at which to sell to indirect purchasers, the direct purchaser automatically adds a contractually predetermined sum to the price he paid the seller" 431 U.S. at 732 n.12; and (2) "where the direct purchaser is owned or controlled by its customer." Id. at 736 n.16. Some courts have expanded the second exception to include where the direct purchaser is owned or controlled by its *supplier*. See, e.g., *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1160-61 (5th Cir. 1979). Some courts have adopted a third exception—the "co-conspirator" exception—holding that *Illinois Brick* is

"inapplicable to claims against remote sellers when the plaintiffs allege that the sellers conspired with the intermediates in the distribution chain to fix the price at which the plaintiffs purchased." *State of Ariz. v. Shamrock Foods Co*., 729 F.2d 1208, 1212-13 (9th Cir. 1984). Thus, the Supreme Court could remand for the lower courts to determine the sufficiency of the pleadings or develop the factual record to decide if any of the exceptions would apply.

Otherwise, the court could decide that respondents have standing either as "direct purchasers" under *Illinois Brick* or by overruling *Illinois Brick*. Based on their questions during oral argument, several justices appeared to be in favor of this outcome, with Justices Sotomayor, Breyer, Kagan, and possibly Kavanaugh, expressing no concern that Petitioner's claim would be barred by *Illinois Brick*, while Justices Alito and Gorsuch questioned whether *Illinois Brick* should be overturned.

Justice Sotomayor reiterated Petitioners' argument that app consumers are direct purchasers from Apple, noting that, unlike the "vertical monopoly" in *Illinois Brick*, this situation is "dramatically different" in that the customers are transacting *with the monopolist itself.* Justice Breyer followed up with the analogy that "if Joe Smith buys from Bill, who bought from the monopolist, then we have something indirect. But, if Joe Smith bought from the monopolist, it is direct." Justice Kagan also observed that Apple App Store customers pay Apple directly.

Numerous industry groups identified concerns regarding the consequences for e-commerce markets of a decision for respondents. The Computer & Communications Industry Association stated in its amicus brief that such a ruling would particularly harm platform-based businesses because, "by definition, [they] interface with multiple interrelated groups of users," and thus could be subject to suit by multiple parties—app buyers and app creators. ACT—The App Association also submitted an amicus brief, arguing that permitting app consumers to sue would drastically undermine the vital relationship between platforms and app developers. It warned that affirming the Ninth Circuit's decision could "disrupt[] the symbiotic and pro-consumer relationship that exists between app developers and app platforms" which "could damage and disrupt an ecosystem that has demonstrated significant societal value." Finally, the Chamber of Commerce asserted in its amicus brief that a decision in favor of respondents would have ripple effects throughout the technology industry. It observed that a decision subjecting Apple to treble-damages liability in actions brought by remote purchasers would extend to other technology companies, which could "chill innovation, discourage commerce, and hurt developers, retailers, and consumers alike."

A decision in favor of app purchasers would most likely result in more frequent antitrust suits brought against platform developers.

Similar concerns would arise if the court overturns *Illinois Brick*, which both Justices Alito and Gorsuch suggested during oral argument may be the right outcome. Justice Alito questioned whether the economic theory underlying the decision in *Illinois Brick*—"what makes for an effective and efficient litigation scheme"—is still valid. Justice Gorsuch went even farther, noting that, even in states with *Illinois Brick* repealer laws, there have not been a huge number of reported duplicative recoveries like the *Illinois Brick* court feared would occur if indirect purchasers had standing under §4.

While neither party has asked the court to overturn *Illinois Brick*, Texas, Iowa, and 29 other states filed an amicus brief arguing for that outcome because the court "can overrule its precedents based on briefing by amici, and it has done so before." The 31 states note that States have "overwhelmingly rejected, under state antitrust law, a limitation of damages actions to those who purchased directly from a violator." As a result, they say, state courts and federal courts hearing state-law antitrust claims have *decades* of experience assessing proof and calculating damages experienced by *both* direct and indirect-purchasers, undermining the concern articulated in *Illinois Brick* that courts are unable to accurately calculate such damages.

All four potential Supreme Court decisions in *Apple v. Pepper* come with varying implications. A decision in favor of app purchasers would most likely result in more frequent antitrust suits brought against platform developers. Whether that means there is higher likelihood for duplicative recoveries, or more efficient enforcement of the antitrust laws, is now up for the Supreme Court to decide.