Implications and Questions Arising From The Supreme Court's Antitrust Ruling in *Apple, Inc. v. Pepper*

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Appellate and Supreme Court

On May 13, 2019, the Supreme Court (“the Court”) announced its 5-4 decision in *Apple, Inc. v. Pepper*, permitting iPhone users to proceed with an antitrust suit against Apple alleging that it monopolized the retail market for iPhone apps. The Court emphasized that it decided only the threshold issue, ruling that the iPhone users were not barred by federal law from bringing the suit, and did not address the merits of the claims. The Court concluded that consumers could bring suit against Apple because they purchased apps directly from Apple—through the Apple App Store—even if app developers (and not Apple) were setting the retail price of the apps. The opinion raises a number of questions about the Supreme Court’s antitrust precedents relating to direct and indirect purchasers, and it may encourage some businesses to re-evaluate the structure of their transactions.

Background on *Apple v. Pepper*

As the Court observed, the phrase “there’s an app for that”—for messaging, photography, videography, health, transportation, food ordering, weather, personal finance, and many other purposes—has firmly entered our popular lexicon. For iPhone users, those apps are available through the App Store, an electronic retail space where iPhone owners can purchase and download iPhone applications. Apple launched its App Store in 2008, the year after it began selling iPhones. The App Store currently houses approximately 2 million iPhone apps.

Apple generally does not develop the apps that are distributed through the App Store. Instead, independent app developers create apps and pay Apple a $99 annual fee to provide those apps to iPhone users through the App Store. App developers set the sales price for the apps (so long as that price ends in $0.99), and Apple earns a 30 percent commission on each app sale.

The plaintiff iPhone users claim that this arrangement raises antitrust issues. In 2011, four iPhone users alleged that Apple had monopolized the retail market for iPhone apps on the basis that iPhone users may obtain apps only through the App Store. The users complained that, if they could purchase apps from other sources, they would pay lower prices because they could pay less than the 30 percent commission Apple charges app developers. The plaintiffs allege that the app developers pass at least some of that charge on to iPhone users when setting app prices.

Apple moved to dismiss the complaint, arguing that developers, not iPhone users, pay the 30% distribution fee charged by Apple, which is reflected in the fact that app developers, not Apple, set the retail price for apps. Under *Illinois Brick*—which limited the class of potential antitrust plaintiffs to *direct* purchasers of an alleged monopolized good or service—the suit was barred.

Agreeing with Apple, the district court dismissed the complaint. On appeal, however, the Ninth Circuit reversed, concluding that the plaintiff iPhone users were direct purchasers from Apple when they bought iPhone apps through the Apple App Store.

The Supreme Court's Decision

The Supreme Court affirmed the Ninth Circuit in a 5-4 ruling. Writing for the majority, Justice Kavanaugh determined that "[t]he sole question presented at this early stage of the case is whether these consumers are proper plaintiffs for this kind of antitrust suit," and in particular, "whether the consumers were 'direct purchasers' from Apple." In the majority's view, that question was easily answered: because it was "undisputed that the iPhone owners bought the apps directly from Apple," it followed that "under *Illinois Brick*, the iPhone owners were direct purchasers who [could] sue Apple for alleged monopolization."

The Court viewed that to be a straightforward conclusion that followed from the statutory text and antitrust precedent. The majority concluded that the "broad text" of Section 4 of the Clayton Act, which confers the right to sue upon "any person" who has been "injured" by reason of an antitrust violation, "readily covers consumers who purchase goods and services at higher-than-competitive prices from an allegedly monopolistic retailer." And the "bright-line rule of *Illinois Brick*" means only that "indirect purchasers who are two or more steps removed from the antitrust violator in a distribution chain may not sue." Here, by contrast, there was "no intermediary in the distribution chain between Apple and the consumer," a fact the Court found to be "dispositive."

In rejecting the contention that consumers purchase directly from the app developers that set the retail price, the Court again cited Section 4's text and *Illinois Brick*, which in the majority's view "sought to ensure an effective and efficient litigation scheme." The Court concluded that it did so by establishing a "bright line that allowed direct purchasers to sue but barred indirect purchasers from suing," and was "not based on an economic theory about who set the price." The majority concluded that Apple's theory "would draw an arbitrary and unprincipled line among retailers based on retailers' financial arrangements with their manufacturers or suppliers." More specifically, that alternative rule would allow a consumer to "sue a monopolistic retailer when the retailer set the retail price by marking up the price it had paid the manufacturer or supplier for the good or service," but not "when the manufacturer or supplier set the retail price and the retailer took a commission on each sale." Apple's proposed rule therefore might "provide a roadmap for . . . evad[ing] antitrust claims," because retailers could sell based on commission rather than mark-up.

Finally, the Court looked to *Illinois Brick*'s rationales, which it concluded "cut strongly in the plaintiffs' favor." The majority opined that a bright-line direct purchaser rule would promote more effective enforcement of antitrust laws, and, even if the rule would result in complicated damages calculations, those are not uncommon in antitrust suits.

Justice Gorsuch, writing for the dissent, criticized the majority for "recasting *Illinois Brick*" in order to "replace[] a rule of proximate cause and economic reality with an easily manipulated and formalistic rule of contractual privity." In the dissent's view, *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." But plaintiffs' allegations "depend[] on just [that] sort of pass-on theory" because plaintiffs effectively seek to recover an alleged overcharge imposed on app developers in the first instance. And because plaintiffs advance a pass-on theory like the one *Illinois Brick* rejected, the case "will necessitate a complex inquiry into how Apple's conduct affected third-party pricing decisions," and "raise difficult questions about apportionment of damages . . . along with the risk of duplicative damages awards."

Implications & Questions

The Court's decision interprets *Illinois Brick* as setting forth a bright-line rule that consumers may bring antitrust claims against any allegedly monopolistic retailer from whom they directly purchase goods or services—regardless of whether that retailer sets the price of the goods or services. But the opinion leaves many questions unanswered.

For one, the Court's opinion emphasized that it did "not assess the merits of the plaintiffs' antitrust claims against Apple, nor … consider any other defenses Apple might have." And the Court, in addressing Apple's economic arguments, stated that, "[t]o be sure, if the monopolistic retailer's conduct has not caused the consumer to pay a higher-than-competitive price, then the plaintiff's damages will be zero," but the Court would not assume that for all cases and left that for case-by-case assessment.

Second, while the Court declined to overrule any of its precedents addressing pass-on theories of antitrust injury, it did not address a number of potential implications of its decision. For example, as Justice Gorsuch suggested in the dissent, the decision raises questions about the meaning of *Illinois Brick*. In the dissent's view, the plaintiffs' claims in this case present "even more starkly than did the claims at issue in *Illinois Brick"* the complications and inefficiencies of determining causation, avoiding duplicative damages, and addressing potential apportionment. The dissent also noted that *Hanover Shoe*'s status is not entirely clear: "Before today, *Hanover Shoe* would have prevented Apple from reducing its liability [in a hypothetical antitrust suit brought by app] developers by arguing that they had passed on [any] overcharge to consumers. But the Court's holding that *Illinois Brick* doesn't govern this situation surely must mean *Hanover Shoe* doesn't either."

Finally, the Court's decision raises a number of questions—particularly for companies that operate multi-sided platforms—about potential strategies for managing antitrust risk. Going forward, businesses may give further consideration to the structure of their transactions. In dissent, Justice Gorsuch suggested one possible means of restructuring as an illustration of his form-over-substance critique of the Court's opinion: "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."

What is clear is that there will be an active debate—and more litigation—over the proper application of the Court's decision going forward.

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