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Apple Inc. v. *Pepper* — Supreme Court Clarifies Scope of *Illinois Brick*

U.S. Supreme Court Permits Antitrust Claims Against Apple by Purchasers of iPhone Apps to Proceed Under *Illinois Brick*

SUMMARY

This week, in a widely watched antitrust case, the U.S. Supreme Court held in *Apple Inc.* v. *Pepper*[1] that the prohibition on indirect-purchaser claims articulated in *Illinois Brick Co.* v. *Illinois* did not bar a lawsuit brought against Apple by consumers who purchased iPhone applications from Apple's App Store. The Court ruled that, although developers set the prices of their "apps" sold through Apple's App Store, the consumers who bought those apps were direct purchasers from Apple, and thus permissible plaintiffs under *Illinois Brick*. In so ruling, the Court rejected Apple's argument that the *Illinois Brick* analysis should turn on whether an antitrust defendant sets the retail purchase price. The Court's decision clarifies the application of the indirect-purchaser bar in lawsuits against commission-based retailers, and thus may spur additional antitrust suits against such retailers.

BACKGROUND

Apple sells iPhone applications directly to consumers via its online App Store. The vast majority of these apps, however, are created by independent developers that contract with Apple to offer their products through the App Store. The developers set the price of their own apps (subject to certain constraints), and Apple retains a 30 percent commission on every sale.[2] Through technological and contractual limitations, Apple requires iPhone owners to purchase iPhone apps exclusively through the App Store.[3]

In *Apple Inc.* v. *Pepper*, a putative class of iPhone owners sued Apple under the antitrust laws for allegedly monopolizing the retail market for iPhone apps, arguing that Apple's imposition of a 30 percent commission, together with the foreclosure of other retail options for purchasing iPhone apps, amounts to

an unlawful, monopolistic pricing scheme.[4] Apple moved to dismiss, arguing that the lawsuit was barred by *Illinois Brick Co.* v. *Illinois*,[5] which precludes antitrust damages claims brought by indirect purchasers. In *Illinois Brick*, the defendant manufacturer sold concrete blocks to masonry contractors, who sold them on to general contractors, who in turn sold them to the State of Illinois. The Court ruled that Illinois could not sue the manufacturer for alleged price fixing, even if the entirety of the monopolistic overcharge had been passed on to the State.[6]

The district court agreed with Apple, ruling that the iPhone owners were indirect purchasers because app developers—not Apple—set purchase prices in the App Store.[7] The Ninth Circuit reversed, holding that the indirect-purchaser bar was inapplicable because the iPhone owners had purchased apps *directly* from Apple.[8] The Supreme Court granted certiorari.

THE SUPREME COURT'S DECISION

In a 5-4 opinion by Justice Kavanaugh, the Court held that *Illinois Brick* did not preclude the iPhone owners from asserting their antitrust claims against Apple. The majority reasoned that this "conclusion follows from the text of the antitrust laws and from [the Court's] precedents."[9] As to text, the Clayton Antitrust Act authorizes "any person" who has been "injured" by an antitrust violation to sue for damages.[10] In the Court's view, this "broad" language "readily" covered the plaintiffs in *Apple*, who alleged that they were injured by purchasing apps at higher prices than Apple could charge in a truly competitive market.[11] As to precedent, under the "bright-line rule" established in *Illinois Brick*, "immediate buyers" may sue for antitrust violations, whereas indirect purchasers "two or more steps removed from the violator in a distribution chain may not."[12] The Court reasoned that because the iPhone owners bought apps directly from Apple—rather than through an intermediary—*Illinois Brick* did not apply.[13]

The Court also rejected Apple's argument that a plaintiff may sue "only the party who sets the retail price"—here, the app developers—"whether or not that party sells the good or service directly to the complaining party."[14] The Court held that, in addition to undermining *Illinois Brick*'s bright-line rule, which "ensure[s] an effective and efficient litigation scheme in antitrust cases,"[15] this approach would arbitrarily distinguish between different types of upstream business arrangements.[16] Specifically, under Apple's proposed rule, a consumer could sue a retailer if it used a markup-based pricing model (where the retailer purchases the product from the manufacturer and then marks up the price before selling to the consumer), but not if it used a commission-based pricing model (where the manufacturer sets the retail price and the retailer takes a commission on each sale).[17] The Court saw no basis for distinguishing between these two scenarios and stated that doing so would enable monopolistic retailers to evade antitrust liability simply by restructuring their business models.[18]

The Court also rejected Apple's arguments based on the three rationales underlying *Illinois Brick*: (1) facilitating the effective enforcement of antitrust law; (2) avoiding complicated damages calculations; and (3) eliminating duplicative damage awards against antitrust defendants.[19] *First*, the Court reasoned

that accepting Apple's position would "contradict the longstanding goal of effective private enforcement and consumer protection in antitrust cases" by artificially limiting the class of proper plaintiffs to app developers.[20] *Second*, although the Court acknowledged that calculating damages might be complicated and require expert assistance, it described this as "hardly unusual in antitrust cases."[21] *Third*, the Court explained that its holding would not invite overlapping recoveries by multiple parties against a single defendant based on the same theory of harm. Whereas iPhone owners sought damages based on "the difference between the price they paid and the competitive price," a lawsuit brought by developers would seek "lost profits that they could have earned in a competitive retail market."[22]

Justice Gorsuch dissented, joined by the Chief Justice and Justices Thomas and Alito.[23] In the dissent's view, *Illinois Brick* bars "pass-on" theories of damages.[24] Here, because the alleged overcharge "falls initially on the developers"—who must then choose whether to "pass on" that charge to consumers—the dissent concluded that the facts fell squarely within the ambit of *Illinois Brick*.[25] The dissent criticized the majority for ignoring the economic substance of the transaction and supplanting *Illinois Brick*'s rule of proximate cause with a "formalistic rule of contractual privity."[26]

IMPLICATIONS

The Court's ruling in *Apple* clarifies application of the *Illinois Brick* indirect-purchaser bar, with potentially significant practical consequences. Retailers who operate on a commission basis—permitting the manufacturer to set the ultimate price, but retaining a commission for each sale—will likely be unable to invoke *Illinois Brick* as a bar to monopolization suits brought by consumers going forward. As a result, plaintiffs may seek to rely on *Apple* to pursue antitrust claims against other retailers with very high market shares that rely on this pricing model. The effect of the Court's holding may be particularly significant in the Third and Eighth Circuits, whose precedent Apple relied on in its arguments to the Court.[27] It is worth noting, however, that the Court expressly limited its holding to whether *Illinois Brick* barred the suit at issue, and did not address other defenses that retailers may assert in similar cases.[28]

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ENDNOTES

1 *Apple Inc.* v. *Pepper*, __ U.S. __ (2019), No. 17-204, slip op. (May 13, 2019).

2 *Id.* at 2.

3 *Id.*

4 *Id.* at 2-3.

5 431 U.S. 720 (1977).

6 *Id.* at 726-28.

7 *Apple Inc.*, slip op. at 3.

8 *Id.*

9 *Id.* at 4.

10 15 U.S.C. § 15(a).

11 *Apple Inc.*, slip op. at 5.

12 *Id.* (internal quotation marks omitted).

13 *Id.* at 6.

14 *Id.* at 7.

15 *Id.*

16 *Id.* at 8.

17 *Id.* at 8-9.

18 *Id.* at 9-10.

19 *Id.* at 11.

20 *Id.* at 12.

21 *Id.*

22 *Id.* at 13.

23 *Apple Inc.* (Gorsuch, J., dissenting), slip op. at 1.

24 *Id.* at 4.

25 *Id.* at 5.

26 *Id.* at 1, 8-9.

27 *See Howard Hess Dental Labs. Inc.* v. *Dentsply Int'l, Inc.*, 424 F.3d 363, 372 (3d Cir. 2005); *Campos* v. *Ticketmaster Corp.*, 140 F.3d 1166, 1172 (8th Cir. 1998).

28 *Apple Inc.* (majority opinion), slip op. at 2.

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