U.S. SUPREME COURT: ANTITRUST "DIRECT PURCHASER" RULE SURVIVES, BUT SO DO MONOPOLIZATION CLAIMS AGAINST APPLE

On May 13, 2019, the U.S. Supreme Court reaffirmed that private claims under the federal antitrust laws cannot be brought by "indirect purchasers" who did not purchase goods or services directly from the alleged anticompetitive actor(s), an important and longstanding constraint on treble damages claims. In *Apple v. Pepper*, the Court permitted a putative class of iPhone owners to proceed with their claims that Apple monopolized the aftermarket for iPhone applications ("apps"), allegedly allowing Apple to charge supracompetitive commissions on apps sold through its App Store. Yet in so doing, the Court held by a 5-4 vote that the iPhone owners' claims were not barred by the "direct purchaser" rule first articulated in the Court's *Illinois Brick* decision, because the iPhone owners claimed to have purchased apps directly from Apple.[1] While the facts of Apple's case may be unique, the decision could have significant implications as private litigants test the applicability of the Court's holding to similar online distribution platforms, with the Antitrust Division of the U.S. Department of Justice signaling that it plans to intervene in such cases.

Background: Federal Antitrust Law Bars "Indirect" Purchaser Claims

Section 4 of the Clayton Act permits "any person" injured by a violation of the federal antitrust laws to pursue a private damages claim for three times the amount of their injury.[2] In a pair of decisions in the 1960s and 70s, the Supreme Court limited antitrust damages actions to the parties that pay supracompetitive prices directly to antitrust violator(s). First, in *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, the Court invoked common law tort principles limiting damages claims to "the first step" in a chain of transactions,

1 No. 17–204 (May 13, 2019).
2 15 U. S. C. § 15(a).

holding that an antitrust defendant cannot avoid liability to a direct purchaser that has "passed on" some or all of an anticompetitive overcharge to downstream consumers.[3] A decade later, the Court held in *Illinois Brick Co. v. Illinois* that antitrust plaintiffs cannot recover damages for supracompetitive prices passed on to them by a party who dealt directly with the defendant(s).[4] With these decisions, the Court adopted a bright-line rule that avoided the challenges of apportioning damages between purchasers at different levels of the distribution chain.

The *Illinois Brick* doctrine has been subject to criticism. Consumer activists have argued, for example, that *Illinois Brick's* bar on "pass on" claims may deter private antitrust enforcement by limiting claims to directly-affected distributors who may not wish to sue their suppliers. Others assert that *Illinois Brick* encourages windfall damages to direct purchasers who sue despite passing on overcharges to their customers, while preventing recovery by the downstream consumers who ultimately bear the costs of the antitrust violation. For reasons like these, most U.S. states have, by statute or judicial decision, enacted contrary rules to *Illinois Brick*, allowing indirect purchasers to sue under those states' antitrust laws. Due to the discord between the federal and state antitrust standards, the Antitrust Modernization Commission—of which the current head of the Antitrust Division of the U.S. Department of Justice, Assistant Attorney General Makan Delrahim, was a member—also advocated for the repeal of *Illinois Brick* to allow for efficient litigation of direct and indirect purchaser cases in the federal courts.[5]

Apple v. Pepper

The *Apple* plaintiffs—a proposed class of iPhone owners—claimed that Apple monopolized the aftermarket for iPhone apps sold through its App Store, harming consumers by excluding competitors who might otherwise charge lower distribution prices and preventing app developers from selling apps to iPhone owners directly. The plaintiffs alleged that, while app developers decide whether, and at what prices, to charge for their apps, Apple takes a 30% commission on all apps sold through the App Store. According to the plaintiffs, although Apple does not take ownership of the apps, consumers pay Apple directly: Apple deducts its 30% commission and remits the balance to the app developer.

The district court dismissed the complaint, holding that *Illinois Brick's* direct-purchaser rule barred the claims, because Apple charged its 30% commission to the app developers as a distribution cost. iPhone owners incurred this cost only indirectly to the extent it was passed on in the price of the app. On appeal, the Court of Appeals for the Ninth Circuit reversed the district court's ruling. The appellate court held that the "direct-purchaser" rule did not bar the iPhone owners' claims, because the plaintiffs had alleged that Apple distributed apps directly to consumers.

Apple sought Supreme Court review, arguing that *Illinois Brick* "allows consumers to sue only the party who sets the retail price" of a product. The Antitrust Division joined the Solicitor General in filing an amicus brief urging the Court to hear the appeal and adopt Apple's view of the *Illinois Brick* direct-purchaser rule.

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3 392 U. S. 481 (1968).
4 431 U. S. 720, (1977).
5 Antitrust Modernization Comm'n, Report and Recommendations (Apr. 2007), *available at* https://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

The Majority

The Supreme Court affirmed the Ninth Circuit's decision, which will allow the case to go forward. The majority opinion, authored by Justice Kavanaugh, emphasized the "undisputed" allegation that the plaintiff iPhone owners bought the apps "directly from Apple," and paid the alleged overcharge "directly to Apple." This fact compelled the "straightforward conclusion" that the iPhone owners were "direct purchasers" not barred from suit by what the majority characterized as *Illinois Brick's* "bright-line rule" prohibiting indirect purchaser claims. The majority explained that, unlike in *Illinois Brick*, there was "no intermediary in the distribution chain" between the iPhone owners and Apple, the alleged antitrust violator.

In so holding, the majority rejected Apple's argument that *Illinois Brick* permits plaintiffs to sue "only the party who sets the retail price" of a good, whether or not that party dealt with the plaintiff directly. The Court held that Apple's "who sets the price" theory would replace *Illinois Brick's* bright-line rule with arbitrary distinctions based on retailer's pricing models. As an example, the majority explained, Apple's proposed rule would allow direct purchasers to recover from monopolistic retailers who imposed their own retail mark-up, but not when the retailer charged the same supracompetitive price based on a commission arrangement with an upstream manufacturer. Finally, the majority held that the risk that app developers could *also* sue Apple on a "monopsony" theory did not present the *Illinois Brick* concern for "conflicting claims to a common fund." The Court explained that seeing both upstream and downstream claims is "not atypical" in cases where "the intermediary in a distribution chain is a bottleneck monopolist or monopsonist (or both) between the manufacturer on the one end and the consumer on the other end."

In light of its conclusion that *Illinois Brick* does not bar the plaintiffs' claims against Apple, the Court noted that it had "no occasion" to consider arguments—raised by thirty-one State Attorneys General in an amicus brief—for overruling *Illinois Brick*.[6]

The Dissent

In a sharply-worded dissent, Justice Gorsuch, joined by the remaining members of the Court, insisted that *Illinois Brick* barred the plaintiffs' claims. Justice Gorsuch—who as a judge on the Court of Appeals for the Tenth Circuit authored several opinions articulating concern that over-application of the antitrust laws could chill economically beneficial free-market behavior—criticized the majority decision as recasting *Illinois Brick* "as a rule forbidding only suits where the plaintiff does not contract directly with the defendant." To the dissenters, the suit against Apple was premised on "just the sort of pass-on theory that *Illinois Brick* forbids." The dissent focused on the fact that Apple's 30% commission "falls initially on the developers," making them the parties "directly injured" by the alleged overcharge. The plaintiff iPhone owners would only suffer injury if the developers "are able and choose to" pass on the overcharge by raising app prices. The dissent also posited that the majority's holding "replaces a rule of proximate cause and economic reality with an easily manipulated and formalistic rule of contractual privity." Under the majority's test, Apple or other retailers could evade antitrust liability by

[6] Brief for Texas, Iowa, and 29 Other States as Amici Curiae in Support of Respondents, *Apple, Inc. v. Pepper*, Case No. 17-204 (Oct. 1, 2018).

contracting for payment to be processed by the supplier, who would then remit the commission to the retailer.

Implications

Following *Apple*, *Illinois Brick* remains on the books and will continue to narrow antitrust class actions to damages incurred by those who have directly bought from, or sold to, an alleged violator. The Supreme Court confirmed the prior rule prohibiting federal antitrust claims by a consumer that is "two or more steps removed" in a "vertical distribution chain." In contrast, the majority suggested, upstream and downstream claims are not in conflict in cases involving an "intermediary" distributor like Apple—where there is an allegation that the plaintiffs directly purchased the product from that distributor. Those who have advocated for *Illinois Brick* to be overturned may see this decision as a chink in the precedent's armour and be rejuvenated in their calls for its repeal.

The *Apple* case will now return to the district court for further proceedings, which may involve further motions practice regarding the complaint and, if unsuccessful, will then lead to discovery and briefing on the merits of the plaintiffs' antitrust claims.

Although limited to determining whether a plaintiff may pursue antitrust damages under the *Illinois Brick* direct-purchaser rule, this decision demonstrates the Supreme Court's confidence that prevailing antitrust doctrine is sufficiently versatile to address the digital economy. Both the majority and the dissent employed hypotheticals involving brick-and-mortar businesses to explain the application of the antitrust laws to Apple's online marketplace. Yet it would be premature to view this decision as leading to greater antitrust enforcement against tech companies. Whereas the Supreme Court's decision examines a private damages standard, government enforcers will likely continue to adhere to a "consumer welfare" standard, which counsels that consumers benefit from the efficiencies generated by free-market competition and the innovation it drives.

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