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Antitrust Group

Client Alert

Supreme Court Opens Door to Antitrust Claims Against Online Platforms in *Apple Inc. v. Pepper*

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In *Illinois Brick*, the Supreme Court established a fundamental rule that—barring limited exceptions—only antitrust plaintiffs who purchase products or services *directly* from an entity charging inflated prices can seek damages for their overcharges.[1] Indirect purchasers (typically consumers) cannot sue such an entity under federal antitrust law, even though their overcharges may have been passed on to them by direct purchasers (such as distributors or retailers). The *Illinois Brick* rule has been justified as facilitating more effective enforcement of the federal antitrust laws by concentrating damages recoveries in directly affected parties, simplifying damages calculations, and preventing antitrust defendants from facing duplicative claims. However, the rule has been controversial, and it is not applied to indirect purchasers suing defendants under the antitrust laws of many states.[2]

In *Apple Inc. v. Pepper*, the Supreme Court was given the opportunity to revisit *Illinois Brick* in the context of digital commerce transactions. In their *amicus* brief, 30 states and the District of Columbia argued that the Supreme Court should overrule *Illinois Brick*.[3] While the Supreme Court declined to take up the states' invitation, it has handed down a decision that affects the antitrust risk calculus for certain online platforms and other entities that operate in two-sided markets.[4] The Supreme Court held that users who purchased products directly from Apple (and by implication, from other similarly situated platforms and intermediaries) may seek antitrust damages for Apple's alleged overcharges—irrespective of whether the platform or another party (such as an application developer) sets the retail price of the product to the consumer.

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1 *See generally Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

2 *See* Brief for Texas et al. as Amici Curiae in Support of Respondents, at 12, *Apple Inc. v. Pepper*, No. 17- 204 (May 13, 2019).

3 *Id.* at 6.

4 In two-sided markets, a platform or other intermediary connects users on one side of the market with suppliers on the other. Credit card networks (which act as an intermediary between cardholders and merchants) and newspapers (which connect readers with advertisers) are two classic examples of intermediaries in two-sided markets.

Background

The dispute in *Apple Inc. v. Pepper* centered on Apple's iPhone App Store. Developers create applications for the App Store pursuant to contracts with Apple. Apple charges a 30% commission to developers every time a user downloads their applications. Developers set the retail price to users for purchasing their applications. Whenever an iPhone user purchases an application through the App Store, Apple deducts its 30% developer commission and the remainder is remitted to the developer. By contract, and because of technological limitations, the App Store is the only place where iPhone owners may lawfully buy iPhone applications, and the only place where developers may sell them.

Plaintiffs—iPhone users who bought applications through the App Store—alleged that Apple monopolized the aftermarket for iPhone applications, causing iPhone users to pay higher prices for those applications.[5] Apple moved to dismiss these claims, arguing that its 30% commission was incurred by application developers and then passed on to iPhone users that Apple argued were indirect purchasers.[6] Plaintiffs contend that they were direct purchasers who had standing to sue under *Illinois Brick* because they purchased applications directly from Apple through the App Store.[7]

The Northern District of California agreed with Apple,[8] but the Ninth Circuit reversed, finding Plaintiffs to be direct purchasers because they purchased applications directly from Apple.[9]

The Supreme Court's Decision

On May 13, 2019, the Supreme Court affirmed the Ninth Circuit's ruling in a 5-4 decision that confirmed Plaintiffs' standing to sue Apple to recover their alleged overcharges without implicating the indirect purchaser prohibition in *Illinois Brick.*[10] In a majority opinion written by Justice Kavanaugh, the Court noted that *Illinois Brick* established a bright-line rule allowing suits by direct purchasers.[11] iPhone users were direct purchasers because users paid the alleged overcharges directly to Apple.[12]

The Court rejected Apple's claim that *Illinois Brick* only allows consumers to sue the party who sets the retail price of a product.[13] The Court reasoned that this theory is inconsistent with Section 4 of the Clayton Act, which broadly affords injured parties a right to sue under antitrust laws that are designed to promote efficient litigation and "the longstanding goal of effective private enforcement and consumer protection."[14] The Court explained that Apple's proposed rule would create unjustified distinctions between (a) traditional wholesaler-retailer models (where a retailer adds a mark-up to the wholesale price and profits by that margin), and (b) "commission pricing model[s]" under which a manufacturer and retailer agree to sell a product for a certain price, and the manufacturer profits by that commission. In theory, the Court noted, that commission could equate to the same margin that the retailer would have made under the traditional model.[15] Apple's "line-drawing" did "not make a lot of sense" to the Court, which held that the "form of the upstream arrangement between the manufacturer or supplier and the retailer" should not determine whether a consumer can sue a monopolistic retailer, as it would allow monopolists to escape antitrust scrutiny.[16]

The Supreme Court also rejected Apple's argument that barring iPhone users from recovering their alleged overcharges would advance the goals of the *Illinois Brick* doctrine (i.e., facilitating more effective enforcement of antitrust laws, avoiding complicated damages calculations, and eliminating

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[5] Resp't's Brief at 1, *Apple Inc. v. Pepper*, No. 17-204 (May 13, 2019).
[6] Pet'r's Brief at 2-3, 5, *Apple Inc. v. Pepper*, No. 17-204 (May 13, 2019).
[7] *Id.* at 13-14, 24-37.
[8] *See In re Apple iPhone Antitrust Litig.*, Case No. 11-cv-06714-YGR, 2013 WL 6253147, at *6-*7 (N.D.Cal. Dec. 2, 2013)
[9] *See In re Apple iPhone Antitrust Litig.*, 846 F.3d 313, 322-24 (9th Cir. 2014).
[10] *See Apple Inc. v. Pepper*, No. 17-204, slip op., at 1 (May 13, 2019).
[11] *Id.* at 5-6.
[12] *Id.*
[13] *Id.* at 7-11.
[14] *Id.* at 7, 12.
[15] *Id.* at 8-9.
[16] *Id.*

duplicative claims).[17] The Court explained that iPhone users should not be left at "the mercy of monopolistic retailers" simply because upstream application developers also could sue Apple.[18] The Court also disagreed that calculating damages would be too difficult under the Court's reading of *Illinois Brick*, or that such a reading would result in conflicting or duplicative claims.[19] The Court held that the "mere fact that an antitrust violation produces two different classes of victims hardly entails that their injuries are duplicative of one another."[20] The Court further stated:

> A retailer who is both a monopolist and a monopsonist[21] may be liable to different classes of plaintiffs—both to downstream consumers and to upstream suppliers—when the retailer's unlawful conduct affects both the downstream and upstream markets. Here, some downstream iPhone consumers have sued Apple on a monopoly theory. And it could be that some upstream app developers will also sue Apple on a monopsony theory. In this instance, the two suits would rely on fundamentally different theories of harm and would not assert dueling claims to a "common fund," as that term was used in *Illinois Brick*. The consumers seek damages based on the difference between the price they paid and the competitive price. The app developers would seek lost profits that they could have earned in a competitive retail market. *Illinois Brick* does not bar either category of suit.[22]

The Dissenting Opinion

Justice Gorsuch authored the dissenting opinion and was joined by Justices Roberts, Thomas, and Alito.[23] The dissent observed that the 30% commission "initially" was incurred by developers—that is, that developers were the only parties directly injured by the alleged overcharge.[24] Plaintiffs could only be injured if the developers chose to pass on the overcharge to them.[25] According to the dissent, allowing such a "pass-on" case would necessitate complex damages calculations.[26] The dissent also suggested one possible means of restructuring transactions to avoid antitrust scrutiny, stating: "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."[27]

What Happens Next?

The Supreme Court held that iPhone users were direct purchasers that could seek damages from Apple without implicating the *Illinois Brick* rule. However, the Court did not reach the merits of Plaintiffs' claims. In order to recover from Apple. iPhone users and application developers (assuming they pursue claims) still need to meet their burden of proving in the district court proceedings that Apple's conduct harmed competition and resulted in anticompetitive effects.

Apple Inc. v. Pepper comes on the heels of another Supreme Court case, *Ohio v. American Express* Co. ("Amex"), where the Court, this time led by a conservative majority, rejected plaintiffs'

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[17] *Id.* at 11-14.
[18] *Id.* at 11-12.
[19] *Id.*
[20] *Id.* at 13.
[21] A monopsonist is a single buyer that controls a dominant portion of the purchases of the goods or services in question.
[22] *Id.* at 13.
[23] *Id.* (Gorsuch, dissenting).
[24] *Id.* at 5.
[25] *Id.*
[26] *Id.*
[27] *Id.* at 8.

antitrust claims based on Amex's use of anti-steering provisions in its agreements with merchants.[28] In *Amex*, the Supreme Court held that plaintiffs' claims failed because plaintiffs did not prove anticompetitive effects. Plaintiffs focused only on showing that Amex had increased merchant fees on credit card transactions on the merchant side of the market without accounting for the value that Amex cardholders derived from those fees in the form of enhanced cardholder services and benefits on the consumer side of the market.[29] *American Express* underscores that establishing anticompetitive harm may be a significant hurdle in two-sided markets, especially for suppliers such as application developers, because they need to show harm to both sides of the market, not just to their own.

Implications of the Decision

Key takeaways from the Supreme Court's decision include:

- The *Illinois Brick* rule remains intact notwithstanding efforts by many states to overturn it.
- Online platforms and other intermediaries that transact directly with consumers may have antitrust exposure for their pricing decisions even where the prices that consumers pay are set by the platform's suppliers, rather than the platform itself.
- Online platforms, distributors, and other intermediaries may consider having their suppliers transact directly with consumers and require their suppliers to pay them, rather than consumers, in order to mitigate the impact of the Supreme Court's decision.
- Justice Kavanaugh's decision to join the liberal majority and author the opinion in *Apple Inc.* v. *Pepper* suggests that he will be an influential and potentially decisive voice in Supreme Court antitrust cases going forward.

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[28] *See generally* 138 S. Ct. 2274 (2018).

[29] *Id.*