

## *Apple Inc. v. Pepper*: The Supreme Court Chips Away at *Illinois Brick*, Allowing iPhone Users to Sue Apple for Monopolizing iPhone Apps

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### Key Points

- The U.S. Supreme Court split 5-4 on how to apply *Illinois Brick*'s prohibition on federal indirect purchaser lawsuits to a case where plaintiff app purchasers bought apps from the Apple App Store, paying a price set by the app developers not Apple.
- While both the majority and the dissent signaled potential antagonism to *Illinois Brick*, the plaintiff app purchasers did not ask that it be overruled, focusing instead on having the Court uphold the 9th Circuit's application of the case.
- In the short term, the decision permitting the suit to go forward will likely have only marginal practical impact; longer term, this opinion signals that this Court might consider overturning *Illinois Brick*.

### Apple's App Store

You may be reading this Alert on an iPhone or iPad. If so, you are undoubtedly aware that one of the apps on your device is "the App Store," where you can find millions of apps you can download for innumerable purposes. By and large, Apple does not create these apps. They are created by independent app developers who contract with Apple to make their apps available in the App Store. The only place on your iPhone or iPad that you can buy these apps, however, is the App Store. When you do buy an app through the App Store, the price has been set by the app developer, but the money you pay goes to Apple, which collects a 30 percent commission and then gives the rest of the money to the app developer. The plaintiffs in *Apple Inc. v. Pepper*, 587 U.S. \_\_\_\_ (2019), say that they've paid too much for apps because of Apple's allegedly anticompetitive policy of not allowing app purchasers on Apple devices to buy apps from other platforms. That policy has allowed Apple to make more money by charging a higher commission than it would have in a competitive situation.

But the iPhone owners ran into a legal problem: *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), which prohibits federal antitrust suits by indirect purchasers. Apple argued that the commissions it received were from the app developers who then determined what price to charge the app purchasers. In *Illinois Brick* parlance, the app developers

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were the “direct purchasers” because they paid a commission ostensibly to use the App Store platform and the plaintiff app purchasers were “indirect purchasers” paying the price determined by the app developers. The district court agreed with Apple and dismissed the suit under *Illinois Brick*. The 9th Circuit disagreed, finding that the plaintiff app purchasers bought the apps from Apple through the App Store and were thus “direct purchasers” from Apple.

### **The *Illinois Brick* Rule: No Damages for Indirect Purchasers in Antitrust Cases**

The Supreme Court decided in 1977 that the state of Illinois could not sue Illinois Brick Company, a manufacturer of concrete blocks, because the company sold its products to masonry contractors, who in turn sold the products to general contractors, who in turn sold them to the state. The Court reasoned that the state was too far down the distribution chain and that only the masonry contractors (the direct purchasers) could recover any alleged anticompetitive overcharge by Illinois Brick Company.

The rationale of the decision was essentially one of judicial economy. The Court held that it would be too complicated and too unwieldy for courts to try to determine whether direct purchasers like the masonry contractors passed an alleged overcharge on to others (the general contractors) in whole, in part or not at all and whether the passed-on overcharges were then passed on to the end purchaser state in whole, in part or not at all. This was especially true, in the view of the Court, because a seller defendant like Illinois Brick Company cannot defend against a direct-purchaser suit on the ground that alleged overcharges were “passed on.” *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968).

**Diagramming** *Illinois Brick* helps understand what led to the sharp split in *Apple v. Pepper*.

In the diagram linked above, both the flow of charges (and the alleged overcharges) and the order of purchases go in the same direction. Illinois Brick Company overcharged the masonry contractors, who may or may not have passed it onto others. Also, Illinois Brick Company sold directly to the masonry contractors, who then subsequently sold the overcharged bricks.

The facts of *Apple v. Pepper* do not fit neatly into this rubric. Please click [here](#) to view.

If we focus on the flow of the alleged overcharge, Apple charges a 30 percent commission to app developers, who then set a price that does or does not pass on all (or a portion) of the 30 percent overcharge. In other words, the iPhone owners may pay all, none or some portion of the alleged difference between a competitive commission and the alleged “monopoly” commission that Apple charges. Focusing, instead, on the order of purchases, iPhone owners purchase apps from the App Store, paying Apple, who then passes on the money (minus its commission) to the app developers.

So, then, the key question becomes: Is *Illinois Brick* about whom the plaintiff paid or is it about whether there are intermediary economic actors between the plaintiff and the defendant that determine whether and to what extent any harm passes to the plaintiff? Justice Kavanaugh and the Supreme Court’s majority said it was the former; Justice Gorsuch and the dissent, the latter. Reading the tea leaves, the only thing on which the justices seem to agree is that Illinois Brick may be due for reconsideration.

## Majority and Dissent Split on Which Relationship Matters

Justice Kavanaugh's short opinion for the majority can be summarized as follows: iPhone users buy apps directly from Apple through the App Store. Therefore, under *Illinois Brick*, they are direct purchasers. "All of that seems simple enough."<sup>1</sup>

Though the case is all about how to apply *Illinois Brick*, the majority opinion does not start with *Illinois Brick*. Rather, it starts by quoting Section 4 of the Clayton Act, which "provides that *any person* who shall be injured in his business or property" may sue for harms under the antitrust laws.<sup>2</sup> "The broad text of § 4," the opinion continues, "readily covers consumers who purchased goods or services at higher-than-competitive prices from an allegedly monopolistic retailer."<sup>3</sup>

The opinion then turns to *Illinois Brick* and describes it as simply creating a "bright-line," "straightforward" rule that direct purchasers may seek damages, while those "who are two or more steps removed from the antitrust violator in a distribution chain may not sue."<sup>4</sup> "The iPhone owners pay the alleged overcharge directly to Apple. The absence of an intermediary is dispositive."<sup>5</sup> For the majority, *Illinois Brick* is about the privity relationship between the plaintiff and the defendant.

The opposite is true for the dissent. For Justice Gorsuch and the other dissenters, *Illinois Brick* is about the economic pass-through and is born out of the practical difficulties of calculating damages where harm is filtered through an economic intermediary.<sup>6</sup> "Plaintiffs can be injured only if the developers are able and choose to pass on the overcharge to them in the form of higher app prices that the developers alone control."<sup>7</sup> Like *Illinois Brick*, most of the dissent is devoted to explaining the difficulties attendant to calculating how much of the monopolistic surplus would be passed on to the plaintiffs.<sup>8</sup> For the dissenters, *Illinois Brick* is about the economic relationship between the plaintiff and the defendant; if there is an intermediate economic actor who can alternatively absorb or pass through the supracompetitive price, that actor is the only proper plaintiff.

## Despite Disagreeing on the Outcome, They Might Agree on *Illinois Brick*

There appeared to be agreement from **both** opinions that *Illinois Brick* should probably be reconsidered. At oral argument, justices in both the majority and the dissent questioned the decision's continued viability and the wisdom of overturning it. In both opinions, the justices took some subtle and not-so-subtle swipes at *Illinois Brick* and signaled that they believe the case is worth reconsidering. For instance, in the majority opinion, as noted, Justice Kavanaugh starts with a textual analysis based on the phrase "any person" in Section 4 of the Clayton Act.<sup>9</sup> This notion patently rejects the central rationale of *Illinois Brick*, that courts should not engage in the difficult task of splitting up supracompetitive rents among downstream actors.<sup>10</sup> As Justice Gorsuch notes, "Maybe the Court proceeds as it does today because it just disagrees with *Illinois Brick*."<sup>11</sup>

Potentially signaling agreement, the dissent recounts arguments from *amici* in favor of overturning *Illinois Brick* and declares, "Maybe there is something to these arguments; maybe not."<sup>12</sup> Yet the plaintiffs did not ask the court to do so; in fact, they explicitly disavowed that they were seeking an overruling at oral argument.<sup>13</sup> Thus, the dissent noted, the Court did not have the benefit of full briefing on the "many hard questions" that would need to be answered. But it is hard to read either the majority or the dissent as particularly fond of *Illinois Brick*.

## Practical Considerations Moving Forward

While this case will get a lot of attention, we do not expect it to have a tremendous impact on litigation outside the technology space in the near term. For now, the law of the land is that courts will simply ask “did the plaintiff purchase the product directly from the defendant?” If the answer is “yes,” they are a direct purchaser. For markets involving tangible goods, this represents little change; like *Illinois Brick*, both the privity and economic relationships will run in parallel.

Indeed, the decision likely has little effect on the thorny *Illinois Brick* issues pending in lower courts. For example, the 7th Circuit is currently considering whether *Illinois Brick* bars suits by health care provider hospitals and clinics where the nominal direct purchasers (medical product distributors) are part of an alleged conspiracy with the manufacturers of medical products. See *Marion Healthcare, LLC, et al. v. Becton Dickinson & Co., et al.*, No. 18-3735 (7th Cir.). Despite both cases hinging on *Illinois Brick*, *Apple v. Pepper* offers little, if any, guidance to the 7th Circuit’s determination of whether *Illinois Brick* applies where the plaintiff purchased products from an alleged antitrust conspirator but not directly from the alleged manufacturer monopolist.

Even within the technology space, Apple (and companies like it) should be able to avoid such suits as a matter of prospective liability by changing the flow of payments from its App Store, so that they go to the app developers who then pay a commission to Apple.

Longer term, plaintiff class action lawyers will likely be emboldened to engage in a litigation strategy that seeks to overturn *Illinois Brick*, which would enable indirect purchasers to seek damages under federal antitrust laws. While significant, this would not be an entirely watershed outcome: Many states have laws that already allow indirect purchaser lawsuits, and national antitrust class actions are routinely accompanied by indirect purchaser class actions based on state law.

<sup>1</sup> *Pepper*, Slip Op. at 7.

<sup>2</sup> *Id.* at 4 (emphasis in original, quotation marks omitted).

<sup>3</sup> *Id.* at 5.

<sup>4</sup> *Pepper*, Slip Op. at 5–6.

<sup>5</sup> *Id.* at 6.

<sup>6</sup> *Pepper* dissenting opinion at 4–6.

<sup>7</sup> *Id.* at 5.

<sup>8</sup> *Id.* at 5–7.

<sup>9</sup> *Pepper*, Slip Op. at 5.

<sup>10</sup> *Id.* at 9–10.

<sup>11</sup> *Pepper* dissenting opinion at 9.

<sup>12</sup> Note, at oral argument, Justice Gorsuch himself seemed to advocate that the Court should explore overturning *Illinois Brick*.

<sup>13</sup> Tr. of Oral Arg. 40