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Report from Washington

Supreme Court Considers How the *Illinois Brick* Doctrine Applies to Apple's App Store and Other Electronic Marketplaces

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Introduction

"You're asking us to extend Illinois Brick*...But why should we build on* Illinois Brick*? Shouldn't we question* Illinois Brick*, perhaps, given the fact that so many states have done so. They've repealed it."*

— Justice Gorsuch

The Supreme Court heard oral arguments in *Apple v. Pepper*, No. 17-204, on November 26, 2018, to decide if purchasers of "apps" on the Apple iPhone may sue Apple for alleged monopolization of the market for iPhone apps, despite the fact that those apps are developed and priced by third parties. During argument, the Court re-considered the *Illinois Brick* doctrine—which prohibits suits under the Sherman Act by so-called "indirect purchaser" plaintiffs—and its application to this case. Justices Breyer, Ginsburg, Kagan, Kavanaugh, and Sotomayor pushed Apple's counsel on how *Illinois Brick* applies to this set of circumstances where app purchasers ***did*** buy apps directly from Apple. By contrast, Chief Justice Roberts, and to some extent Justices Alito and Gorsuch, questioned Plaintiffs' counsel more extensively on how Plaintiffs' claim could survive a motion to dismiss under the *Illinois Brick* doctrine. Justices Alito and Gorsuch also asked counsel for both parties whether *Illinois Brick* should be overturned.

The case has attracted significant interest from a number of third parties, with the U.S. Government submitting an amicus brief in support of Apple and 31 states submitting a brief in favor of overturning *Illinois Brick* altogether. The Court's decision in this case could provide guidance on how antitrust law applies to modern industries and business models, specifically by clarifying how the *Illinois Brick* doctrine applies to the electronic marketplace and other e-commerce businesses that do not use a traditional distribution model.

Background

In 2011, a group of iPhone app purchasers filed a putative class action suit in the District Court for the Northern District of California against Apple Inc. under § 2 of the Sherman Act, alleging that Apple has monopolized the market for iPhone apps on the App Store. In their

operative complaint, Plaintiffs allege that Apple offers third-party developers the opportunity to sell their apps on the App Store in exchange for a $99 annual registration fee and a 30% commission on the sale of all apps and in-app purchases. App purchasers pay the full price of the app directly to Apple when they purchase it on the App Store, after which Apple remits 70% of the proceeds to the developer, keeping the remainder as the commission. The iPhone is also a "closed system," meaning that Apple controls all apps that are sold and operate on the device. For that reason, Apple prohibits app developers from selling iPhone apps on other platforms, and prohibits iPhone owners from downloading apps that are not sold through the App Store. Plaintiffs allege Apple's conduct has enabled it to charge an exorbitant 30% commission, which Plaintiffs paid as part of the purchase price of the apps.

"[W]hat was Illinois Brick *about? Was it about a vertical supply chain or, instead, was it about a pass-through theory?"*

— Justice Kagan

Apple moved to dismiss the complaint on the basis that Plaintiffs, as indirect purchasers, lacked antitrust standing under § 4 of the Clayton Act to sue Apple. Apple relied primarily on the Supreme Court's seminal 1977 decision *Illinois Brick Co. v. Illinois*,[1] in which the Court barred suits for damages by indirect purchasers under the federal antitrust laws. In so ruling, the Supreme Court emphasized three principal concerns: (1) duplicative liability and inconsistent judgments, (2) evidentiary complexities of apportioning damages between direct and indirect purchasers, and (3) undermining incentives for private enforcement by diluting the direct purchaser's ultimate recovery.

Apple argued that the district court should follow the approach of the Eighth Circuit in *Campos v. Ticketmaster Corp.*[2] In that case, ticket purchasers sued Ticketmaster for monopolizing the market for ticket distribution services. The Eighth Circuit held that those ticket purchasers were indirect purchasers as to Ticketmaster because of Ticketmaster's "antecedent transaction" with the concert venues. In reaching this decision, the Eighth Circuit did not find it dispositive that the ticket purchasers had purchased the tickets from Ticketmaster, and instead focused on the fact that Ticketmaster's compensation was derived from its contracts with venues. By the same token, Apple argued that its antecedent transactions were with the app developers, and app consumers were not direct purchasers despite paying the purchase price of the app to Apple.

The district court granted Apple's motion to dismiss, agreeing that the Plaintiffs were indirect purchasers barred from suing Apple for damages by the *Illinois Brick* doctrine.

[1] 431 U.S. 720 (1977).

[2] 140 F.3d 1166 (8th Cir. 1998), *cert. denied*, 525 U.S. 1102 (1999).

Specifically, the district court noted that Plaintiffs' claim rested on a theory that the app developers have "passed on" Apple's commission to the app purchasers in the prices they set.

The Ninth Circuit reversed, holding that the app purchasers were in fact direct purchasers as to Apple and consequently have standing to sue Apple for damages. The Ninth Circuit framed the issue by looking at the "fundamental distinction between a manufacturer or producer, on the one hand, and a distributor, on the other," noting that Plaintiffs would have standing to sue the latter but not the former. The Court ultimately held that Apple was a distributor of the third-party apps because it supplied the apps directly to the purchasers, who simultaneously paid Apple the full purchase price of the apps. Consequently, the Court held that the app distributors had standing to sue Apple for allegedly monopolizing the market for iPhone apps. In reaching its decision, the Ninth Circuit expressly disagreed with the Eighth Circuit's *Campos* decision.

"But we have ambiguity about what Illinois Brick *means here, and shouldn't that ambiguity, if—if there is such ambiguity, be resolved by looking at the text of the statute? Any person injured?...That's broad."*

— Justice Kavanaugh

In August of 2017, Apple petitioned the Supreme Court for a writ of certiorari, and the U.S. Solicitor General submitted a brief in support of that petition. The Supreme Court granted the petition to resolve the circuit split on the application of *Illinois Brick* to these e-commerce distribution services scenarios.

Oral Argument

Justices Sotomayor, Breyer, Ginsburg, Kagan, and Kavanaugh pushed back against Apple's claim that Plaintiffs lacked statutory standing to sue Apple, noting that app purchasers bought their apps directly from Apple. These justices appeared to view the factual background of *Apple v. Pepper* as "dramatically different" from that of previous cases examining the *Illinois Brick* standard. Specifically, Justice Sotomayor noted that unlike the purchasers in previous *Illinois Brick* cases—who purchased products from distributors in a vertical supply chain—the app purchasers here bought products directly from Apple in a "closed loop." Justice Breyer agreed that the fact that the app purchasers bought apps directly from the alleged monopolist distinguished this case from *Illinois Brick*. Consequently, he suggested holding that app purchasers have standing to sue Apple would not conflict with the Court's prior decision. When Apple's counsel argued that that distinction was irrelevant because the allegedly monopolized transactions stemmed from Apple's distribution service contracts with the app developers, Justice Kagan pointed out that Plaintiffs claimed the relevant market was for iPhone apps, not for distribution services, in which case she believed the app purchasers' payments directly to Apple distinguish it from the transactions in other *Illinois Brick* cases.

Solicitor General Noel Francisco, arguing on behalf of the United States in support of Apple, urged the Court to view the issue from a proximate cause rather than a transactional proximity perspective. General Francisco clarified that the Court should focus on whether or not it is speculative that Apple's 30% commission caused consumers to pay higher prices, especially in light of the fact that app developers could have absorbed that commission without raising prices. Justice Kavanaugh pushed back on General Francisco's characterization of the transactions, reiterating Justice Kagan's point that Apple effectively served as a retailer in its sale of apps to consumers. Because Apple's role differed in this case, Justice Kavanaugh maintained that there was some ambiguity as to how *Illinois Brick* applied to these circumstances. He subsequently stated that, given this ambiguity, the Court should look to the text of the statute, which specifically states that "any person injured" by a violation of the antitrust laws can have standing to sue the perpetrator, opening the door to a broader revisiting of the *Illinois Brick* doctrine.

When the focus shifted to the rationale behind the *Illinois Brick* decision, Apple's counsel maintained that *Illinois Brick* firmly rejected the pass-through theory. The justices did not necessarily agree. While Justice Alito stated that he believed the *Illinois Brick* decision was not focused on an economic theory but instead was premised on the Court's desire to develop "an effective and efficient litigation scheme," Justice Gorsuch said he understood *Illinois Brick* to be premised on the economic realities of the underlying transactions rather than the contractual formalities that exist between the alleged monopolist and victim.

Justice Roberts briefly raised the specter of duplicative recovery, pressing Pepper's counsel to confirm that, if consumers are allowed to sue, Apple would not be subject to multiple lawsuits. Pepper's counsel responded that Plaintiffs' damages—higher prices than they would ordinarily pay in a competitive market—are distinct from those of the app developers—lost profits from selling apps to iPhone owners through Apple's App Store.

At several points some of the justices questioned whether the Court should consider overturning at least in part the landmark *Illinois Brick* decision. Touching upon his argument that *Illinois Brick* rested on the notion that courts should have an effective litigation scheme, Justice Alito questioned if direct purchasers are in fact the most effective enforcers to sue in the antitrust context. To illustrate his point, Justice Alito asked Apple's counsel if any of the app developers had attempted to sue Apple for its alleged monopolization of the app distribution market. Apple's counsel responded they had not, but maintained that the app developers' inaction was not a result of Apple's efforts to keep them from pursuing litigation. Justice Gorsuch raised a similar concern that the app developers, or entities in the chain of distribution in general, would not have an incentive to sue if the

monopolists opt to share the monopoly overcharge with them. Furthermore, Justice Gorsuch noted that 31 states had explicitly disagreed with the holding in *Illinois Brick* by repealing it in their state antitrust statutes.

With those issues in mind, several of the justices notably asked both Apple and Plaintiffs' counsel if the *Illinois Brick* doctrine should be overturned. Both parties claimed they did not want to overturn the case, albeit for different reasons. Counsel for Apple indicated the Court should leave such a decision to the political branches, noting that Congress has contemplated overturning the doctrine but legislation has never gained any traction. By contrast, Plaintiffs' counsel maintained that the app purchasers fell squarely within the definition of a direct purchaser, so for purposes of resolving this case, respondents were not asking the Court to overturn *Illinois Brick* and the Court did not need to consider that larger question.

Implications

The justices' questions seemed to indicate they may be rethinking the applicability of the traditional *Illinois Brick* doctrine to modern markets. The Court's opinion may thus provide clarity as to how the *Illinois Brick* doctrine applies to the e-commerce market and other burgeoning sales channels. If that is the case, the Court's decision will follow a recent trend of opinions that shed light on how antitrust law applies and adapts to modern industries, as just last term the Court released an opinion providing guidance on how the Rule of Reason applies to two-sided electronic commerce markets.[3]

Given the combination of justices who criticized Apple's claim that app purchasers do not have standing to sue Apple, the Court seems primed to hold that Plaintiffs have pled sufficient statutory standing to sue Apple. Should the Court side with Plaintiffs in this case and allow the suit to go forward, it may be inclined to issue a narrow opinion applicable only to facts closely analogous to the Apple App Store.

Nonetheless, the Court's questions and concerns raised by third parties leave open the possibility that the Court could issue a broader opinion that alters the *Illinois Brick* doctrine to some extent. Although the U.S. Government argued in support of Apple in this particular case, current leaders of the Department of Justice's Antitrust Division have reportedly expressed the view that the *Illinois Brick* doctrine should be overturned.[4] Furthermore, 31

[3] *Ohio v. Am. Express Co.*, 138 S. Ct. 2274 (2018).

[4] *The Latest: Trump DOJ's Next Target: the Illinois Brick Indirect Purchaser Rule?*, NAT'L. L. REV. (Feb. 2, 2018), *https://www.natlawreview.com/article/latest-trump-doj-s-next-target-illinois-brick-indirect-purchaser-rule*.

states filed an amicus brief seeking to overturn that decision. A broader ruling that alters or overturns the *Illinois Brick* doctrine altogether would dramatically alter the landscape of private antitrust litigation.

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