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Apple v. Pepper, Indirect Purchaser Antitrust Class Actions, and the Future of Illinois Brick (Part 2)

by Bona Law PC

Author: **Jarod Bona**

This is part two of an article **about the Supreme Court's 2019 decision in Apple v. Pepper, the classic antitrust cases of Illinois Brick and Hanover Shoe, indirect purchaser lawsuits, and state antitrust claims**. If you haven't read that article, you should because it provides the background for this article.

If you read it, but it has been awhile because we published it a long time ago—yes, **we've been busy opening offices** and hiring **new attorneys** (and **attorneys** and **attorneys**)—here is where we left off:

We described how the **US Supreme Court** decided to deal with the issue of both direct purchasers and indirect purchasers wanting damages for alleged antitrust violations. The Supreme Court first prohibited defendants from raising the defense that direct purchasers "passed-on" any damages to indirect purchasers (**Hanover Shoe**).

Later, the Supreme Court prohibited indirect purchasers from seeking damages for federal antitrust claims (**Illinois Brick**).

When the indirect purchasers—represented by **a resourceful bunch**—then ran to the states and brought actions under state antitrust law, the Supreme Court reviewed whether those claims should be preempted by federal law. They (perhaps surprisingly), let the claims continue to go forward (**California v. ARC America Corp**.).

So the Supreme Court left a bit of a mess in the **antitrust class action world**. Defendants can't argue that direct purchasers passed on any damages, indirect purchasers can only bring injunctive actions under federal antitrust law, and indirect purchasers bring damage actions under state antitrust laws (but only some state antitrust laws because not all of them allow indirect purchaser damage claims). **Antitrust class actions are certainly complex**.

By the way, before we dig into the issues, just a reminder that **we at Bona Law** are biased **in favor of antitrust class action defendants because we defend class action lawsuits**. We don't represent plaintiff classes in class actions (despite many requests to do so).

The Supreme Court and Apple v. Pepper

The **US Supreme Court took up Apple v. Pepper** and had to determine whether certain plaintiffs were direct or were indirect purchasers in this **antitrust class action**. Phrased that way, the case doesn't look that interesting. But before the decision came out, there was some speculation about whether the Supreme Court would gut the entire indirect/direct purchaser structure. The present structure doesn't make much sense and isn't based upon statute anyway (like much of federal antitrust law, I suppose).

Apple v. Pepper involves an **antitrust class action** lawsuit by consumers purchasing Apps from Apple and App developers (indeed—the actual source of their purchase is part of the controversy). They contend that Apple "has monopolized the retail market for the sale of apps and has unlawfully used its monopolistic power to charge consumers higher-than-competitive prices." (slip p. 1).

For those of you that recently arrived from 1985, here is how the Apple App Store works: If you own an IPhone and want to add an app to your phone, you have no choice but to purchase it through the Apple App Store, which—according to the US Supreme Court—contains about 2 million apps available for download.

You might think to yourself, "Wow, Apple has been busy; it must be a lot of work to create 2 million separate apps." But, no, Apple isn't doing that themselves and they aren't even hiring out to do it. Instead, independent app developers create the apps and, through contract, the apps are sold in the app store to consumers (my **use of passive voice** here is purposeful—as telling you who is selling them takes a position in this case; sort of, anyway).

The app developers pay Apple a $99 membership fee and get to pick the price for their app, so long as it ends in **$0.99—an old marketers trick**. No matter what the sales price, Apple keeps 30 percent of the revenue for each sale.

Apple asserted that the consumers can't sue for damages under federal antitrust law because they are indirect purchasers under **Illinois Brick**, and the App developers are the direct purchasers from Apple. Plaintiffs, by contrast, allege that they are—literally—direct purchasers because they purchase Apps from Apple in the Apple App Store.

The Result: Spoiler

This may ruin the ending—so go to the next paragraph if you don't want to hear it: The plaintiffs won, as the Supreme Court held that plaintiffs are, indeed, direct purchasers and were thus not precluded from the indirect-purchaser rule from suing for damages under federal antitrust law.

The Majority Opinion in Apple v. Pepper

Justice Kavanaugh wrote the majority opinion (joined by Justices Ginsburg, Breyer, Sotomayor, and Kagan (my administrative law professor at Harvard Law: in case you were wondering, she came off as smart, charismatic and funny)).

The Supreme Court summarized the plaintiff class antitrust claim as follows: "that Apple exercises monopoly power in the retail market for the sale of apps and has unlawfully used its monopoly power to force iPhone owners to pay Apple higher-than-competitive prices for apps." (slip p. 4).

And the Court distilled the issue before it as "whether these consumers are proper plaintiffs for this kind of antitrust suit—in particular, our precedents ask, whether the consumers were 'direct purchasers' from Apple." (slip p. 4).

To answer this question, Justice Kavanaugh consulted both the text of the Sherman Act and precedent.

Consulting the text of a statute is a common and appropriate approach to interpreting a statute—but this is less common with federal antitrust laws because the text doesn't say much and the federal courts have created a sort of common law of antitrust doctrine.

[In fact, Courts will often explain that when Section 1 of the Sherman Act says it prohibits "every contract, combination . . . or conspiracy in restraint of trade," it doesn't really mean it because, well, every contract, combination and conspiracy does, technically, restrain trade because it limits the contractual ability within the market of one or more players. Instead, the first section of the Sherman Act prohibits "unreasonable" restraints. Sure, that clears it up.]

Anyway, Justice Kavanaugh recited **Section 2 of the Sherman Act**, then moved on to Section 4 of the Clayton Act, which describes **who can sue under the antitrust laws**: "*any person* who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue." (slip p.4). Well, that's easy, the Court concluded, because "any person" "readily covers consumers who purchase goods or services at higher-than-competitive prices from an allegedly monopolistic retailer." (slip p. 5).

Now, on to precedent. According to **Illinois Brick** and **Kansas v. UtiliCorp. United, Inc**., the Supreme Court has "consistently stated" that "'the immediate buyers from the alleged antitrust violators' may maintain a suit against the antitrust violators." At the same time, "*indirect purchasers* who are two or more steps removed from the violator in a distribution chain may not sue." (slip p. 5).

We knew that already: That is the indirect purchaser rule. But how do we apply it here?

In this case, for Justice Kavanaugh and the majority, the answer is obvious. No complex analysis required. The IPhone owners purchased the apps directly from Apple—in the Apple App Store. And Apple is the alleged antitrust violator. So the IPhone owners are direct purchasers—literally—from Apple—duh! Privity.

According to the Court, the "absence of an intermediary is dispositive." (slip p. 6).

As the Court says, "All of that seems simple enough." But then the Court goes on to address Apple's "strenuous" arguments "against that seemingly simple conclusion." (slip p. 7).

Notably, Apple argues that the indirect purchaser rule "allows consumers to sue only the party who sets the retail price, whether or not that party sells the good or service directly to the complaining party." (slip p. 7). In this case, of course, the app developer set the retail price, not Apple.

The Court dismisses that argument, explaining that (1) Apple's theory contradicts statutory text and precedent; (2) Apple's proposed rule is not persuasive economically or legally; and (3) Apple's rule would provide a roadmap for monopolistic retailers to structure their manufacturer/supplier transactions to evade antitrust claims by consumers.

In addition, while addressing hypotheticals of various sorts of distribution structures, the Court explained that accepting Apple's rule would elevate form—the upstream distribution arrangement between the supplier and retailer—over substance ("is the consumer paying a higher price because of the monopolistic retailer's actions?").

This form/substance distinction keeps showing up in Supreme Court antitrust cases (**American Needle**, **NC Dental**, etc.). Watch for it—including in the dissent.

Of course, in this case, the Court's invocation of the form v. substance distinction doesn't seem to fit because the entire basis for the indirect purchaser rule is to elevate an arbitrary form over substance to simplify antitrust enforcement. So if we are going to use the form v. substance reasoning to decide this, we might as well go all the way and just trash the rule and doctrines surrounding indirect purchasers. And that is where we could end up in the future.

The Court next supported its decision by reference to the three reasons the ***Illinois Brick*** Court listed for barring indirect purchaser suits:

First, allowing IPhone consumers to sue—despite Apple's arguments to the contrary—certainly facilitates more effective enforcement of antitrust laws. More classes of plaintiffs = more lawsuits.

The ***second*** rationale of Illinois Brick was to avoid complicated damages calculations. The Court explains that expert testimony like this isn't unusual in an antitrust case. Of course, this rationale for the indirect purchaser rule seems to be outdated for that same reason.

The ***third*** leg supporting Illinois Brick and its surrounding doctrine is "eliminating duplicative damages against antitrust defendants." It looks like the three-legged stool just fell because the present reality contemplates state antitrust indirect purchaser claims and federal direct purchaser claims at the same time (**remember ARC America**).

Anyway, the Court dismissed this concern because what Apple faced was not two sets of plaintiffs going after the same damages for one action, but instead two sets of plaintiffs going after Apple on both sides—upstream and downstream—because Apple's conduct affected both consumers and suppliers. This point isn't that persuasive, however, because it is preordained by the Court's decision to define the consumers as direct purchasers. But for that conclusion, Apple wouldn't really be in the middle between consumers and the App developers. Instead, the vertical line would go like this: Apple, App Developers, Consumers.

In summary, Justice Kavanaugh took a straightforward or simplistic (pick the word based upon whether you like the decision) approach to determining whether the IPhone consumers were direct or indirect purchasers of the Apps.

What was telling, however, was that when Justice Kavanaugh examined the decision in the context of the rationale for the overall doctrine, it was clear that the indirect-purchaser doctrine doesn't make much sense in **the practical world of antitrust litigation**. The Court wasn't ready to junk it yet, but I wouldn't be surprised to see that in the future.

If the Court can remove resale price maintenance from federal antitrust per se condemnation, it can gut a Supreme Court-made doctrine from the 1970s that—like some of the architecture of the same era—just isn't necessary to experience anymore.

The Dissent in Apple v. Pepper

Justice Gorsuch penned the dissent, joined by Chief Justice Roberts, and Justices Thomas and Alito.

The Dissent says that the Majority "replaces a rule of proximate cause and economic reality with an easily manipulated and formalistic rule of contractual privity." (Dissent slip p. 1).

That is interesting because the Majority seemed to think that the contrary result would have allowed easy manipulation and elevated form over substance. So the Justices all agree that formalism and manipulation is bad, but can't seem to agree which result will lead to those sins.

The Dissent sees the indirect purchaser doctrine (including **Hanover**, etc.) as rooted in proximate causation—antitrust with a backdrop of the common law. The Dissent points out, interestingly enough, that with a proximate-cause rationale for the entire doctrine, it doesn't make sense to have different approaches to injunctive relief and damages. (Reminder: The indirect purchaser doctrine only applies to actions for damages, not injunctive-relief actions).

I know this is a dissent, but it is four Justices: Is this the first pesky thread to the unraveling of *Illinois Brick*?

The Majority took a straightforward approach to the issue: The consumers purchased directly from Apple, so they are "direct purchasers," not indirect purchasers.

The Dissent, by contrast, explained that Apple charges a 30% commission to the developers, so if Apple is engaging in anticompetitive conduct, these developers are the ones that are directly injured. The next question is whether the ***app developers*** pass on the alleged overcharge to consumers. And that question is what *Illinois Brick* sought to prohibit. (Dissent slip p.5).

The Dissent then goes through the catastrophic difficulties of calculating overcharges and everything else that *Illinois Brick* and *Hanover Shoe* warned about.

Interestingly, the Dissent also speculated that Apple may face duplicative liability if the developers might bring suit separately from the consumers, **which actually did happen**. The separate suits were combined before the same judge.

The Majority explained that its decision avoided a form over substance ruling. But the dissent accuses the Majority of exalting form over substance by focusing on privity instead of the "traditional proximate cause question." And the Dissent also worried that it would be easy for Apple to evade antitrust liability under the Majority's decision. The Majority, of course, worried about the same if the Dissent were to prevail.

Interestingly, the Dissent accuses the Majority of just pretending to agree with Illinois Brick because it "proceeds to question each of Illinois Brick's rationales—doubting that those directly injured are always the best plaintiffs to bring suit, that calculating damages for pass-on plaintiffs will often be unduly complicated, and that conflicting claims to a common fund justify limiting who may sue." (Dissent slip p. 9).

Why Didn't the Supreme Court Overrule *Illinois Brick*?

Doesn't it seem like all the Justices have some doubts about *Illinois Brick* and its surrounding doctrine (and for good reason)?

They could have overruled it. But they didn't. According to the Dissent, the "plaintiffs have not asked us to overrule our precedent—in fact, they've disavowed any such request. So we lack the benefit of the adversarial process in a complex area involving a 40-year-old precedent and many hard questions." (Dissent slip p. 11). That is a good point.

The Future of *Illinois Brick*

Illinois Brick, *Hanover Shoe* and the entire gang are here until the Supreme Court says it isn't. But I would expect that litigants would begin challenging its application, despite the majority opinion. To the extent any of the Justices recited the rationales for *Illinois Brick* in supporting their decision, their words seemed forced and they came close to admitting that they didn't believe in the basis for the doctrine.

So if *Illinois Brick* has a future, it needs a new foundation. You saw in the dissent a proposal for that foundation—proximate cause. Of course, that leaves open the question of *Hanover Shoe* and whether defendants can use pass-on as a defense as it is stretching to apply proximate cause to limit that defense.

In the meantime, I expect both plaintiffs and defendants to challenge the limits of this doctrine and to seek decisions from federal district and **appellate** courts on these issues. They may lose and lose, but eventually the **Supreme Court** may take it up again and that is where we may see some change.

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