Antitrust

Justice Department Urges Supreme Court To Resolve Scope of *Illinois Brick* in Case With Major Implications For Tech Industry

By: Daniel T. Fenske and Gabriel K. Gillett

Last week, the US Department of Justice urged the US Supreme Court to grant review in *Apple Inc. v. Pepper*, No. 17-204, which centers on the scope of the so-called bar on indirect purchaser suits under *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).[1] A class of consumer plaintiffs alleged that Apple monopolized the iPhone app distribution market through its closed-system App Store, enabling it to charge app developers a higher commission than it could in a competitive market. That, in turn, allegedly caused app developers to charge more for apps than they would have if Apple's commission were lower, harming consumers. The district court dismissed the suit as incompatible with *Illinois Brick*, because the plaintiffs' theory alleged that developers passed on Apple's overcharge to consumers through higher app prices. The Ninth Circuit disagreed, concluding that because consumers had a direct relationship with Apple by purchasing apps through Apple's own App Store, *Illinois Brick* did not apply.

The solicitor general has now urged the Supreme Court to grant review of the Ninth Circuit's decision and reverse. The solicitor general argues that *Illinois Brick* applies if the plaintiff's theory of harm is premised on the defendant allegedly passing on higher costs imposed by a third-party, even if the plaintiff had a direct relationship with the defendant. Under that test, Apple would prevail because the plaintiffs' theory is that consumers were harmed when app developers passed on Apple's allegedly excessive commissions in the form of higher prices for the apps themselves. That consumers have a "direct" relationship with Apple is irrelevant in the solicitor general's view.

The solicitor general's position dramatically increases the likelihood that the Court will hear the case, which has potentially significant implications for the antitrust risks facing tech companies that operate online sales platforms. A ruling for Apple could provide a road map for operators of those platforms—such as StubHub, eBay, Google and Facebook, among others[2]—to significantly reduce their federal antitrust exposure. Such a ruling could also impact the antitrust risk from distribution structures in other sectors of the economy. Thus, the Court's forthcoming decision about whether to hear the *Apple* case—and the outcome of the case if the Supreme Court hears it—warrants close attention.

I. The Scope of *Illinois Brick* and the *Apple* case.

Section 4 of the Clayton Act authorizes treble damages to "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws."[3] But that remedy, the Supreme Court explained in a trio of cases dating back fifty years, is not available to indirect purchasers who assert a "pass-on" theory of injury. In *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, the Court held that a defendant could not avoid a Section 4 damages claim simply because its customer (the plaintiff) passed on the alleged overcharge to its own customers.[4] In *Illinois Brick*, the Court extended *Hanover Shoe* by holding that a downstream plaintiff could not predicate a Section 4 damages claim on allegations that it paid more than it otherwise would have when the person who first paid an overcharge (commonly called the direct purchaser) passed on that overcharge to the plaintiff (the indirect purchaser).[5] And in *Kansas v. UtiliCorp United Inc.*, the Court reaffirmed *Hanover Shoe* and *Illinois Brick* and declined to "carve out exceptions" that may undermine the rule against indirect-purchaser suits.[6] In each case, the Court reasoned that allowing claims or defenses based on a pass-on theory would risk holding a defendant liable multiple times for the same conduct and would "greatly complicate and reduce the effectiveness" of claims for treble damages.[7]

In *Apple Inc. v. Pepper*, Robert Pepper sued on behalf of a class of individuals who purchased apps from developers through the App Store, Apple's electronic "closed system" marketplace.[8] Plaintiffs alleged that they overpaid when buying apps from developers, through the App Store, because Apple charges developers a 30% commission based on the sale price set by the developer.[9] The plaintiffs' theory is that Apple would have to charge a lower commission if it had not monopolized the app market by operating a "closed system," that is, if it allowed app developers to sell their apps through other platforms beyond Apple's own App Store. The district court found that plaintiffs had alleged that the 30 percent commission was "borne by the *developers*" and then "passed-on to u[sers] as part of the purchase price" for each app.[10] As a result, the district court found *Illinois Brick* barred plaintiffs' claim.[11]

The Ninth Circuit reversed. The panel interpreted the Supreme Court's teachings as barring indirect-purchaser damages claims against manufacturers and producers, but permitting those claims against distributors with which the plaintiff has a direct relationship.[12] Function was key, the panel explained. And because Apple functioned as a distributor of apps—delivering them directly to consumers on behalf of developers—the Ninth Circuit held that plaintiffs could pursue treble damages against Apple under Section 4.[13] The Ninth Circuit reached that conclusion despite acknowledging that developers could bring their own Section 4 claims against Apple, and that developers (not Apple) set the price of apps, which seemed to risk the duplicative recovery and complex damages analysis that *Illinois Brick* sought to avoid.[14] The panel also acknowledged that it was creating a circuit split, as it expressly "disagree[d] with the majority's analysis" in *Campos v. Ticketmaster Corp.*, 140 F.3d 1166 (8th Cir. 1998).[15]

Apple sought certiorari and the Court sought the views of the solicitor general. Last week, the solicitor general urged the Court to grant review and reverse, reasoning that *Illinois Brick* does not turn on whether the plaintiffs have a "direct" relationship with the defendant, but rather on the plaintiffs' theory of harm. In his view, if the plaintiffs are necessarily relying upon a "pass-on" theory of damages—where the plaintiff purchased a product at an allegedly inflated price because a third-party passed on allegedly inflated costs from a monopolist in an upstream market—then *Illinois Brick* bars the suit. Here, because the plaintiffs' theory of harm is that app developers have passed on Apple's allegedly inflated commissions in the form of higher app prices, their claims flounder under the Solicitor General's reading of *Illinois Brick*.[16] The solicitor general urged the Court to grant review to resolve the conflict between the Eighth and Ninth Circuits "on an important question of federal antitrust law."[17]

The solicitor general's support for Apple's petition increases the likelihood of a cert grant, as the Court is more likely to hear a case that the solicitor general agrees the Court should hear.[18]

II. Potential Implications of *Apple Inc. v. Pepper*

Apple is poised to have a major impact. If the Court grants the petition and adopts the solicitor general's proposed interpretation of *Illinois Brick*, then companies that operate online marketplaces will have a roadmap to significantly lower their risk of federal antitrust consumer suits. Under the solicitor general's proposed rule, any online marketplace may be largely immune from those suits if (1) third parties set the prices and (2) the marketplace operator receives compensation through a sales commission. Under such a structure, after all, the marketplace operator does not determine the prices charged to consumers and so could harm the consumer only if the third party passes on excessive commissions. Any consumer suit based on purchases through an online marketplace premised on that pass-on theory would thus run headlong into the *Illinois Brick* rule, as the solicitor general interprets it. Further, the Supreme Court's resolution of the *Apple* case could impact other distribution arrangements—not just online marketplaces. *Apple* thus could impact the way that tech companies across the United States, and possibly other companies, choose to structure their operations to minimize the risk of antitrust consumer suits. Accordingly, impacted companies should closely watch the *Apple* case.

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[1] Br. of United States as *Amicus Curiae, Apple Inc. v. Pepper*, No. 17-204 (U.S. May 8, 2018) ("Amicus Br.").

[2] See Petition for a Writ of Certiorari, *Apple Inc. v. Pepper*, No. 17-204, at 5 (Aug. 2, 2017).

[3] 15 U.S.C. § 15(a).

[4] 392 U.S. 481, 487-89 (1968).

[5] *See* 431 U.S. at 730-32.

[6] *See* 497 U.S. 199, 216 (1990).

[7] *Illinois Brick,* 431 U.S. at 731-32; *see also Hanover Shoe*, 392 U.S. at 493-94; *UtiliCorp.,* 497 U.S. at 216.

[8] *In re Apple iPhone Antitrust Litig.*, 2013 WL 6253147, at *1-2 (N.D. Cal. Dec. 2, 2013).

[9] *Id.* at *2.

[10] *Id.* at *5-6.

[11] *Id.*

[12] *In re Apple iPhone Antitrust Litig*., 846 F.3d 313, 324 (9th Cir. 2017).

[13] *Id.* at 323.

[14] *Id.*

[15] *Id.* at 323-24.

[16] Amicus Br. 5-19.

[17] Amicus Br. 5-6, 19-21.

[18] *See* Adam Feldman, *Empirical SCOTUS: Lessons In Not Throwing Caution To the Wind*, (June 2, 2016), https://empiricalscotus.com/2016/06/02/caution-to-the-wind/ ("Of the 13 cases where the OSG has recommended grants since the 2012 Term and the Court has come to a decision on cert, 11 or 85% led to granted petitions."); *cf.* Stephen M. Shapiro, et al., *Supreme Court Practice* 237 (10th ed. 2013) ("The Supreme Court has consistently granted approximately 70 percent of the certiorari petitions filed by the Solicitor General, in contrast to the 3 to 4 percent rate at which the Court grants paid petitions filed by other parties.").

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