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Legal Sidebar

Antitrust and the iPhone: Supreme Court to Consider Whether App Store Customers Can Sue Apple for Monopolization

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November 23, 2018

On November 26, 2018, the Supreme Court will hear oral arguments in *Apple v. Pepper*, an antitrust case involving the iPhone's App Store that may have significant implications for other electronic marketplaces like Google Play, eBay, and StubHub. In *Pepper*, the Court is considering whether purchasers of iPhone applications (apps) created by third-party developers may sue Apple (which distributes apps on behalf of developers) for monopolizing the market for such apps. Specifically, the *Pepper* case will require the Court to decide whether a doctrine of antitrust standing known as the "indirect purchaser" rule prevents app purchasers from suing Apple for charging app developers monopolistic commissions based on the theory that such commissions ultimately increase app prices.

This Legal Sidebar discusses the *Pepper* litigation and its implications. First, the Sidebar provides an overview of the indirect purchaser rule. Second, the Sidebar reviews the history of the *Pepper* litigation and the main arguments that the Supreme Court will consider in the case. Finally, the Sidebar discusses the implications of the Court's decision for electronic marketplaces and the possibility of renewed congressional interest in legislatively overturning the indirect purchaser rule.

Antitrust Standing and the Indirect Purchaser Rule

Section 4 of the Clayton Act provides that "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor . . . and shall recover threefold the damages sustained by him." While the Supreme Court has acknowledged that "[a] literal reading of the statute is broad enough to encompass every harm that can be attributed directly or indirectly to the consequences of an antitrust violation," the Court has relied on the statute's common-law background to

Congressional Research Service
7-5700
www.crs.gov
LSB10219

CRS Legal Sidebar
Prepared for Members and
Committees of Congress

limit the types of plaintiffs that can bring antitrust actions. Specifically, the Court has held (with certain limited exceptions) that "indirect" purchasers along a supply chain—that is, parties that do not purchase goods or services directly from an alleged antitrust violator, but instead purchase goods or services from a company that purchases them from an antitrust violator—do not have standing to sue the antitrust violator under the Clayton Act. Instead, the Court has limited private antitrust standing to parties that deal directly with an alleged antitrust violator, even if such direct purchasers "pass on" some or all of a monopolistic overcharge to their own customers.

The Supreme Court's skepticism towards pass-on theories of antitrust liability originated with its 1968 decision in *Hanover Shoe, Inc. v. United Shoe Machinery Corp*. In *Hanover Shoe*, the Court held that antitrust *defendant*s cannot rely upon pass-on theories of liability to reduce a plaintiff's recovery. In that case, a shoe manufacturer (Hanover) sued a manufacturer of shoe-making machines (United Shoe) on the grounds that United Shoe had monopolized the market for shoe-making machines. In response, United Shoe argued that Hanover had not been injured by its conduct because Hanover had passed on any monopolistic overcharges to its own customers. The Supreme Court rejected this argument and concluded that a plaintiff that has been unlawfully overcharged is entitled to recoup the entire amount of the overcharge, even if the plaintiff passed on some or all of that overcharge to its own customers. The Court identified two justifications for this conclusion. First, the Court reasoned that determining the extent to which a plaintiff had passed on an overcharge would create "insurmountable" empirical difficulties for courts, which would be required to hold "long and complicated proceedings" involving "massive evidence" and "complicated" economic theories. Second, the Court expressed concern that a pass-on defense would reduce the deterrent effect of antitrust lawsuits, because the end-consumers who would often shoulder the largest share of a monopolistic overcharge would have "only a tiny stake in a lawsuit and little interest in attempting a class action."

Nine years after *Hanover Shoe*, the Supreme Court extended that decision's reasoning to conclude that *plaintiffs* cannot use pass-on theories of liability offensively to bring antitrust claims against firms with which they do not directly transact. The Court adopted this rule in *Illinois Brick Co. v. Illinois*, a case that commentators have described as the "mirror image" of *Hanover Shoe*. In *Illinois Brick*, Illinois and a group of local governments brought price-fixing claims against manufacturers of concrete blocks. While the plaintiffs had not purchased concrete from the defendants, they argued that they were nevertheless harmed by the price-fixing conspiracy because they had hired contractors who had purchased concrete from the defendants. The plaintiffs accordingly contended that they were harmed by the alleged conspiracy because the contractors had passed on part or all of the defendants' overcharges in setting their prices. The Court rejected this argument, reasoning that "allowing offensive but not defensive use of pass-on [damages] would create a serious risk of multiple liability for defendants," because both direct and indirect purchasers would be entitled to recover for the same overcharge. The Court also emphasized the empirical difficulties with measuring pass-on damages that motivated its decision in *Hanover Shoe*, explaining that "apportion[ing] the recovery" in antitrust suits "among all potential plaintiffs that could have absorbed part of the overcharge . . . would add whole new dimensions of complexity" to antitrust litigation and "seriously undermine [its] effectiveness."

In the years following *Illinois Brick*, the Court has reaffirmed the indirect purchaser rule and declined to create an exception to it, even in markets in which direct purchasers pass on the entirety of an overcharge to their customers.

Apple v. Pepper

Pepper involves the application of the indirect purchaser rule to a distribution chain that differs from those at issue in *Hanover Shoe* and *Illinois Brick*. As discussed, Apple sells iPhone apps created by third-party developers through its App Store. However, during this process, Apple does not purchase apps from developers or take title to them. Instead, Apple distributes apps on behalf of third-party developers in exchange for a 30 percent commission on all app sales (commissions that reportedly totaled roughly $11.5 billion in 2017). App Store customers accordingly pay Apple when they purchase an app, and Apple remits 70 percent of the purchase price to the app's developer. Apple also plays only a limited role in setting app prices. Specifically, Apple requires app developers to set their prices at a number ending in $0.99 (*e.g.*, $0.99, $1.99, $2.99, etc.), but otherwise allows app developers to determine the prices of their apps.

In *Pepper*, a putative class of App Store customers allege that Apple has monopolized the market for apps by (among other things) designing iPhones so that their owners can purchase apps only through the App Store. The plaintiffs contend that as a result of this conduct, Apple is able to charge app developers monopolistic 30 percent commissions to distribute their apps. The plaintiffs argue that these monopolistic commissions increase app prices because app developers pass on some or all of the costs of these commissions in setting app prices.

The *Pepper* case accordingly has some similarities and some differences with the facts of *Illinois Brick*. Like the plaintiffs in that case, the plaintiffs in *Pepper* allege that they have been harmed by overcharges that the defendant (Apple) has imposed on other entities (app developers) to the extent that those other entities have passed on the cost of the overcharges in setting the prices that the plaintiffs have paid. However, unlike the plaintiffs in *Illinois Brick*, App Store customers purchase apps from the entity imposing the relevant overcharge in the first instance (Apple), not from the entities responsible for passing on part or all of that overcharge (app developers).

The history of the *Pepper* litigation reflects disagreement over which of these features of the app distribution chain is significant for purposes of the indirect purchaser rule. In December 2013, a federal district court dismissed the plaintiffs' claims under *Illinois Brick*. However, in January 2017, the U.S. Court of Appeals for the Ninth Circuit reversed that decision, emphasizing the differences between the app market and the distribution chains at issue in *Hanover Shoe* and *Illinois Brick*. Specifically, the Ninth Circuit reasoned that because Apple serves as a "distributor" that sells apps "directly" to app purchasers (as opposed to a "manufacturer" or "producer" that sells apps to an intermediary that in turn sells them to app purchasers), *Illinois Brick* does not prevent app purchasers from suing Apple for monopolizing the market for apps. In arriving at this conclusion, the Ninth Circuit created a circuit split with the Eighth Circuit, which held in 1998 that *Illinois Brick* prevented customers in a similar market for concert tickets from suing a ticket distributor based on monopolistic fees the distributor charged concert venues.

In August 2017, Apple filed a petition for a writ of certiorari with the Supreme Court, which the Office of the Solicitor General (OSG) supported. Like Apple, the OSG contends that the plaintiffs' claims are barred by *Illinois Brick*. The Court granted Apple's petition in June 2018.

Implications of the Court's Decision

The Court's decision in *Pepper* may have important implications for the types of plaintiffs that are able to bring antitrust claims against other electronic marketplaces that employ agency-sales models like Google Play, eBay, and StubHub. Apple and certain amici have argued that the Ninth Circuit's decision may undermine the rapid growth of such marketplaces by threatening e-commerce companies with increasingly complex litigation. By contrast, the plaintiffs and other amici have argued that denying customers of electronic marketplaces the ability to bring antitrust claims based on monopolistic overcharges first absorbed by third parties threatens to eliminate private antitrust enforcement against such marketplaces. According to this argument, many of the third parties that first absorb monopolistic overcharges (in this case, app developers) are reluctant to initiate litigation against monopolistic distributors for fear of retaliation (a contention that Apple rejects). One amicus brief responds to this argument by contending that the Department of Justice, Federal Trade Commission, and state attorneys general can provide effective relief to consumers in such circumstances.

The *Pepper* case may also prompt Congress to consider legislative changes to the indirect purchaser rule. While the rule has its defenders, 17 bills seeking to repeal it have been introduced in Congress since *Illinois Brick*. Moreover, most states have rejected the indirect purchaser rule when it comes to their own antitrust laws through judicial decisions or statutes known as "*Illinois Brick* repealers." In fact, 31 states have signed an amicus brief in *Pepper* urging the Court to overturn the rule. Although no bills to repeal the indirect purchaser rule have been introduced in the 115th Congress, a Supreme Court decision in favor of Apple may generate renewed attention to the rule, especially in light of increased interest in more vigorous antitrust enforcement from some Members of Congress.