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Cracking *Pepper*: An Analysis of the Supreme Court's Latest Pronouncement on the Indirect Purchaser Rule

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On May 13, 2019, in a 5-4 opinion written by Justice Kavanaugh, the U.S. Supreme Court held that the *Illinois Brick* indirect purchaser rule does not bar consumers from bringing monopolization claims against retail distribution monopolists that operate using an "agency" rather than a "wholesale" business model. The majority opinion embraces several arguments set forth in an amicus brief submitted by the American Antitrust Institute (AAI). Among other things, the decision has important implications for consumers and small suppliers who do business with dominant internet platforms, and it may be a boon to plaintiffs in future disputes over the scope of the indirect purchaser rule. The opinion leaves intact, for now, both the *Illinois Brick* rule barring indirect purchaser suits and the *Hanover Shoe* rule barring defendants from asserting a "pass-on" defense. And it may shed new light on emerging antitrust dynamics on the reconstituted Supreme Court.

I. Background

In *Apple Inc. v. Pepper*, a class of consumers alleged that Apple monopolized the sale of iPhone apps through a combination of iOS design features, exclusivity provisions in app developer license agreements, and threats against iPhone users who purchase apps outside the Apple ecosystem. Apple moved to dismiss the complaint on grounds that the plaintiffs lacked standing under the *Illinois Brick* indirect purchaser rule. Apple admitted that it dealt directly with the plaintiffs through the iOS App Store, but it argued that *Illinois Brick* nonetheless applied because Apple employs an "agency" business model. Under the model, the app 0developer sets the price at which Apple offers the app for sale in the iOS App Store. In exchange for providing an online retail sales site, Apple charges the developer a 30% "commission" based on the app's sale price.

The district court agreed with Apple and held that the plaintiff iPhone users were indirect purchasers. The court reasoned that, if Apple has monopolized the distribution channel, the monopoly overcharge first affects the app developers, who then "pass on" the overcharge as part of the app's sale price. Therefore, consumers are direct purchasers from the app developers but indirect purchasers from Apple, the alleged antitrust violator.

On appeal, the Ninth Circuit reversed. The court held that payment and price-setting formalities do not overcome straightforward application of the *Illinois Brick* rule, whereby the first person in a supply chain injured by an alleged overcharge – in this case consumers who purchased apps directly from Apple – has standing to recover all of the alleged overcharge damages. Apple appealed, with support from the U.S. Solicitor General. The Supreme Court granted certiorari.

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Without taking a position on the merits of the underlying antitrust claim, AAI filed an amicus brief explaining why it is essential that injured customers have standing to recover for overcharge damages caused by monopolization of the retail distribution tier of a supply chain. The brief argues that an agency distribution model should not be favored in the marketplace by insulating Apple or other distribution monopolists from claims by their immediate buyers. Monopolization of distribution is equally harmful regardless of whether the distributor uses an agency or traditional wholesale business model, and market forces, not antitrust rules, should inform the commercial decision of which business model to choose.

Moreover, Apple's attempt to style itself as a seller of upstream "distribution services," rather than of downstream "apps," is an economically meaningless distinction. The effect of a monopolized distribution tier on customers is the same, regardless of how the distributor (here, Apple) is labeled. And the mere fact that an antitrust violation produces multiple classes of victims – in this case developers who lose profits because of inflated distribution costs and consumers who pay an overcharge when they buy apps – does not trigger *Illinois Brick*'s concern with "pass on." Among other things, the injuries are not duplicative.

The brief also explains that Apple cannot avoid the operation of *Illinois Brick* by anointing itself an "agent" of app developers when Apple itself imposes the relationship through a non-negotiable license agreement. Agency law requires, as an essential element, that the *principal* exercise control over the *agent*. Here, the opposite is true: Apple, not the developer, is the one in control. And even if control were not critical, Apple's relationship with the *consumers* does not turn on the law of agency.

Finally, the AAI brief explains that denying a claim to the immediate buyers who suffer overcharge damages is contrary to longstanding antitrust policy and would undermine private antitrust enforcement, without serving the underlying policy goals of *Illinois Brick*. The brief concludes by noting that any reform of the indirect-purchaser rule is appropriately left to Congress, particularly because any change in the rule needs to ensure adequate deterrence through private enforcement.

II. The Court's Holding and Rationale

The Supreme Court majority held that the consumer-plaintiffs have standing to sue Apple because *Illinois Brick* establishes a bright-line rule that permits immediate buyers from alleged antitrust violators to sue for overcharge damages. The Court explained that this straightforward conclusion follows from the Court's precedent and the statutory text of Section 4 of the Clayton Act. It believed a standard that would look beyond the immediate buyer to consider financial arrangements between manufacturers and suppliers—as Apple had argued—would be "unprincipled and economically senseless." Moreover, such an approach, if accepted, would furnish monopolistic retailers with a "how-to guide" for evading consumer antitrust claims and thwarting effective enforcement. Retailers like Apple could simply restructure their upstream business model to nominally serve as agents of developers and manufacturers rather than as wholesalers who purchase and mark-up the developer's or manufacturer's products. The Court declined "to green-light monopolistic retailers to exploit their market position in that way."

In important respects the logic of Judge Kavanaugh's majority opinion closely mirrors that of the Court's controversial 5-4 opinion in *Kansas v. Utilicorp,* which the majority cited repeatedly. *Utilicorp* was decided in 1990 and authored by Justice Kennedy (for whom Justice Kavanaugh would serve as a law clerk three years later). Several states brought *parens patriae* actions against natural gas producers on behalf of consumers, alleging that the gas producers fixed prices. The producers first sold natural gas to regulated utilities for distribution to consumers, but the utilities were allegedly required to pass on all of their costs to consumers, including the full amount of the alleged overcharge. Although the consumers allegedly absorbed 100% of the overcharge and the utilities absorbed 0%, the Court held that the utilities were the proper plaintiffs to sue the producers; the consumers lacked standing under *Illinois Brick* because they were not the immediate buyers from the alleged antitrust violators.

The Court in *Utilicorp* emphasized that, although "the rationales underlying *Hanover Shoe* and *Illinois Brick* will not apply with equal force in all cases," it did not wish to "carve out exceptions to the [direct purchaser] rule for particular types of markets." The Court believed "[t]he possibility of allowing an exception, even in rather meritorious circumstances, would undermine the rule," because "the process of classifying various market situations according to the amount of pass-on likely to be involved and its susceptibility of proof in a judicial forum would entail the very problems" that the rule was meant to avoid. In other words, "the litigation over where the line should be drawn in a particular class of cases would inject the same 'massive evidence and complicated theories.'" Thus, the Court thought it an "an unwarranted and counterproductive exercise to litigate a series of exceptions."

Without citing or discussing *Utilicorp*, Justice Gorsuch's dissent argued that the *Illinois Brick* rule was never intended to turn on contractual privity between the purchaser and the violator. Rather, the dissent believed *Illinois Brick* rests on the premise that pass-on theories of damages violate proximate cause principles, because they require complex apportionment calculations and lengthy proceedings while permitting recovery for derivative and remote injuries. Accordingly, the dissent believed the iPhone consumer-plaintiffs' claim was barred. Justice Gorsuch further argued that the consumers' injuries were derivative of the app developers' injuries, and that allowing them to recover would entail a complex inquiry into how Apple's conduct affected developers' pricing decisions, difficult apportionment calculations between developers and customers, and the risk of duplicative damages awards against Apple.

The majority saw no merit in these arguments. It found that *Illinois Brick*'s three rationales cut in favor of the plaintiffs, not Apple. First, it rejected the supposition that vesting recovery exclusively with app developers better promotes enforcement. The Court believed that "[l]eaving consumers at the mercy of monopolistic retailers simply because upstream suppliers could *also* sue the retailers makes little sense." Second, complex damages calculations requiring expert testimony are not unusual in antitrust cases. And in a retail monopolization case like this one, the complexity is substantially the same regardless of whether the alleged monopolist employs an agency or wholesale business model. Third, Apple is incorrect to suggest that it would be subject to conflicting overcharge claims. If iPhone owners and app developers were to both sue Apple, they would "rely on fundamentally different theories of harm," with iPhone owners claiming the entirety of the overcharge damages and app developers claiming lost profits. Perhaps channeling the AAI brief, the Court noted that "[b]asic antitrust law tells us that the 'mere fact that an antitrust violation produces two different classes of victims hardly entails that their injuries are duplicative of one another.'"

At bottom, however, the majority's core holding is that "plaintiffs purchased apps directly from Apple and therefore are direct purchasers under Illinois Brick." It found that "[t]he absence of an intermediary is dispositive." It explained that *Illinois Brick* "was not based on an economic theory about who set the price," but rather "sought to ensure an effective and efficient litigation scheme in antitrust cases." Indeed, the Court described *Illinois Brick* as a "bright-line rule" six times in the span of seven pages. It was simply unwilling to dim the sharp edges of the rule, and in this sense *Pepper* may be understood as a necessary corollary to *Utilicorp*. It effectively holds that the *Utilicorp* Court's aversion to litigating exceptions to the direct-purchaser rule may be employed "offensively" by plaintiffs to confer standing, just as it may be employed defensively by defendants to deny standing. To Justice Kavanaugh's way of thinking, "All of that seems simple enough."

III. Implications of the Holding

The Court's holding in *Pepper* is significant for several reasons. Most immediately, it ensures that dominant internet platforms do not enjoy de facto immunity from antitrust damages claims by both upstream suppliers and downstream purchasers. Very often, upstream suppliers dependent on the platform for retail distribution make for reluctant antitrust plaintiffs. Filing a lawsuit against an important customer, such as Apple, is fraught with business risk—especially when, as here, the customer operates as a gatekeeper. Meanwhile, if the dissent's view had prevailed, downstream purchasers would have been barred under *Illinois Brick* whenever the platform employs an agency model. The likely result would have been zero deterrence or victim compensation from private upstream or downstream antitrust claims, in this case and many others.

After *Pepper*, immediate buyers from retail monopolists have clear standing, which means appropriate downstream claims can at least survive a motion to dismiss. However, the plaintiffs in this case and others will still have to overcome hurdles in the form of summary judgment and class certification (as well as 12(b)(6) motions on other grounds). For that reason, it is unlikely that the *Pepper* decision will unleash a torrent of antitrust claims against Silicon Valley firms. The holding is a necessary but not sufficient condition for creating stronger litigation incentives.

The Court's opinion is also significant because it clarifies that damages claims for overcharges and lost-profits are legally "non-duplicative" under *Illinois Brick*. The dissent believed that allowing both consumers and developers to sue over the same allegedly unlawful commission would result in what *Illinois Brick* described as "conflicting claims to a common fund." The dissent noted, for example, that the plaintiffs conceded there is only one 30% mark-up, and it argued accordingly that the claims of consumers and developers were to a "common fund" under *Illinois Brick* insofar as each would seek "a piece of the same 30% pie."

The majority flatly rejected the proposition that Apple's 30% commission created a "common fund" as *Illinois Brick* used the term. It explained that "This is not a case where multiple parties at different levels of a distribution chain are trying to all recover the same passed-through overcharge initially levied by the manufacturer at the top of the chain." Although Apple could be subject to multiple suits by different plaintiffs, "Illinois Brick did not purport to bar multiple liability that is unrelated to passing an overcharge down a distribution." Here, the plaintiffs would be entitled to recover the full amount of the *overcharge*, and there would be no passing on of an overcharge "by anyone or to anyone." While "[t]he consumers seek damages based on the difference between the price they paid and the competitive price, . . . [t]he app developers would seek lost

profits that they could have earned in a competitive retail market." The Court held that "Illinois Brick does not bar either category of suit."

The holding confirms that upstream and downstream firms may each independently bring antitrust claims against intermediaries without interference from *Illinois Brick*. It also preserves the possibility of claims by upstream sellers once removed from a powerful intermediary (i.e. an "indirect seller"). For example, a component-goods manufacturer may be able to maintain a claim against a powerful retailer, notwithstanding that the finished-goods manufacturer deals directly with the retailer. Lost profit damages at each distribution level would seem to be non-duplicative of lost profit damages sustained at other levels. But after *Pepper*, *Illinois Brick*'s bar on indirect claims for overcharges from a common fund would not apply regardless. Of course, such a seller would still have to establish antitrust standing under the Court's holding in *Associated General Contractors*, which bars suits by certain private plaintiffs on alternative ("efficient enforcer") grounds.

Importantly, the Court resolved the non-duplicative nature of consumer and supplier claims against intermediaries not only by applying precedent, but also by interpreting the Clayton Act's statutory text in a manner that helps reinvigorate the law's broad mandate encouraging victim recovery. The Court emphasized that Section 4 of the Clayton allows "*any person*" to recover threefold for injuries caused by antitrust violations. And it held that "To the extent that Illinois Brick leaves any ambiguity about whether a direct purchaser may sue an antitrust violator, we should resolve that ambiguity in the direction of the statutory text."

Among other things, the instruction that lower courts should err on the side of recognizing standing when *Illinois Brick*'s application is ambiguous will have important implications in *Marion Healthcare v. Becton Dickinson & Co.,* an ongoing Seventh Circuit case involving the "conspiracy exception" to the indirect purchaser rule. Under the "exception," a purchaser may sue a manufacturer despite the presence of an intermediary if the manufacturer and the intermediary are alleged to have participated together in a vertical conspiracy. This is less an exception than an application of the indirect purchaser rule. The purchaser from the intermediary is in fact the first buyer in the distribution chain to buy from an alleged violator.

Marion Healthcare recently attracted an amicus brief from the Antitrust Division of the Department of Justice (DOJ), which supports standing in the case even though it opposed standing in *Pepper*. The *Pepper* majority's analysis of Section 4's "any person" language strongly suggests the plaintiffs should have standing in *Marion Healthcare*. The same rationale also should encourage standing in other close cases. Litigation may turn on whether a given set of facts presents a genuine "ambiguity"; if not, then the Court's emphasis on maintaining "bright-line rules" may control.

IV. What We Learned About the Future of Illinois Brick

During the Supreme Court briefing in *Pepper*, thirty states and the District of Columbia submitted an amicus brief urging the Court to overrule *Illinois Brick*. The DOJ had also highlighted criticism of the current regime under *Illinois Brick* and *California v. Arc America* (which sanctioned state *Illinois Brick* "repealer" laws) and questioned whether the rationale underlying *Illinois Brick* had withstood the test of time. The AAI brief argues that the issue is appropriately left to Congress. If undertaken without due care, reform to the existing regime threatens to undermine the deterrent value of antitrust treble damages class actions.

AAI is concerned that overturning *Illinois Brick* likely means overturning *Hanover Shoe* (often described as Illinois Brick's "corollary") as well, notwithstanding that the States did not propose to do so. Allowing a pass-on defense would burden direct-purchaser class actions with complex new class certification issues under Rule 23, involving predominance of common issues (including the ability to prove impact (or injury) on a classwide basis), ascertainability, and damages calculation. These matters currently tend not to arise under the indirect purchaser rule, but if *Illinois Brick* and *Hanover Shoe* were overturned, they would present challenges to effective private antitrust enforcement.

The *Pepper* majority explained that, in light of its ruling in favor of the plaintiffs, it had no occasion to consider the argument for overturning *Illinois Brick*. The dissent, for its part, believed the Court lacked "any invitation or reason to revisit [its] precedent." It noted that the plaintiffs had disavowed any request to overrule *Illinois Brick*, and consequently the Court lacked the benefit of the adversarial process in considering a complex rule rooted in 40-year-old precedent. However, the dissent did pose the question: "If we are really inclined to overrule *Illinois Brick*, doesn't that mean we must do the same to *Hanover Shoe*?"

V. What We Learned About the New Supreme Court's Antitrust Dynamics

In reviewing Justice Kavanaugh's sparse antitrust record on the D.C. Circuit prior to his Supreme Court confirmation, AAI found cause for concern that he holds disturbing anti-enforcement views. Those views were not evident in his first antitrust opinion for the Court. The opinion is organized and written as a straightforward application of existing precedent, which otherwise looks to the statutory text of the Clayton Act for guidance. The opinion does not betray hostility to the antitrust laws, and instead takes an appropriately expansive view of antitrust standing given the confines of precedent and the plain meaning of the relevant statutory language.

However, the dissenting opinion for four justices was willing to embrace a remarkably activist and troubling interpretation of longstanding precedent in *Illinois Brick*. The dissent would have construed the "rule and reasoning" of *Illinois Brick* to be primarily concerned with ensuring that proximate cause principles limit indirect plaintiffs from recovering for injuries, and it would have given Section 4's "any person" language a comparably limited interpretation. The dissent simply ignored that the Court's stated purpose in *Illinois Brick* was to promote "the longstanding policy of *encouraging* vigorous private enforcement of the antitrust laws" (emphasis added) by ensuring sufficient financial motivation to bring suit. And it did not address the Court's ruling in *Utilicorp*, apparently content to leave undisturbed a plaintiff's inability to assert substantive economic arguments offensively while allowing defendants to do so defensively.

Moreover, in a footnote, the dissent offered the unprecedented suggestion that *Illinois Brick* should be expanded to bar indirect purchaser claims for injunctive relief. The majority countered, also in a footnote, that *Illinois Brick*'s holding applied to damages claims and did not address injunctive relief. The Solicitor General, which otherwise supported Apple, argued that the "Illinois Brick rule does not apply to suits seeking injunctive relief" and that all of the Court's precedent in this domain is "rooted in concerns specific to monetary relief."

It remains to be seen whether Justice Kavanaugh will hew as closely to precedent as he did here when confronted with the prospect of joining the four dissenting justices in antitrust merits cases.