Purchasers of iPhone Applications Still Standing

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EDITOR's NOTE: An Article that appeared in last Winter's issue of the Hausfeld Competition Bulletin addressed a 9th Circuit decision to the effect that individual purchasers had standing to sue Apple (as the proprietor of the App Store) rather than app developers, for prohibiting the app developers from selling iPhone apps outside of the App Store.

On October 10th, the Supreme Court invited the Solicitor General of the United States to file a brief expressing the government's views on the petition for certiorari in the case, now known as *Apple, Inc. v. Pepper*. The Solicitor General's recommendation usually carries significant weight with the Justices.

The case is of considerable interest, because it involves an interpretation of the forty-year old Supreme Court *Illinois Brick* doctrine, which generally prohibits indirect purchasers from seeking treble damages for Sherman Act violations, Accordingly, we are reprinting below the Article examining the 9th Circuit decision, which conflicted with an 8th Circuit decision in a similar case..

On January 12, 2017, the Ninth Circuit Court of Appeals issued an opinion in *In re Apple iPhone Antitrust Litigation*,[1] reversing a lower court decision that the consumer plaintiffs in an antitrust class action lacked standing, and providing greater clarity as to the proper analysis for determining direct purchaser standing under the federal Sherman Act.

Development Of Federal Law On the Passing-On Doctrine

In 1968, in *Hanover Shoe, Inc. v. United Shoe Mach. Corp.*,[2] the U.S. Supreme Court first addressed what has become known as the "passing-on defense" in antitrust actions. Plaintiff Hanover Shoe was a shoe manufacturer that leased certain shoe machinery from defendant United Shoe Machinery Corporation ("United"). In response to Hanover's Sherman Act claim that United had unlawfully monopolized the shoe machinery industry, United asserted that Hanover Shoe was not injured because it had passed-on the overcharge to its customers when it raised its resale prices. The Supreme Court rejected the passing-on defense. According to the Court, the direct purchaser need only show that it was unlawfully overcharged in order to recover full damages. Whether the direct purchaser passed on that overcharge to downstream customers, also known as indirect purchasers, was irrelevant.

Nine years later, in *Illinois Brick Co. v. Illinois*,[3] the Supreme Court followed up by rejecting the "offensive" use of damages passing-on by customers of the original purchaser in a price fixing case. The plaintiffs in *Illinois Brick* were indirect purchasers of defendants' concrete blocks. Specifically, defendants sold their blocks to masonry contractors, who then sold structures incorporating those concrete blocks to general contractors, who in turn sold buildings incorporating those masonry structures to the plaintiffs. Plaintiffs alleged they were injured because the two levels of contractors had passed-on the defendants' illegal overcharges to them. The Court ruled that allowing indirect purchasers standing in such a suit created unacceptable risks of duplicative recovery and difficult issues of damage allocations. Accordingly, only the direct purchaser had standing to obtain damages, even though its losses may have been passed downstream on resale to indirect purchasers from the original seller.[4] Thus, the prohibition of a passing-on damages claim by an indirect purchaser has become known as the "indirect purchaser" doctrine.[5]

The Ninth Circuit *Apple* decision addressed the question of how to distinguish direct purchasers with standing to sue for overcharges from indirect purchasers without such standing, when the matter involves plaintiffs who purchased a licensor's products required to be sold on the distributor's digital distribution platform.

The District Court Decision

The plaintiff in *In re Apple iPhone Antitrust Litigation*, were consumers who purchased iPhone applications from the Apple App Store, a digital distribution platform developed and maintained by defendant Apple Inc. ("Apple").[6] Independent software developers created many of these applications (generally known as "Apps"), which were sold to consumers through the Apple App Store (the "App Store"). Apple explicitly prohibited the software developers from allowing their Apps to be sold to consumers anywhere other than its App Store. To further ensure that the App Store was the only platform in which consumers could purchase iPhone Apps, Apple threatened to invalidate a consumer's iPhone warranty if the consumer downloaded an App from any source other than the App Store. The consumer plaintiffs alleged that through this practice, Apple monopolized and attempted to monopolize the iPhone Apps market in violation of Section 2 of the Sherman Act.

When consumers purchase third-party Apps from the App Store, Apple takes 30% of the payment as a "commission," passing on the remaining 70% to the developer of the App. Plaintiffs alleged that they were direct purchasers from Apple, the distributor of the App, and that the 30% "mark-up" constituted an illegal overcharge to them directly.

The district court disagreed, finding that plaintiffs were indirect purchasers because the 30% fee was created by Apple's agreement with third party developer requiring the developer to pay Apple—an amount passed-on to the consumers as part of the consumer's purchase price.[7] In other words, the court determined purchaser status by analyzing the order in which the overcharge was shouldered at each level of trade. Because the developers agreed beforehand to pay Apple the 30% commission, they theoretically "paid" for the overcharge first before passing it downstream to consumers. Based on this rationale, the consumers were indirect purchasers of an application from its developer, without standing to sue Apple.

The Ninth Circuit Decision

The Ninth Circuit panel reversed dismissal, holding that the consumer plaintiffs were in fact direct purchasers of third-party Apps from Apple—the alleged wrongdoer.[8] The panel emphasized that the proper analysis of purchaser status rests on the structure of the chain of distribution. Using this line of inquiry, the Ninth Circuit concluded that the software developers were the producers of the Apps, and Apple, which distributed the Apps to the consumer plaintiffs through the App Store, served the function of a distributor. As such, the consumers of the Apps were direct purchasers from Apple, the alleged wrongdoer, and therefore had standing to bring their monopolization suit against Apple.

In response to the parties' arguments, the Ninth Circuit articulated the factors it would *not* rely on to determine direct purchaser status:

1. **Order of payment**. The panel declared that purchaser status should not rest on "the formalities of payment or bookkeeping arrangements."[9] Otherwise, a defendant could avoid antitrust liability "simply by tinkering with the order in which digital banking data zips through cyberspace during a sales transaction."[10]

2. **Form of payment**. The fact of a 30% "commission" to Apple might have suggested that it overcharged the software developers, and the overcharge was then passed on to indirect purchasing consumers. On the other hand, a 30% "mark-up" by Apple might suggest that the fee was added by Apple when consumers purchased the Apps from it, making the consumers a direct purchaser from the wrongdoer. The panel concluded, however, that the "distinction between a markup and a commission is immaterial" to its analysis of purchaser standing.[11]

3. **Who determined the ultimate price to the consumer.** In line with a prior Ninth Circuit decision in *Delaware Valley Surgical Supply, Inc. v. Johnson & Johnson*,[12] the panel stated that its analysis was not based on the identity of who actually determined the "ultimate price paid" by the end-consumers.[13]

4. **Whether the Eight Circuit had gotten it right.** Finally, the Ninth Circuit rejected an "antecedent transaction analysis" that had been applied by the Eighth Circuit in *Campos v. Ticketmaster Corp.*[14] According to the Eighth Circuit, plaintiffs are indirect purchasers if they "bear some portion of a monopoly overcharge only by virtue of an antecedent transaction between the monopolist and another, independent purchaser [...]".[15] In declining to adopt this approach, the Ninth Circuit agreed with the dissent in *Ticketmaster* that the fact of an "antecedent transaction" will not automatically turn all purchasers of a monopolized product into indirect purchasers for the purposes of *Illinois Brick*.[16]

In sum, the Ninth Circuit concluded quite simply that because consumers essentially were required to purchase the allegedly overpriced product from the alleged wrongdoer—an alleged monopolistic distributor that prohibited both its suppliers and customers from dealings through other trade channels—the consumers had standing to charge the distributor with whom they dealt directly from violating the Sherman Act.

Analysis

The Eighth Circuit "antecedent transaction" analysis bears similarities to the district court's *Apple* decision by focusing on the chronology in which an overcharge is paid by a plaintiff. However, such an approach does not address the crux of the *Apple* plaintiffs' complaint: that Apple's alleged ability to limit the sale of third-party Apps to its App Store, thereby eliminating consumers' ability to shop around for a better deal, is anticompetitive conduct prohibited by the Sherman Act.

In contrast, the Ninth Circuit's approach to ascertaining the status of a purchaser in its *Apple* decision was highly relevant to the allegedly monopolistic conduct that was charged. Apple, the distributor, controlled where iPhone Apps could be sold to consumers—not just the prices to be paid. Under this framework, the way Apple could avoid antitrust liability would be for it to allow software developers to sell their Apps through whatever channels they find suitable. In addition, this approach provides a fairly simple method of determining purchaser standing in the modern digital world, where business transactions have become increasingly complex and convoluted.

Footnotes

[1] 846 F.3d 313 (9th Cir. 2017).

[2] 392 U.S. 481, 488 (1968).

[3] 431 U.S. 720, 735 (1977)/

[4] There are a few narrow exceptions to the rule that are not relevant to this discussion. *See Kansas v. UtiliCorp United, Inc.,* 497 U.S. 199, 217-18 (1990); *see also In re ATM Fee Antitrust Litig*., 686 F.3d 741, 749 (9th Cir. 2012).

[5] More than half the states have enacted statutes rejecting *Illinois Brick* and allowing indirect purchaser antitrust suits under state law.

[6] Case No. 11-cv-06714-YGR, 2013 WL 6253147 (N.D. Cal. Dec. 2, 2013).

[7] *Id.* at *6.

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

[9] *Id*. at 324

[10] *Id*.

[11] *Id*.

[12] 523 F.3d 1116 (9th Cir. 2008).

[13] *Id*.

[14] 140 F.3d 1166 (8th Cir. 1998).

[15] *Id*. at 1169.

[16] *Id*. at 1174.

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