

Apple Inc. v. Pepper: Online App Stores Are Retailers, Whether or Not They Are Platforms

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In May 2019, the Supreme Court issued a 5-4 decision in *Apple Inc. v. Pepper*, one of the Court's most closely watched recent antitrust rulings. The majority opinion, written by Justice Kavanaugh, takes aim at overly broad restrictions on antitrust standing, holding that iPhone owners who purchased apps from Apple's App Store are direct purchasers with standing to sue Apple for alleged monopolization under the federal antitrust laws. Many expected that the Supreme Court would also provide further guidance regarding two-sided platforms or broader e-commerce issues, particularly in light of its 2018 decision in *Ohio v. American Express Co.*,¹ the Court's most recent pronouncement regarding two-sided platforms. But the Court declined to address those issues by limiting its decision to the narrow standing issue before it. How courts will treat other firms operating in the expanding marketplace of multi-sided technology platforms thus remains largely uncertain.

The case involves Apple's control over apps running on iOS, which powers its popular iPhone, and the Apple App Store where iPhone users can find, purchase, and download iPhone-compatible apps.² Even though most apps are developed by third parties, Apple earns a commission on every app purchased: 30 percent of the purchase price goes to Apple, while 70 percent goes to the developer.³ Apple also prohibits third-party developers from selling iPhone apps through channels other than the App Store, including directly to iPhone owners, and generally discourages iPhone owners from downloading unauthorized apps.⁴ Apple has the right to cut off sales by a developer who violates the prohibitions, and threatens to void the warranties of iPhone users who download unauthorized apps.⁵

A putative class of iPhone owners sued Apple, challenging the App Store restrictions and claiming direct purchaser standing—a critical status in light of the Court's prior decisions. Relying on the Supreme Court's 1977 decision in *Illinois Brick v. Illinois*,⁶ Apple argued that consumers could not sue for antitrust damages because third-party app developers would be the immediate victims of the alleged offense and thus the only ones with standing to sue.

The Supreme Court held that, because iPhone users buy apps from Apple through the App Store, they are direct purchasers for purposes of their suit against Apple.⁷ The Court pointed to

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¹ 138 S. Ct. 2274 (2018) (*AmEx*).

² *In re Apple iPhone Antitrust Litig.*, 846 F.3d 313, 315–16 (9th Cir. 2017), *aff'd sub nom. Apple Inc. v. Pepper*, 139 S. Ct. 1514 (2019).

³ *Id.* (Many apps in the App Store are free.)

⁴ *Id.*

⁵ *Id.*

⁶ *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

⁷ *Apple Inc. v. Pepper*, 139 S. Ct. at 1519.

the bright-line rule of *Illinois Brick*, noting that although indirect purchasers “two or more steps removed from the antitrust violator in a distribution chain may not sue,” the *Apple* plaintiffs, as immediate buyers from an alleged antitrust offender, may sue.⁸

Notably, both the majority and the dissent in *Apple Inc. v. Pepper* argued that their position reflected economic realities and not “formalistic line drawing.” In the majority opinion, the Supreme Court characterized its determination that iPhone owners were direct purchasers who could sue Apple as merely a “straightforward conclusion follow[ing] from the text of the antitrust laws and from our precedents.”⁹ The Court rejected Apple’s claim that consumers could not sue Apple because developers, not Apple, set the retail price charged, concluding “Apple’s rule would elevate form (what is the precise arrangement between manufacturers or suppliers and retailers?) over substance (is the consumer paying a higher price because of the monopolistic retailer’s actions?).”¹⁰

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Likewise, according to dissenting Justice Gorsuch, the majority decision “replaces a rule of proximate cause and economic reality with an easily manipulated and formalistic rule of contractual privity. That’s not how antitrust law is supposed to work”¹¹ The dissent assesses the critical flaw as “exalt[ing] form over substance.”¹² And the dissent claims that the substantive economic determination is where the alleged overcharge is “first felt,” while the majority’s test turns on who happens to be in privity of contract with whom.¹³ The dissent concludes that because Apple can evade private liability just by amending its contracts, the majority opinion is “whittling [the *Illinois Brick* rule] away to a bare formalism.”¹⁴

While the majority opinion is correct that the alleged antitrust violation, not the adjacent transactions, should be the primary focus of the standing analysis, the dissent is also likely correct that any rule that can be evaded by a contractual amendment—without changing the reality of the economic transaction—does not accord with modern antitrust case law. Thus, the form versus substance principle may be less useful as a basis for legal line-drawing than an assessment of economic reality. Nevertheless, *Apple Inc. v. Pepper* elevates who purchases from whom to an issue of “economic reality” sufficient for a final standing determination.

Although some expected *Apple Inc. v. Pepper* to provide further guidance regarding two-sided platforms or broader e-commerce issues, the Court implicitly declined to address those issues by narrowly construing the issue before it and by failing to connect its reasoning with its 2018 decision in *AmEx*. But the Courts in *Pepper* and in *AmEx* were addressing two distinct issues: (1) who has standing to sue for damages in the first instance, and (2) how a “transaction platform” should be analyzed on the merits for purposes of assessing anticompetitive effects.

The Court in *Apple Inc. v. Pepper* emphasized at the outset that the case came before it on appeal from a motion to dismiss and so it was addressing only the one narrow issue before it: “The sole question presented at this early stage of the case is whether these consumers are proper

⁸ *Id.* at 1521.

⁹ *Id.* at 1520.

¹⁰ *Id.* at 1523.

¹¹ *Id.* at 1526.

¹² *Id.* at 1529.

¹³ *Id.*

¹⁴ *Id.* at 1531.

plaintiffs for this kind of antitrust suit—in particular, our precedents ask, whether the consumers were ‘direct purchasers’ from Apple.”¹⁵

In contrast, the Court in *AmEx* had to determine whether the plaintiffs had proven—after a seven-week trial—that American Express’s conduct caused anticompetitive effects as required to prove a claim in a rule-of-reason case under Section 1 of the Sherman Act.¹⁶ The Court’s extensive analysis of two-sided platforms was necessary to make that determination given the parties’ competing arguments regarding whether the Court should look at the effects on just one side of the platform or on both sides of the platform to determine whether there was ultimately an anti-competitive effect. A similar consideration of the economics of two-sided platforms was unnecessary to resolve the standing question presented in *Apple Inc. v. Pepper*.

Thus, while some commentators have noted that the Court in *Apple Inc. v. Pepper* could have or should have addressed two-sided e-commerce issues more broadly,¹⁷ it is unsurprising that the Court declined to do so. The Court repeatedly has noted that it will not wade into issues that are not before it, particularly those relating to novel concepts or relatively new technologies like those at issue here.

Indeed, neither the majority nor the dissent even mentioned *AmEx* even though Apple specifically asked the Court to analogize the App Store to the two-sided platform at issue there. Citing *AmEx*, Apple had argued that “app stores ‘are basically platforms connecting app users (smart-phone owners) and app developers.’ They are ‘two-sided’ platforms, where a platform operator, such as Apple, ‘offers different products or services to two different groups who both depend on the platform to intermediate between them.’”¹⁸

The plaintiffs rejected that characterization, noting that *AmEx* specifically addressed two-sided transaction platforms and arguing that the App Store was more akin to a traditional retailer:

As this Court explained in *Amex*, a two-sided transaction platform is “best understood as supplying only one product—transactions—which is jointly consumed” by the parties on both sides of the platform. The App Store is not a “transaction platform” but a retail operation selling apps; the fact that Apple collects payment from customers and renders payment to suppliers does not make it a two-sided transaction platform any more than a corner grocery, which does the same thing.¹⁹

Indeed, the Court in *AmEx* had reasoned that the credit card networks at issue thus were not acting as a retailer selling a product or service to consumers. The “product” being offered on each

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¹⁵ *Id.* at 1520.

¹⁶ *Ohio v. Am. Express Co.*, 138 S. Ct. 2274, 2284 (2018) (“Here the parties ask us to decide whether the plaintiffs have carried their initial burden of proving that Amex’s antisteering provisions have an anticompetitive effect.”).

¹⁷ See, e.g., Bret Swanson, *Apple’s App Store: Monopoly or Miracle?*, AEIDEAS (May 28, 2019); Geoffrey Manne & Kristian Stout, *In Apple v. Pepper, SCOTUS Leaves Home Without Its Amex*, TRUTH ON THE MARKET (May 13, 2019).

¹⁸ Brief for Petitioner at 35, *Apple Inc. v. Pepper*, 139 S. Ct. 1514 (2019) (No. 17-204.) (citing *Ohio v. Am. Express Co.*, 138 S. Ct. 2274, 2280 (2018)).

¹⁹ Respondent’s Brief at 31–32, *Apple Inc. v. Pepper*, 139 S. Ct. 1514 (2019) (No. 17-204) (internal quotations omitted). See generally Andrew Gavil & Jordan Ludwig, *The Many Sides of Ohio v. American Express Co.*, ANTITRUST, Fall 2018, at 8. The plaintiffs went on to emphasize the differences between the App Store and the two-sided transaction platform at issue in *AmEx*: “The contrast between a credit card network and the Apple App Store is stark. A credit card network is indifferent to the nature of the purchase and sale that gives rise to a financial transaction, and the service provided is the purely financial one of enabling payment—whether for a chair, a milk can, or eight volumes of Gibbon. By contrast, Apple carefully controls the products offered through its App Store as well as limits the prices charged for them to even dollar amounts.” Respondent’s Brief at 31–32 n.12, *Apple Inc. v. Pepper*, 139 S. Ct. 1514 (2019) (No. 17-204) (internal quotations and citations omitted).

side of the platform was the transaction itself, “which is jointly consumed by a cardholder and a merchant.”²⁰ The “merchant services” offered on one side of the platform, and the “cardholder services” offered on the other side were “both inputs to this single product.”²¹

The Court in *Pepper* did not directly weigh in on whether the two-sided platform analysis in *AmEx* applied. It did, however, consistently characterize Apple as a traditional retailer selling goods (apps) to consumers through an electronic retail outlet (the App Store). For example, in distinguishing *Illinois Brick*, the Court explained that “iPhone owners are not consumers at the bottom of a vertical distribution chain who are attempting to sue manufacturers at the top of the chain [but rather they] purchase apps directly from *the retailer Apple*, who is the alleged antitrust violator.”²² Indeed, the majority and the dissent collectively used the word “retailer” or “retail” to characterize Apple and the App Store almost 100 times. Neither the majority nor the dissent once described Apple as selling “transactions” as the Court did in *AmEx*, and the word “platform” is used just once by the dissent in describing the plaintiffs’ allegations.

The impact of these two decisions on future cases involving technology and e-commerce giants that connect consumers with goods or services is thus unclear. The term “platform” is being used to describe a variety of such firms and business models. Many share characteristics with both the Apple App Store’s “retail” sales and the “transaction” service being sold in *AmEx*. For example, certain ride-sharing, food-delivery, and lodging apps seem more like the credit card networks in *AmEx*, arguably selling just a “transaction” by matching a consumer looking for a ride, a meal, or a place to stay, on the one hand, with someone offering one on the other hand. But on each of those platforms, as with the App Store, the consumer remits payment to the company facilitating the transaction, which in turn takes its share and then pays the agreed amount to the driver, restaurant, or lodging provider.

Other online marketplaces appear to function more like the App Store, selling, for example, concert tickets, cars, or homemade crafts, and effectively maintaining virtual retail store fronts where individuals offer those goods for sale. But those platforms, as in *AmEx*, require also that both a willing seller and a willing buyer simultaneously choose to use the platform for the transaction at issue.²³

Yet other technology and e-commerce companies use various hybrid business models that can share some characteristics of both the “retail” goods sold in Apple’s App Store and the “transaction” service being sold in *AmEx*. It is likely, therefore, that the courts will continue to grapple with both the form and economic substance of e-commerce businesses. Further discussions on these important issues and future legal determinations are nearly certain. As the differing analyses in *AmEx* and *Pepper* make clear, the outcomes likely will depend on the procedural posture of the cases, the specific issues presented to the Court, and, most importantly, the particular characteristics of the firms and the competitive effects of their conduct. ●

²⁰ *AmEx*, 138 S. Ct. at 2286.

²¹ *Id.*

²² *Apple Inc. v. Pepper*, 139 S. Ct. at 1520 (emphasis added).

²³ Another important distinction is that not all two-sided platforms are alike. Unlike *AmEx*, the App Store is not necessary to facilitate transactions between developers and iPhone users. The merits of the case focus on the plaintiffs’ objection to the contractual terms Apple has imposed on developers and consumers to, in effect, interpose itself as an intermediary. Its “platformness” is artificial, and not the result of market forces or indirect network effects. In contrast to credit cards, it is not at all necessary to the “transaction,” which could be accomplished directly between developers and consumers without Apple. Developers can compete with each other and sell directly to consumers without any “platform” acting as a toll bridge between them. See Gavil & Ludwig, *supra* note 19, at 10.