WASHINGTON LEGAL FOUNDATION
February 16, 2018

On the Merits:

STATES OF OHIO, CONNECTICUT, IDAHO, ILLINOIS, IOWA, MARYLAND, MICHIGAN, MONTANA, RHODE ISLAND, UTAH, AND VERMONT,

Petitioners,

v.

AMERICA EXPRESS COMPANY AND AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC.,

Respondents.

No. 16-1454
United States Supreme Court

Question Presented: Whether under Section 1 of the Sherman Act the government's bare showing that a vertical restraint stifled price competition on the merchant side of a credit-card platform suffices to prove an unreasonable restraint of trade sufficient to shift to the defendant the burden of establishing any procompetitive benefit in the affected market?

Summary of the Case: In this antitrust enforcement action, a group of states challenged "anti-steering" rules that American Express ("Amex") imposes on the merchants that accept its credit cards. Those rules prohibit the merchants from either encouraging their customers to use other credit cards that charge merchants a lower fee or disclosing to customers the relative costs to merchants of different cards.

Applying the rule of reason, the U.S. District Court for the Eastern District of New York held that the rules stifle price competition among credit-card networks by blocking low-fee rivals, inflating retail prices, and allowing major networks to raise their merchant fees. On appeal, the Second Circuit reversed, holding that the district court's findings were legally insufficient to establish a prima facie case that the anti-steering rules unreasonably restrain trade.

On the Merits:
Judgment for Respondents
Kevin D. McDonald

Amex offers merchants a simple bargain. It provides processing services for credit sales to both cardholder and merchant. It also provides rewards for Amex cardholders, and other services to merchants, such as data analysis for marketing. In return, the merchant must pay Amex's discount-rate fee on each transaction, which largely funds the benefits that Amex offers cardholders. These fees are worth it, Amex maintains, because its "marquee" cardholders spend more (per year and per purchase) than others.

Merchants do not have to accept Amex's terms, and roughly one out of three U.S. retailers opts not to do so. Most Amex cardholders also carry Visa or MasterCard, which combined account for 68% of credit transaction volume, compared to Amex's 26.4%. Moreover, the only measure of output seriously advanced by

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any of the parties (*see* Pet. Br. at 3)—total dollars spent on U.S. credit transactions—has expanded at all relevant times.

Under attack are the Amex non-discrimination provisions ("NDPs") that forbid merchants from "steering" customers to cards with lower merchant fees. NDPs prohibit offering rebates or other inducements to persuade purchasers to switch. Petitioners assert that "[b]y prohibiting competition 'at the point of sale' … [NDPs] disrupt the proper functioning of the price-setting mechanism of the market." (Pet. Br. 34.) The district court agreed. It limited the relevant market to the purchase of credit-processing services by *merchants*, and found harm due to the "supracompetitive" prices (*i.e.*, discount fees) they paid to Amex. The Second Circuit reversed, holding that "[t]he District Court erred in excluding the market for cardholders from its relevant market definition." 2d Cir. Op. 36. The proper test required "balancing … effects on merchant behavior against … effects on cardholder behavior." *Id*. at 42.

We need not decide whether this is a case of separate markets that must be considered together or of a novel, single market with a "double-sided platform." Even in Petitioner's market, what the merchants are purchasing is an input to the underlying retail product being sold. (No one goes to the store to pick up some credit-processing services; they go to buy a pizza. The pizza's inputs may include cheese, pepperoni, delivery, and credit-processing.) Determining price and output in an input market depends directly upon the demand for, and output of, the underlying product. The proper analysis does not require "balancing" disparate effects, but recognizing that conclusions about competitive effects in an input market turn on the full nature of its supply and demand.

Petitioners rely on "direct" proof of two anticompetitive effects: supracompetitive prices and "disruption" of the competitive process. First, the attempt to label Amex's fees "supracompetitive" is unsupported. There is nothing suspect about high or even increasing prices accompanied by expanding output. Showing an output restriction in the case of this input is even trickier, given its one-to-one relationship with the output of the underlying product. If output had been restricted, we would expect evidence that merchants who don't take Amex (those free of NDPs and "high" prices) somehow consume more credit processing services than those who do. We find none. Even the conclusion that Amex's prices are "higher" is flawed: they were not adjusted for quality, and the district court conceded that Visa's services were only a portion of those covered by Amex's discount-rate. *See* 2d Cir. Op. 41-42 n.45.

Second, Petitioners' claim that, unlike other vertical restraints, NDPs prevent "horizontal price competition" at the point-of-sale is nonsense. *Agreements* may be horizontal or vertical, but *all* competition is horizontal. And all commercial contracts, as we have often pointed out, restrain competition in theory. By this logic, there is no exclusive agreement, tying arrangement, requirements contract, or franchise term that does not prevent "horizontal" competition for every individual sale during its term. (As this list shows, moreover, it is not true that the rule of reason applies only to restrictions on intrabrand competition.) By this logic, the first step in every rule of reason analysis would be satisfied, and the burden shifted to the defendant, for every contract in every case. We decline to do so.

And consider the Edenic, point-of-sale "competition" that Petitioners declare so essential. At that moment, the alleged consumer (the merchant) has no power to make its own purchase decision. All agree that, with or without the NDPs, the cardholder makes that decision. *See* Pet. Br. 35; United States Br. 26. Nor at that moment do the purported horizontal competitors (the card companies) have any ability to, well, compete—by offering better terms. Petitioners acknowledge but ignore the price competition that did take place, and the purchase decision the merchant did control, when it agreed to "accept[] a network's card for *all* transactions." Pet. Br. 35. By joining Amex's network, it reaped some of the systemic benefits that Amex provides, perhaps

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leading to the very sale it now seeks to "steer" elsewhere. Some would call that free-riding. We are skeptical that it constitutes competition "on the merits" (whatever that means). But even if it does, it is typical of the competition that every procompetitive vertical restriction precludes.

The judgment is affirmed.

Dissenting View:
Eric F. Citron
Goldstein & Russell, P.C.

In a restraint case, we care about market power because, without it, the targets of a restraint can fight back through competition itself—that is, by refusing the defendant's anticompetitive terms and directing business to its competitors instead. The allegation here is that American Express's NDPs restrain merchants by preventing them from encouraging competition between Amex and its competitors. So, here the market-power question is whether Amex can "force a purchaser [*i.e.* merchant] to do something that he would not do in a competitive market." *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 464 (1992).

Amex cannot seriously dispute that power. The record shows that the world's largest merchants were forced to capitulate quickly after threatening to stop taking Amex; that Amex does not even worry about merchant attrition when it sets merchant prices; and that Amex (and its competitors) were able to repeatedly raise merchant prices from already-competitive levels as part of Amex's "value recapture" initiative. Of course, there's nothing illegal about Amex's market power. It just means that merchants are generally forced to accept Amex's terms, and that those terms might in turn succeed in suppressing competition if that is in their nature.

Suppressing competition, however, *is* in the nature of Amex's NDPs. These terms prohibit merchants from encouraging their customers to use one card over another. The consequence is that any merchant who takes Amex (as most must) cannot offer Amex's competitors anything of value in exchange for those card networks beating Amex on price. Discover thus testified that it made no progress at all when it tried to compete with Amex on merchant prices, and so raised rates rapidly instead to be commensurate with Amex's (and the other networks'). The district court found that actual anticompetitive effects resulted, including supracompetitive prices, elimination of horizontal competition, and the suppression of innovative business models. It was thus correct to find an antitrust violation in the coupling of Amex's market power and anticompetitive restraints.

The Second Circuit only found otherwise by indulging two related, deeply misguided views about Amex's "two-sided" business model. It reasoned that, because Amex sells services to both cardholders and merchants, it inhabits a "two-sided market" and so both market power and anticompetitive effects must be analyzed in that two-sided context. Put otherwise, the Second Circuit believed the government had (1) mis-defined the "relevant market" to include only merchants, and it instead needed to show (2) "net" harm across both merchants and Amex cardholders. This entire line of reasoning is not just wrong but dangerous, which is why just about every notable antitrust scholar has encouraged the Court to reverse.

Two-sided *business models* are important aspects of business strategy, but in a restraint case like this one, there cannot be a two-sided *relevant market* for antitrust purposes. No market can be defined to include both merchant and cardholder services because these are not "substitute" or "reasonably interchangeable" products—the sole standard the Court has used for market definition for over 60 years. *See United States v. E.I. du Pont Nemours & Co.*, 351 U.S. 377, 404 (1956). Remember, we care about market power because we want to know if there are sufficient competitors for the *restrained party* to direct its business elsewhere. Merchants cannot take out new credit cards with Amex's competitors in the cardholder-services market (say, Capital One) to combat anticompetitive terms in Amex's merchant-services offerings. In any event, the Court has already

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rejected the proposition that both sides of a two-sided business model must be included in the relevant market for antitrust purposes. *See Times-Picayune Pub. Co. v. United States*, 345 U.S. 594, 612 n.31 (1953).

To avoid this precedent, Amex points out that cardholders and merchants use their (different) Amex services simultaneously to close two-sided "transactions." But this does not create a two-sided "transactions" market—as Amex argues—because Amex doesn't *produce* or *supply* "transactions" that both cardholders and merchants buy. Instead, it supplies complimentary *services* of different kinds on different terms to merchants and cardholders, and those terms are set (or "purchased") well before merchants and cardholders use those services to close transactions between themselves. Importantly, Amex's two different services represent two different sets of market relationships, and it is Amex's relationship with the restrained party (*i.e.* merchants) that matters here.

Relatedly, the states had no need to show "net" harm across a market that includes both cardholders and merchants. The fundamental premise of the Sherman Act is that free-market forces should determine the balance of economic costs and benefits for merchants and cardholders, rather than Amex's market power and restraint of trade. Restraining merchants and directing the rents to competition for cardholders would be an antitrust problem even if Amex passed every dollar over to the cardholder market. Indeed, it is precisely because a restraint of trade in one market will force resources to be allocated inefficiently into other markets that economists (and the Sherman Act) condemns them. Companies with two-sided business models do not get a special pass that allows them to escape antitrust condemnation because (inevitably) they have some counterparties who benefit from the harm they visit on others and the economy as a whole. I respectfully dissent.

Kevin D. McDonald is Senior Editor of the Antitrust Law Journal and a member of the D.C. Bar; he recently retired from Jones Day, where he practiced antitrust law for over 37 years. **Eric F. Citron** is a partner with Goldstein & Russell, P.C. A former law clerk to Justices Sandra Day O'Connor and Elena Kagan, he filed an *amicus curiae* merits brief in support of petitioners in this case on behalf of 28 professors of antitrust law.

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