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Report from Washington

Supreme Court Rejects Challenge to AmEx's "Anti-Steering Provisions" and Signals Shift in Antitrust Analysis for "Two-Sided Markets"

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"Evidence of a price increase on one side of a two-sided transaction platform cannot by itself demonstrate an anticompetitive exercise of market power."

— Justice Thomas

Introduction

On June 25, 2018, the Supreme Court in *Ohio v. American Express Co.*, No. 16-1454, held that plaintiffs had failed to demonstrate that Amex's contractual anti-steering provisions unlawfully restrained competition under Section 1 of the Sherman Act. After finding that Amex's two-sided transaction platform constituted a single relevant product market due to strong "indirect network effects," a 5-4 justice majority affirmed the Second Circuit's conclusion that plaintiffs failed to meet their burden of showing that Amex's vertical restraints had a substantial anticompetitive effect that harmed consumers in the relevant market. An important decision for the modern digital economy, where two-sided electronic markets are becoming more and more common, the Supreme Court's ruling signals that modern antitrust jurisprudence should evolve to match the unique factual circumstances of each "market" and that claimants will face a heavy burden in demonstrating that a two-sided platform has unlawfully restrained trade.

Background

Although the text of Section 1 of the Sherman Act literally forbids "every" agreement in restraint of trade, the courts have long condemned only limited types of conduct, such as price-fixing or market allocation, as *per se* unlawful. Under existing Supreme Court precedent, other types of conduct–including vertical restraints like those at issue in this case–are analyzed under the "rule of reason" test and only held to be unlawful if the net effect is more anti-competitive than pro-competitive.

Under the traditional application of this rule of reason test, the plaintiff bears the initial burden to show that the challenged restraint produces anticompetitive effects. If the plaintiff makes this showing, then the burden shifts to the defendant to establish a procompetitive

justification for the restraint. If the defendant establishes a procompetitive justification for the restraint, the burden shifts back to plaintiff to show that the anticompetitive effects of the restraint outweigh its procompetitive justifications.

Amex, like all major credit card networks, charges merchants a fee that is calculated as a percentage of the Amex cardholder's purchase amount at the point of sale with the merchant. Amex in particular uses the revenues from those fees to subsidize generous cardholder rewards programs in order to incentivize its customers to use an American Express card over a competing card, such as a Visa or a MasterCard card. To sustain these superior cardholder incentives, Amex charges higher fees to merchants than do other credit card companies. Because of these higher fees, merchants who accept Amex cards may be tempted to encourage or "steer" customers towards using other cards charging lower fees at the point of sale. To curb this behavior, Amex's standard merchant contracts contain anti-steering or nondiscriminatory provisions ("NDPs"), that the company enforces actively.

In 2010, the three largest credit card networks–Visa, MasterCard, and Amex–all utilized merchant anti-steering provisions. The Department of Justice ("DOJ") and 17 States originally filed suit against all three networks, claiming that their anti-steering provisions unlawfully hindered price competition between credit card companies. Visa and MasterCard settled claims brought against them and agreed to rescind their anti-steering provisions.

Following a seven-week bench trial in the summer of 2014, the United States District Court for the Eastern District of New York ruled that Amex's NDPs violate federal antitrust law. The district court defined the relevant market exclusively as network services for merchants and did not consider the consumer-facing side of credit card services. The court also found that Amex possessed sufficient market power to harm competition in that market because (1) Amex has significant market share of credit card transactions (26.4%), (2) the market is highly concentrated with substantial barriers to entry, and (3) Amex cardholders strongly insist on using their Amex cards. In turn, the district court held that Amex's anti-steering provisions unlawfully reduced price competition in the network services market by "removing the competitive 'reward' for networks offering merchants a lower price for acceptance services."

The Second Circuit reversed, finding that the district court erred by focusing its antitrust analysis exclusively on the merchant side of the network. Instead, reasoning that the cardholder and merchant sides of the platform were too interconnected to be considered separately, the Second Circuit held that plaintiffs had to show a "net" anticompetitive effect,

such that any restraint on merchants is not outweighed by potential procompetitive effects for cardholders, in order to meet their *prima facie* burden under the rule of reason.

Summary of the Court's Opinion

The Court defined the relevant market as a two-sided transaction platform, and after applying the rule of reason to the vertical restraints at issue, found that plaintiffs failed to meet their burden of showing a substantial anticompetitive effect.

"The key feature of transaction platforms is that they cannot make a sale to one side of the platform without simultaneously making a sale to the other."

— Justice Thomas

A Two-Sided Market is Defined by Strength of Indirect Network Effects

In an opinion by Justice Thomas, the 5-4 majority explained that Amex's two-sided credit transaction platform constituted a single relevant product market for purposes of the antitrust analysis because the platform cannot make a sale to one side of the platform without simultaneously making a sale to the other. The Court explained that two-sided platforms should be analyzed as a single relevant market when they exhibit strong "indirect network effects," which exist where the value of the platform to one group depends on how many members of another group participate. In other words, two-sided platforms constitute a single relevant market when the network provider cannot raise prices on one side without risking a feedback loop of declining demand.

The Court noted, however, that not all two-sided platforms should be treated as one market. The Court distinguished this case from *Times-Picayune*,[1] which defined separate markets for newspaper subscribers and for newspaper advertisers despite their interdependence, because "the impacts of indirect network effects and relative pricing in that [newspaper] market are minor," compared to those in credit card transaction network. Whereas newspaper readers are largely indifferent to the amount of advertising that a newspaper publishes, cardholders are deeply vested in the number of merchants who accept their preferred credit card.

The Rule of Reason Framework

As expected, the Court utilized the familiar burden-shifting rule of reason framework to assess whether Amex's vertical restraints were lawful. The Court held that plaintiffs failed to meet their initial burden to prove substantial anticompetitive effects in the first step because their argument regarding increased merchant fees wrongly focused on only one side of the two-sided credit-card market. The Court explained that "focusing on merchant fees alone misses the mark because the product that credit-card companies sell is transactions, not

[1] *Times-Picayune Pub. Co. v. United States*, 345 U.S. 594, 610-12 (1953).

"Amex's business model has spurred robust interbrand competition and has increased the quality and quantity of credit-card transactions."

— Justice Thomas

services to merchants, and the competitive effects of a restraint on a transaction cannot be judged by looking at merchants alone." Not only did the majority reject the plaintiffs' position that Amex's conduct was anticompetitive, the majority found that Amex's increased merchant fees had a procompetitive effect because higher merchant fees support a more robust cardholder rewards program and because the output of credit card transactions grew by 30% during the period of increasing merchant fees. Moreover, the majority found that Amex's conduct impelled Visa and MasterCard to offer new premium card categories with higher rewards to compete with Amex.

Dissent

Justice Breyer read a strong dissenting opinion from the bench that was joined by Justices Ginsburg, Sotomayor, and Kagan. At the outset, Justice Breyer noted that while other countries have responded to concerns about the high fees that credit-card companies charge merchants by regulating such fees directly, the United States has declined to do so.

"Nothing in antitrust law, to my knowledge, suggests that a court…should abandon traditional market-definition approaches and include in the relevant market services that are complements, not substitutes, of the restrained good."

— Justice Breyer

The dissent argued that the credit card business involved the sale of two different, but related card services—(1) speedy payment for merchants and (2) credit for shoppers. The dissent claimed that "the relationship between merchant-related services and shopper-related card services were complements [like gasoline and car tires], not substitutes," and as such, constituted two separate markets. Although the dissent agreed that the rule of reason was the proper analytical framework with which to evaluate the conduct, the dissent further argued that defining the market at the first step was legally unnecessary because there was strong direct evidence of anticompetitive effects (merchant price increases) enabled by the anti-steering provisions. Finally, the dissent argued that even accepting a two-sided payment market definition at the first step, the plaintiffs had satisfied their initial burden by showing evidence of supra-competitive pricing because Amex increased the percentage of the purchase price that it charged merchants, and revenue from that marginal increase was not entirely spent on cardholder rewards, resulting in a higher *net* price.

Implications

This case provides guidance for the application of the rule of reason test to those two-sided platforms with sufficient "indirect network effects" to constitute a single relevant market. Given the explosion of technology-driven business models, such as electronic trading platforms like eBay, Craigslist, and StubHub; networking sites like LinkedIn, Match.com, and Monster.com; real estate services like Zillow; and sharing-economy services like Uber

and AirBnB, this decision could make it more difficult for antitrust claimants to allege or demonstrate a rule of reason violation.

More broadly, the Court's decision could signal a shift in its approach to vertical restraint cases. The Court's focus on market power and market definition at the first step of the rule of reason reflect a reluctance to allow plaintiffs to meet their initial burden of showing anticompetitive effects without addressing these issues, even where they put forth allegations of direct anticompetitive effects. Plaintiffs, particularly those challenging modern transaction platforms, could be required to undertake a more expansive factual investigation, broader expert economic analysis, and more thorough explanation of market share–all at the first step of the rule of reason analysis.

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