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SUPREME COURT FINDS FAILURE TO PROVE A SHERMAN ACT SECTION 1 VIOLATION IN CREDIT CARD MARKET

To Our Clients and Friends:

On June 25, 2018, the Supreme Court of the United States assuaged the concerns of many that antitrust enforcement would hobble new and creative ways of conducting business, particularly businesses that have relied on technology to bring consumers and sellers together by offering a "platform" that creates a highly convenient way for them to interact and consummate sales. In *Ohio v. American Express*, the Court held that plaintiffs failed to prove a Sherman Act Section 1 violation in the credit card market because they presented evidence of alleged anticompetitive effects only on the merchant side of the relevant market. Without evidence of the impact of the challenged practices on the cardholder side of the market, the Court concluded that plaintiffs failed to carry their burden to prove anticompetitive effects.

The Court's opinion has several important elements beyond its holding that certain two-sided platform markets must be evaluated as a single relevant market:

- Significantly, the Supreme Court discussed a framework for analyzing alleged restraints under the rule of reason for the first time. Both the majority and dissent adopted the parties' agreed-upon, three-step framework for analyzing restraints under the rule of reason. Under this framework, the plaintiff bears the initial burden of proving anticompetitive effects, which shifts the burden to the defendant to show a procompetitive justification. If the defendant meets its burden of proving procompetitive efficiencies, then the burden shifts back to the plaintiff to show that those efficiencies could have been achieved through less restrictive means. Notably, the Court did not mention any balancing of anticompetitive effects against procompetitive justifications.

- The third step in the above rule of reason framework may be the focus of scrutiny as plaintiffs look to find "less restrictive alternatives" to overcome defendants' evidence of a procompetitive rationale for a challenged practice. DOJ-FTC Competitor Collaboration Guidelines provide, however, that the agencies "do not search for a theoretically less restrictive alternative that is not realistic given business realities." Section 3.36(b).

- The Court also found that evidence that output of transactions in the relevant market had increased during the relevant period undercut plaintiffs' reliance solely on evidence of price increases by Amex. The Court's reliance on the failure to prove output restriction reinforces the continued vitality of the Court's prior decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

- The Court rejected the argument that market definition could be dispensed with based on evidence of purported actual anticompetitive effects in the form of merchant fee increases by Amex. The Court in this regard distinguished horizontal restraints, which in some cases may be analyzed without "precisely defin[ing] the relevant market," and vertical restraints, stating that vertical restraints frequently do not pose any threat to competition absent the defendant possessing market power. Therefore, it is critical to precisely define the relevant market when evaluating vertical restraints.

The case arose out of a decades-old practice. For more than fifty years, American Express Company and American Express Travel Services Company (together, "Amex") have included "anti-steering" provisions in contracts with merchants who agree to accept American Express cards as a means of payment. These provisions prohibited merchants from trying to persuade customers to use cards other than American Express cards or imposing special conditions on customers using American Express cards. Absent the challenged provisions, merchants had a strong incentive to encourage customers to use other credit cards because other credit card providers charged merchants lower fees than Amex. Amex uses the money received from its higher merchant fees to fund investments in its customer rewards program, which offers cardholders better rewards than those offered by rival credit card companies.

The United States and several States ("plaintiffs") sued Amex in October 2010, alleging that the anti-steering provisions violated Section 1 of the Sherman Act. The United States District Court for the Southern District of New York entered judgment for plaintiffs, finding that the provisions violated Section 1 because they caused merchants to pay higher fees by precluding merchants from encouraging cardholders to use an alternative card with a lower fee at the point of sale. The district court sided with plaintiffs in finding that the credit card market was really two separate markets: a merchant market and a cardholder market. The United States Court of Appeals for the Second Circuit reversed, holding that the district court erroneously considered only the dealings between Amex and merchants. As a result, it failed to recognize that the credit card market was a single, "two-sided" market, not two separate markets. Therefore, the impact of the anti-steering provisions on the cardholder side of the market had to be analyzed in order to determine if those provisions had a substantial anticompetitive effect in the relevant market. The Supreme Court affirmed in a 5-4 decision.

The majority, in an opinion authored by Justice Thomas, agreed with the Second Circuit that the credit card market should be considered as a single market because credit card providers compete to provide credit card transactions, but can create and sell those services only if both the cardholder and the merchant simultaneously choose to use the credit card network as a means of payment. The market is "two-sided" in that it involves the simultaneous provision of services to both cardholders and merchants; in any transaction, a credit card network cannot sell its payment services individually to only the cardholder or only the merchant.

The majority observed that the credit card market exhibited strong "indirect" network effects because prices to cardholders affected demand by merchants and prices to merchants affected demand by cardholders. Higher prices to cardholders would tend to decrease the number of cardholders, which would decrease the attractiveness of that card to merchants, which in turn would decrease the

attractiveness of the card to cardholders. Conversely, higher prices to merchants would decrease the number of merchants accepting the card, which would decrease the utility of the card to cardholders, decreasing the number of cardholders. In either case, the provider increasing prices faced the risk of "a feedback loop of declining demand." Providers therefore had to strike a balance between the prices charged on one side of the platform and the prices charged on the other side. In the credit card market, different cardholders might attribute different value to broad acceptance of their card by numerous merchants or to generosity of "cash back" or other loyalty or usage rewards. Similarly, merchants might assign different values to the level of fees by a credit card provider versus the card's ability to present the merchant with a higher proportion of "big spenders."

Significantly for future cases, the majority observed that not every "platform" business bringing together buyers and sellers should be considered to be a single market. The majority focused on the strength of the indirect network effects—that is, the potential for increased prices on one side to reduce demand on the other side, prompting a feedback loop of declining demand. The majority discussed a newspaper selling advertisements to advertisers as an example of a "platform" that should not be considered a single market. According to the majority, the indirect network effects operated only in one direction. Advertisers might well care if high subscription prices reduced the number of readers. But because readers are largely indifferent to the amount of advertising in a newspaper, a reduction in advertisements caused by higher advertising rates would not lead to a reduced number of readers.

The Court emphasized the importance of market definition in analyzing alleged anticompetitive effects caused by vertical restraints. Unlike horizontal restraints among competitors, the majority wrote, "[v]ertical restraints often pose no risk to competition unless the entity imposing them has market power, which cannot be evaluated unless the Court first defines the relevant market." Thus, the Court disagreed with plaintiffs' assertion that under *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986), evidence of actual adverse effects in the form of increased merchant fees was sufficient proof. The Court distinguished *Indiana Federation of Dentists* by noting that it involved a horizontal restraint, and therefore the Court concluded it did not need to precisely define the relevant market to evaluate the restraint's competitive impact.

The dissent, authored by Justice Breyer, accused the majority of "abandoning traditional market-definition approaches" by declining to define the relevant market by assessing the substitutability of other products or services for the product or service at issue. As the dissent noted, because consumers' ability to shift to substitutes constrains the ability of a seller to raise prices, it is necessary to include reasonable substitutes within the relevant market. The dissent argued that the card providers' services to merchants and services to cardholders were complements, not substitutes, in the sense that, like gasoline and tires for a car, both must be purchased to have value. But this analogy is inapt in at least two respects. First, there is no need for simultaneity in the purchase of gasoline and tires. Few, if any, consumers buy new tires each time they purchase gasoline. Second, the two complementary products are both purchased by the owner or operator of the vehicle. The seller of gasoline and tires does not have to purchase a service from anyone in order to sell the gasoline or tires (unless the buyer wishes to use a credit card, in which case both the buyer and the merchant must simultaneously choose to use the payment services offered by the credit card provider). This is unlike the credit card context where both

the cardholder and the merchant must simultaneously choose to use the payment services offered by the credit card provider.

The Court's acceptance that some businesses operate in a single, two-sided market has implications for antitrust cases involving technology-based "platform" businesses, such as ride-sharing and short-term home rentals, that have become a substantial and growing component of the economy. The outcomes in future cases are likely to turn on the strength of the evidence showing that network effects constrain pricing decisions. Makan Delrahim, the head of the DOJ's Antitrust Division, said this past week that he had feared the Supreme Court would cause "harm to our economy" by creating a rule for evaluating two-sided markets that would harm new "platform" business models like Uber, AirBnB and eBay. He described DOJ's philosophy with respect to the case as "it's one interrelated market, it's a new business model, and you can't stick your head in the sand and say, 'If you're raising the prices – whether on the consumer or driver – it can't have an effect.' And it could be a positive effect, because a Lyft can do the same thing and now be able to compete better with an Uber or whatever the next one would be." While Mr. Delrahim acknowledged that the *Amex* ruling likely would apply to companies like Uber and AirBnB, he does not believe Google will benefit from it, noting that consumers do not use Google Search just to see advertisements.

Although the Amex decision is notable for its focus on commercial realities and acceptance of the existence of two-sided markets, there are other significant aspects of the decision. Most notably, the Court discussed a three-step, burden-shifting framework for analyzing restraints under the rule of reason. This provides welcome guidance, as the Court had not previously discussed any framework or methodology for evaluating claims under the rule of reason. While the framework was agreed-upon among the parties below, its adoption by the majority (and acceptance by the dissent) nevertheless provides important instruction regarding the steps to be conducted by courts in weighing rule of reason claims under either Section 1 or Section 2. In the first step of the decision's framework, the plaintiff bears the burden to prove anticompetitive effects in the relevant market. If the plaintiff carries that burden, in the second step the burden shifts to the defendant to demonstrate a procompetitive rationale for the challenged restraint. If the defendant makes that showing, then in the third step the burden shifts back to the plaintiff to "demonstrate that the procompetitive efficiencies could reasonably be achieved through less restrictive means."

The Court held that plaintiffs had not satisfied the first step of the rule of reason framework. As with many cases, the Court's definition of the relevant market determined the outcome. To prove anticompetitive effects, plaintiffs relied solely on direct evidence of Amex's increases in merchant fees during 2005-2010. However, the Court concluded that because the market was two-sided, such evidence was incomplete and did not demonstrate anticompetitive effects in the form of either higher prices for credit card transactions or a reduction in the number of such transactions. Indeed, the Court found that certain evidence in the record cut against plaintiffs' claim that the anti-steering provisions were the cause of any increases in merchant fees by Amex—for example, rival card companies had also increased merchant fees. The Court also noted that credit card transaction output had increased substantially during the relevant period, further undermining any claim of anticompetitive effects. Quoting from *Brooke Group*, 509 U.S. at 237, the majority wrote that it will "not infer competitive injury from price and output data absent some evidence that tends to prove that output was restricted or prices were above

a competitive level." The Court's focus on output restriction under *Brooke Group* demonstrates that the Court's continued insistence on the application of sound economic principles in evaluating antitrust claims.

While it noted Amex's rationale for the anti-steering provisions, the Court did not address the second or third step of the rule of reason framework given its finding that the plaintiffs had failed to satisfy the first step. The Court's recognition in the third step that proven procompetitive efficiencies may be overcome by a showing of less restrictive means of achieving those efficiencies will likely cause private plaintiffs and enforcement agencies to increase their focus on potential alternatives.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please feel free to contact any member of the firm's Antitrust and Competition practice group or the following authors:

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