UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

UNITED STATES, *et al.*,

Plaintiffs

v.

AMERICAN EXPRESS CO., *et al.*,

Defendants

NO. 10-CV-04496 (NGG) (RER)
ECF CASE

PUBLIC VERSION

DEFENDANTS' POST-TRIAL BRIEF

Evan R. Chesler
Stuart W. Gold
Peter T. Barbur
Kevin J. Orsini
CRAVATH, SWAINE & MOORE LLP
825 Eighth Avenue
New York, NY 10019
(212) 474-1000

Donald L. Flexner
Philip C. Korologos
Eric J. Brenner
BOIES, SCHILLER & FLEXNER LLP
575 Lexington Avenue
New York, NY 10022
(212) 446-2300

Attorneys for Defendants

September 18, 2014

Page

TABLE OF CONTENTS

Page

Page

Page(s)

TABLE OF AUTHORITIES

Page(s)

Cases

Page(s)

Page(s)

Other Authorities

Defendants American Express Company and American Express Travel Related Services Company, Inc. (collectively, "American Express") respectfully submit this Post-Trial Memorandum pursuant to the Court's order dated August 18, 2014. For the reasons set forth below, we respectfully submit that the Court should enter judgment in favor of American Express.

PRELIMINARY STATEMENT

Through this action, the Government would harm, not enhance, competition. The evidence at trial demonstrates that American Express's Non-Discrimination Provisions are critical to its ability to provide a differentiated product to merchants and customers—a business model that the Government itself once lauded as a pro-competitive bulwark against Visa and MasterCard's dominance. Now, the Government claims that it is entitled to an injunction striking those provisions if it can simply prove that merchant discount fees will fall without the provisions in place. The Government even claims that such proof would be sufficient to permit it to dispense with proving directly that American Express has antitrust market power or even defining the relevant market.

As set forth in detail below, the Government's burden of proving an actual adverse effect on competition (in a properly defined market) is far more substantial. In this two-sided market, all of the economic experts agree that any meaningful analysis of competitive effects requires a consideration of the competitive dynamics on both sides of the market. The Government has failed to do so. Instead, it has called a series of merchant employees with a narrow perspective on their own businesses and effectively tried its case as if the consumer side of the market did not exist. But even setting that flaw aside, and accepting for the sake of argument that the Government could prevail if it simply showed that merchant discount fees will fall, the Government still has not carried its burden.

In fact, the Government's own economic expert, Professor Michael L. Katz, contradicted the Government's theory. He conceded that merchant fees could increase if the Non-Discrimination Provisions were removed, and that product differentiation among the payment card networks could decrease. (FOF ¶ 231.[1]) And that concession is not surprising because the only natural experiment available to test the Government's theory refutes it. There are three million merchant locations within the United States that accept Visa, MasterCard and Discover but not American Express. (FOF ¶ 232.1.) Those merchant locations have been free to discriminate in favor of Visa, MasterCard or Discover for the nearly four years since Visa and MasterCard settled the Government's case against their non-discrimination provisions. (FOF ¶ 232.2.) At the time of that settlement, the Government announced that there would be an immediate benefit of lower discount fees at these merchants through increased point-of-sale competition. (FOF ¶ 232.3.) Yet the evidence shows that almost four years later, the merchant discount fees charged to those merchants have increased; Visa and MasterCard are not competing against each other for point-of-sale steering; and Discover has not pursued its "low cost to merchants" strategy, even though there are literally hundreds of billions of dollars in charge volume available for the taking at these merchants if the Government's claims about the benefits of point-of-sale steering were correct. (FOF ¶¶ 232.4, 232.6.1.)

When pressed on this evidence and his concessions that discount fees might go up, Professor Katz's response was that the Court should remove the Non-Discrimination Provisions anyway and "let the chips fall where they may". (FOF ¶ 231.1.) But the evidence shows that the only winners of that bet would be the dominant firms of Visa and MasterCard. (FOF ¶¶ 259-68.) Consumers and merchants will lose as competition decreases.

[1] Citations of the form "FOF" are to the Proposed Findings of Fact within Defendants' Proposed Findings of Fact and Conclusions of Law, filed herewith.

Kenneth Chenault, who has three decades of experience in this industry, was emphatic: without the assurance of welcome acceptance for American Express Cardmembers provided by the Non-Discrimination Provisions, American Express could not continue to make the investments necessary to serve as an effective competitive check on the dominant networks. (FOF ¶ 265.) He was not alone. American Express's President Ed Gilligan and American Express's expert, Professor B. Douglas Bernheim, among others, agreed that without Non-Discrimination Provisions American Express's ability to compete with a differentiated model would be at an end. (FOF ¶ 265.)

Mr. Chenault's testimony was also confirmed by the testimony and documents of Bradford Morgan—the architect of the Visa "We Prefer" campaign that the Government has featured as the paradigm of the "competition" that removal of the Non-Discrimination Provisions would enable. As he explained in his trial testimony and his 1989 presentation to the Visa Board, the entire purpose of that campaign was to "break the American Express success cycle"; to force American Express back into its "niche"; to attack American Express where it was most vulnerable, at the point of sale; to break the promise of welcome acceptance and to extinguish the financial source of consumer benefits that drive competition. (FOF ¶ 11.2.) And it worked. Even with the Non-Discrimination Provisions in place, the "We Prefer" campaign caused American Express to suffer a significant and sustained loss of share. (FOF ¶ 12.)

Simply put, the parties agree on one basic point: merchant steering works. It causes consumers to use their own preferred card less and less. And it can go only one way: against American Express, since a merchant cannot steer to a card that most consumers do not have. The Government dismisses this evidence on the ground that the antitrust laws should protect competition, not competitors. But that entirely misses the point: the American Express differentiated business model drives innovation and competition, and American Express is the only meaningful competitive check against Visa and MasterCard. (FOF ¶ 60.) That is why the head of the Antitrust Division asked Mr. Chenault to be the Government's lead witness in their prior case and to expound upon the American Express premium model and the myriad ways in which it drives benefits to consumers and to merchants. (FOF ¶ 58.2.)

For these reasons, the Government cannot prevail even if the Court were to focus only on the question of competitive effects. There is no evidence that the Non-Discrimination Provisions have actually harmed competition and ample evidence that they enhance it. A review of the "traditional factors" that courts consider in vertical restraint cases—and which the Government seeks to avoid—further underscores the failure of the Government's proof.

First, with respect to market definition, the proof does not support either of the Government's alleged markets. As to which products are included in the market, the real world has passed by the Government's theory—debit, credit and charge cards compete in the properly defined relevant market. Debit card use has exploded in the years after the United States v. Visa decision and debit cards are generally viewed as largely interchangeable with charge and credit cards. (FOF ¶¶ 80-114.) Similarly, the Government's alleged travel and entertainment ("T&E") price discrimination market is built on an unproven—and erroneous—assumption that the higher average merchant fees charged to T&E merchants are not driven by the higher costs in serving them. (FOF ¶¶ 115-18.) The two competitors that focused on this purported market—Carte Blanche and Diners Club—have all but disappeared. (FOF ¶ 3.3.) And the Government did not even identify who is in its alleged T&E market.

Second, with respect to market power, the traditional metrics refute the notion that American Express has the power to harm competition. Its share of purchase volume is below any threshold of presumptive market power, even if debit is excluded. (FOF ¶¶ 119-22.) With debit included, a finding of market power would be truly unprecedented in the history of vertical restraint cases. American Express is last in merchant coverage, last in cards in force, last in number of transactions and has only nine U.S. banks issuing its cards. (FOF ¶¶ 123-29.) Visa and MasterCard have more than 10,000 banks issuing their cards. (FOF ¶ 127.) Share is a critical metric in this industry, as demonstrated by the Government's concessions that Discover is powerless precisely because of its low share. (FOF ¶ 237.2.)

The Government's pricing evidence is also unavailing. The Government offered no evidence that American Express's price is above the competitive level (or even what the competitive level is) and no evidence that American Express is earning anything above competitive economic profits, admittedly the proper measure. Moreover, when properly adjusted for card-type mix, American Express has no premium. (FOF ¶ 187.) Professor Katz admitted that in that circumstance, price cannot be evidence of market power. (FOF ¶ 187.2.) And the value recapture evidence illustrates that American Express increased merchant discount fees to some merchants after many years of stasis or decline to ensure that it was receiving a fair return on its investments. (FOF ¶ 176.) At the same time, American Express reduced merchant discount fees to more than half of its thousand largest merchants and ultimately was forced to stop its attempt at value recapture because of the pressure merchants were able to exert on American Express. (FOF ¶ 181.) That is competition, not antitrust market power.

Finally, the evidence also established that Cardmember insistence for American Express is the result of continuous, unrelenting investments—it is not the type of durable, need-based insistence that Visa and MasterCard have because of their ubiquity. Indeed, the evidence demonstrates that merchants accounting for a large portion of American Express's charge volume—based on American Express's need to be responsive to them in negotiations as a result of their own loyal customer base—have consistently been able to negotiate significant concessions (hundreds of millions of dollars in signing bonuses, greater flexibility in promoting other forms of payment over the American Express Card products, delays in price increases, etc.), while American Express spends millions on surveys and studies in an attempt to improve its services and the perception of merchants as to the value received for what they pay. (FOF ¶¶ 197-221.) This is not what antitrust market power looks like.

In short, the choice the Government has put to the Court is stark: upend the industry in the face of empirical evidence refuting the Government's basic theory that discount fees will fall and its own expert's candid concession that they might increase, or acknowledge what Mr. Chenault and his colleagues know from the history they have lived—that the Government's previous champion for competition in this industry will be unable effectively to compete. We respectfully submit that under binding precedent the Government has failed to demonstrate that the Non-Discrimination Provisions harm competition (or are even likely to do so) and its request for relief should be rejected.

ARGUMENT

Because the Non-Discrimination Provisions are vertical agreements, the Government's Section 1 claim must be analyzed under the full rule of reason. (Summ. J. Mem. & Order, Dkt. No. 369 ("SJ Order") at 9.) "This most searching form of antitrust analysis involves a context-specific inquiry into the relevant market and a defendant's effect on that market." (Id.) The Government must do more than prove that the Non-Discrimination Provisions actually exist, or that they actually restrain: by their very nature, all vertical restraints restrain some expression of competition. See, e.g., E&L Consulting, Ltd. v. Doman Indus. Ltd., 472 F.3d 23, 29 (2d Cir. 2006) (noting that defendant's vertical agreement, "like any commercial agreement, restrains trade", and dismissing Section 1 claims for failure to show anticompetitive effects beyond the restraint itself); Bd. of Trade v. United States, 246 U.S. 231, 238 (1918) (holding with respect to vertical restraints that "[t]o bind, to restrain, is of their very essence").

Thus, the Government bears the threshold burden of proving that the Non-Discrimination Provisions have actual market-wide adverse effects on competition. To satisfy this threshold burden under Second Circuit law, the Government must first define and prove a relevant antitrust market in which the alleged adverse effects occur. (SJ Order at 10; see also infra Part III.) In addition, the Government must prove that the Non-Discrimination Provisions have had actual adverse effects within that market, either: (1) directly by making an "empirical demonstration concerning the adverse effect of [the Non-Discrimination Provisions] on price or quality" in the market as a whole (the "adverse effects" standard); or (2) indirectly by showing that American Express has antitrust market power in the market and that there exist other grounds to believe that the Non-Discrimination Provisions harm competition as a whole (the "market power" standard). (SJ Order at 11); KMB Warehouse Distribs., Inc. v. Walker Mfg. Co., 61 F.3d 123, 127-28 (2d Cir. 1995). If the Government were to satisfy the threshold burden of proving actual adverse effects in a well-defined antitrust market, the burden would shift to American Express to prove that the Non-Discrimination Provisions have procompetitive justifications that outweigh those effects. (SJ Order at 9.) If American Express satisfies that burden, the burden shifts back to the Government to prove that the procompetitive justifications established by American Express could be achieved through less restrictive alternatives. (SJ Order at 9.)

As set forth below and in the accompanying Findings of Fact and Conclusions of Law, the evidence demonstrates that the relevant market must include debit cards, that American

Express does not possess antitrust market power and that the Non-Discrimination Provisions are essential to the competitive vitality of this market. Because the Government insists, erroneously, that it can prevail without proving its alleged markets and can ignore the substantial evidence demonstrating American Express's lack of antitrust market power, this brief begins by focusing on the Government's failure of proof on the element that even the Government concedes is its burden to carry—the competitive effects of the Non-Discrimination Provisions.

I. THE GOVERNMENT HAS FAILED TO PROVE AN ACTUAL ADVERSE EFFECT ON COMPETITION.

A. <u>The Government Mischaracterizes Its Burden of Proof on Adverse Effects.</u>

In its Pretrial Brief, the Government claimed that it could satisfy the adverse-effects test under the rule of reason merely by showing that the Non-Discrimination Provisions "disrupt the proper functioning of the price-setting mechanism", without showing any actual "effect on Amex's two-sided price level, or any other price". (Pls.' Pre-Trial Mem. ("Pls. Br.") at 5, 55.) This claim mischaracterizes the Government's burden in two fundamental ways.

<u>First</u>, the standard that the Government described in its Pretrial Brief is <u>not</u> the "actual adverse effects" test that must be satisfied under the full rule of reason. It is instead taken from a portion of the Supreme Court's opinion in <u>FTC v. Indiana Federation of Dentists</u>, 476 U.S. 447, 461-62 (1986) ("<u>IFD</u>"), that applied a truncated "quick look" analysis to a horizontal agreement among competitors. As the Supreme Court has explained, quick-look analysis is limited to cases in which "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets". <u>Cal. Dental Ass'n v. FTC</u>, 526 U.S. 756, 770-71 (1999) (reversing a Court of Appeals decision that had applied quick-look analysis to a horizontal

restraint whose anticompetitive effects were not "comparably obvious"). This truncated standard has no application in this vertical case to which the "most searching form" of antitrust scrutiny applies. (See SJ Order at 9.)[2]

Contrary to the Government's claim, the test for proving actual adverse effects in a full rule-of-reason case in the Second Circuit is more demanding. To pass that test, the Government must offer empirical evidence demonstrating that, if the Non-Discrimination Provisions were removed, prices would be lower, output would be greater or quality would increase in the overall market. Todd v. Exxon Corp., 275 F.3d 191, 214 (2d Cir. 2001) (Sotomayor, J.) (applying the adverse-effects test in a full rule-of-reason analysis and requiring a Section 1 plaintiff alleging conscious parallelism among employers to make a "substantial presentation of evidence . . . that salaries would have been higher without the information exchange"); KMB Warehouse, 61 F.3d at 127-28 (no adverse effect of vertical restraint demonstrated where plaintiff failed to present "empirical demonstration concerning the adverse effect of the defendants' arrangement on price or quality" in the overall market and thus "failed to come forward with any evidence that defendants' actions adversely affected service, quality or price market-wide") (internal quotation marks and alterations omitted; emphasis added); see also Tops Mkts., Inc. v. Quality Mkts., Inc., 142 F.3d 90, 96 (2d Cir. 1998) (no adverse effect where plaintiff alleged "potentially" higher prices, but did not demonstrate that prices were actually higher across the market or that quality had actually decreased); Capital Imaging Assocs., P.C. v. Mohawk Valley Medical Assocs., Inc., 996 F.2d 537, 546 (2d Cir. 1993) (no adverse effect

[2] This is a separate issue from the one addressed by the Court on summary judgment as to whether IFD provides a route for the Government to prevail without directly establishing the existence of market power. Given the Court's ruling that a plaintiff can prevail through adverse-effects evidence without separately proving market power, we do not address that issue here (and reserve all rights, as Defendants believe that is not an appropriate route for proving a Section 1 violation in this case). The point here is simply that even if that alternative route is available, the Government cannot satisfy the requirement for direct evidence of adverse effects by employing the presumptive standard for adverse effects from IFD and other "quick look" cases.

where plaintiff conceded price would not be changed absent restraint and failed to adduce evidence that restraint had reduced quality).

In its Pretrial Brief, the Government never even addressed this standard. Instead, virtually every case it cited in discussing competitive effects was applying a quick-look or even a per se analysis to inherently suspect, horizontal conspiracies among competitors with no factual, economic or legal link to the Non-Discrimination Provisions.[3] The Government's claim that it need not show an actual market-wide effect on prices (or quality or output) is directly contrary to Second Circuit law.

Second, the Government's claim that it need not show an effect on two-sided prices is based on a mischaracterization of the law and ignores the testimony of the Government's own expert, Professor Katz. To be clear, every testifying economist in this case agrees that this is a two-sided market, and that the analysis of market definition, market power and the competitive effects of the Non-Discrimination Provisions should account for prices on both sides of the market. That includes American Express's experts, Professor Bernheim and Professor Richard J. Gilbert, who explained that the two-sided market in which American Express participates is the market for transactions, which has the unique feature even among two-sided markets of requiring American Express to set its prices so as to attract exactly one participant on each side of the market—one consumer and one merchant—for each and every unit of output. (FOF ¶ 70.1.) And it includes the Government's expert, Professor Katz, who

[3] See, e.g., FTC v. Super. Ct. Trial Lawyers Ass'n, 493 U.S. 411, 435-36 & n.19 (1990) (finding per se horizontal price-fixing conspiracy); NCAA v. Bd. of Regents, 468 U.S. 85, 98-103, 120 (1984) (applying quick-look analysis, as confirmed by Cal. Dental, 526 U.S. at 769-70, to invalidate horizontal agreement among colleges to restrain price and output); Nat'l Soc'y of Prof'l Engineers v. United States, 435 U.S. 679, 681, 692-93 (1978) (applying quick-look analysis, as confirmed by Cal. Dental, 526 U.S. at 770, to invalidate horizontal agreement among engineers not to allow competitive bidding); United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 223-24 (1940) (finding per se price-fixing conspiracy); Chicago Prof'l Sports Ltd. P'Ship v. NBA, 961 F.2d 667, 669, 674-76 (7th Cir. 1992) (applying quick-look analysis to horizontal agreement); United States v. Apple, 952 F. Supp. 2d 638, 706-07 (S.D.N.Y. 2013) (finding per se price-fixing conspiracy).

agreed in his testimony at trial that changes in price in this two-sided market cannot be adequately assessed by looking only at one side. (FOF ¶ 158.3.) Indeed, the consensus among the experts in this case reflects a broader consensus among economists studying this industry. As former Assistant Attorney General Baxter explained in his seminal article on the payments card industry, it is the need to balance the demands on both sides of the market that makes the two-sided price so critical. (FOF ¶ 158.2.)

The Government disagrees with this economic consensus. It insists that "proof" that the Non-Discrimination Provisions "interfere" with prices on one side of the market is "[a]s a matter of law . . . sufficient to justify relief". (Pls.' Br. at 55.) It attempts to support this contention by pointing primarily to United States v. Visa, a case in which Visa and MasterCard entered into a horizontal agreement with 20,000 competing banks that effectively shut out American Express and Discover from the competition for card-issuing bank partners. 344 F.3d 229, 240, 242 (2d Cir. 2003). The restraint in that case was fundamentally about regulating conduct on one side of the market, the card issuing, i.e., consumer, side—specifically, the Exclusionary Rules prevented American Express and Discover from competing for issuers of Visa and MasterCard payment cards, which prevented consumers from being able to obtain American Express and Discover cards through their depository banks. By contrast, the Non-Discrimination Provisions regulate the way merchants on one side of the market interact with consumers on the other side, and thus fundamentally concern both sides of the two-sided market. It is not surprising, then, that every testifying expert in this case agrees that both sides of the market are relevant to the assessment of the Non-Discrimination Provisions—including Professor Katz, the Government's own expert in Visa. The Government is also simply wrong to suggest that Visa stands for the proposition that competitive harm in this market can be assessed exclusively by looking at one side: even in the context of a restraint that, unlike the Non-Discrimination Provisions, regulated conduct on only one side of the market, the district court's opinion nonetheless expressly analyzed the Exclusionary Rules' impact on the "other" side of the market, i.e., the merchant side. 163 F. Supp. 2d 322, 387-89, 396 (S.D.N.Y. 2001).[4]

Moreover, noticeably absent from the Government's discussion of cases involving two-sided markets is United States v. First Data Corp., No. 03-cv-2169 (D.D.C.), a case in which, as here, the Government alleged that the conduct at issue (a merger between two debit card networks) had direct effects on both sides of the two-sided market. (FOF ¶ 72.3.) Although that case settled before the court had an opportunity to decide it, Professor Katz, who testified against the Government in that case, recognized that the two-sided nature of the market was critical to the analysis of the Government's allegations and accused the Government of telling only half the competitive story by focusing on just one side of the market. (FOF ¶ 72.3.5.) As in

[4] The Government points to a handful of other cases in which courts addressed a two-sided market without specifically addressing issues relating to two-sided price levels. These cases, however, are inapposite. For example, the Government cites two cases involving tying claims, Times Picayune Publ'g Co. v. United States, 345 U.S. 594 (1953) and United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001). (Pls.' Br. at 55-56.) But tying claims do not require proof of price effects; a plaintiff need only prove that the tying and tied products are separate products, that the defendant has market power in the tying market, that the defendant affords consumers no choice but to purchase the tied product from it and the tying arrangement forecloses a substantial volume of commerce. See Microsoft, 253 F.3d at 85. The Government also emphasizes United States v. Apple Inc., 952 F. Supp. 2d 638, 706-07 (S.D.N.Y. 2013), a horizontal price-fixing case in which the court applied per se analysis and so unsurprisingly did not require evidence of price effects. Moreover, none of these cases involved the unique, defining features of this two-sided market—i.e., that for each and every transaction, there must be one consumer and one merchant using the network at the same time, and the prices on both sides of the market are determined by competition among the networks. Times Picayune involved newspapers, which, as Professor Bernheim explained, are a two-sided market in which the attractiveness of the product to readers is not contingent on the newspaper having lots of advertisers (in fact, more advertisements could be seen to make the newspaper less attractive to readers) (FOF ¶ 72.2.3), and Microsoft and Apple both involved two-sided markets in which prices on one side were set by a firm other than the defendant (Tr. 5204:8-5205:13; Tr. 5249:2-5250:5 (Gilbert)).

The Government also attempts to defend its one-sided approach by citing cases that do not involve two-sided markets at all. (Pls.' Br. at 56-57 (citing United States v. Topco Assocs, Inc., 405 U.S. 596, 670 (1972) (invalidating territorial restrictions imposed by supermarket association); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 370 (1963) (refusing to assess competitive effects in New York of merger of two Philadelphia banks)).) These cases are irrelevant: both involved separate one-sided geographic markets, not two-sided markets.

First Data, the Government's claim in this case is that the conduct at issue directly affects behavior on both sides of the market. Indeed, the Government's central claim is that the Non-Discrimination Provisions prevent merchants on one side of the market from influencing Cardmember behavior at the point of sale on the other side; thus, like First Data, this case is fundamentally about both sides of the market. And, as in First Data, the Government cannot possibly tell the full story on competitive effects without providing evidence of effects on both sides of the market. Indeed, as Professor Katz conceded, failure to consider the two-sided price creates the risk of reaching "unwarranted and misleading conclusions". (FOF ¶ 158.3.)

B. **The Government Failed to Satisfy Its Burden in Proving an Adverse Effect.**

The evidence in the record simply does not support the conclusion that the Non-Discrimination Provisions have had adverse market-wide effects on price, quality or output. That is true regardless of whether one improperly focuses on just the merchant discount fee, as the Government has done for the vast majority of its case, or the Government's evidence is assessed from the proper two-sided perspective.

1. Even from a One-Sided Perspective, the Government's Proof on Competitive Effects Fails.

First, the Government's central theory that merchant discount fees will decrease with the removal of the Non-Discrimination Provisions is contradicted by the testimony of the Government's own economic expert. At trial, Professor Katz refused to endorse the Government's theory on merchant fees, and, in fact, testified that it is quite possible that merchant discount fees will increase if the Non-Discrimination provisions are eliminated. (FOF ¶ 231.) This testimony from Professor Katz that merchant discount fees might very well increase, by itself, refutes the Government's theory; combined with a record completely devoid of evidence of adverse market-wide effects on price, quality or output (infra Part I.B.2), it is fatal to the Government's claim. Capital Imaging Assocs., 996 F.2d at 546 (no adverse effect demonstrated where plaintiff alleged "an increase in prices for and a deterioration of the quality of radiological services", but "concede[d] in its brief that whether or not it is admitted into the physicians' association, the fee for radiological services will remain the same" and failed to adduce evidence of a decrease in quality). At the risk of repetition: the Government says it brought this case because the elimination of Non-Discrimination Provisions will bring merchant fees down. But its expert conceded they might well go up.

Second, the only "natural experiment" in the record relating to what might happen if the Non-Discrimination Provisions were eliminated does not support the Government's theory that merchant fees and retail prices would decrease. There are approximately three million merchant locations that accept credit and charge cards and have not been subject to non-discrimination provisions for nearly four years as a result of the Government's consent decree with Visa and MasterCard. (FOF ¶ 232.2.) If the Government's theory were valid, one would have expected to see Visa, MasterCard and Discover competing with each other for point-of-sale steering at these merchants, resulting in lower fees for the merchants and lower retail prices for their customers. Indeed, this is what the Government assured the public would happen "immediately" when it announced the consent decree and filed a competitive impact statement with the Court. (FOF ¶ 232.3.) Yet that is not at all what has happened. At these three million merchant locations, the networks' fees continue to increase (FOF ¶ 232.4.1); Visa and MasterCard have abstained from going after one another's charge volume (FOF ¶¶ 232.4.2-232.4.3); Discover has not pursued a "low cost to merchant" strategy that its president, Mr. Hochschild, claims Discover would vigorously pursue if the Non-Discrimination Provisions were eliminated (FOF ¶ 232.4.4); and retail prices have not come down (FOF ¶ 232.5).

The fact that Visa, MasterCard and Discover are not competing for point-of-sale steering at these merchants is not due to a lack of economic incentive—as the record shows, the annual charge volume at these millions of merchants is $280 billion at a minimum (and likely significantly more than that). (FOF ¶ 232.6.1.) Nor is it a matter of technical feasibility—as a technical matter, a network could compete for steering at these merchants simply by publishing a different interchange table with lower rates for merchants who agreed and were contractually able to steer to the network's cards. (FOF ¶ 232.6.2.) And the Government's suggestion that this set of merchants is unrepresentative because it is disproportionately composed of small merchants is wrong: the record shows that 98 percent of the American Express merchant contracts that the Government claims are impeding competition are with small merchants with, to use the Government's term, the same "profile". (FOF ¶ 232.8.1.) The only plausible explanation for the lack of effects at these merchants is that the Government's theory is highly flawed and fails to take into account the real competitive dynamics in this industry—Visa and MasterCard have no incentive to go after one another, and so they are not doing so, and Discover cannot possibly hope to steal charge volume from Visa and MasterCard in light of their ubiquity and scale, and so it has not attempted to do so.[5] Without effective competition from a differentiated product such as American Express offers, the $25-off steering coupons envisioned by the Government, if they ever come, will be offset by higher prices for merchants and consumers.

[5] As explained in the accompanying Proposed Findings of Fact and Conclusions of Law, evidence in the record from foreign countries similarly supports the conclusion that the Government's competitive effects theory is not valid. In Canada, merchant fees have increased, not decreased, despite the fact that steering has been permitted by regulation there since 2010. (FOF ¶ 234.) And in Australia, regulatory caps on discount fees have led to higher credit card fees to consumers and lower credit card rewards, and there is no evidence that lower discount fees have resulted in lower retail prices for consumers. (FOF ¶ 236.3.)

Third, the Government's evidence relating to Discover's "low cost to merchants" strategy does not show that merchant prices would decrease if the Non-Discrimination Provisions were removed. Although Discover has more cards in force than American Express, it has significantly fewer cards in force than Visa and MasterCard, and much less spend on its network. (FOF ¶ 237.2.) Given that dynamic, it is highly implausible that Discover would have success convincing merchants to steer toward it and risk alienating the many customers of the merchant who carry a Visa or MasterCard card, many of whom do not have a Discover card. The Government has presented no evidence that, in the absence of American Express's Non-Discrimination Provisions, Discover would be able to overcome this competitive disadvantage. To the contrary, as noted, the evidence from the three million merchant locations that do not accept American Express strongly indicates that it would not. (FOF ¶ 237.2.2.) Moreover, even if the Government could show that Discover would pursue a low-cost model and have some success with it, that would not prove that eliminating the Non-Discrimination Provisions would improve competition in the overall market. Not even the Government claims that Discover would gain sufficient volume to become a real competitive constraint on Visa and MasterCard, and such a claim would be implausible.[6] Thus, the Government's arguments relating to Discover amount, at most, to a claim that Discover has been injured as a competitor, which plainly is not sufficient to show that the Non-Discrimination Provisions have harmed competition, given Discover's lack of any meaningful record or ability to drive competition in this industry. Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S.

[6] Notably, in its case against Visa and MasterCard's exclusionary rules, the Government asserted that elimination of the rules would enable American Express and Discover to compete more effectively against the dominant networks. (FOF ¶ 145.) Since that time, American Express's share of charge volume (not including debit, for comparative purposes) has slowly climbed from about 20% to about 25%, where it was 25 years ago. (FOF ¶ 145.) But Discover's share has remained at about 5% for the entire period. (FOF ¶ 222.)

477, 488 (1977); see also Solent Freight Servs., Ltd. v. Alberty, 914 F. Supp. 2d 312, 322 (E.D.N.Y. 2012) (Garaufis, J.).

Fourth, the experience of the Visa "We Prefer" campaign does not show that discount fees would decrease if the Non-Discrimination Provisions were removed. In fact, Visa's fees increased during those campaigns (FOF ¶ 238.1), and the evidence shows that, if the campaigns had continued unabated, the end result would not have been the Government's speculative prediction of "vigorous competition" for preference relationships with merchants; it would have been a market dominated by Visa and MasterCard, who would continue to increase prices without the competitive check on their conduct that American Express provides today (FOF ¶¶ 259-68). Nor can the Government claim that the example of the "We Prefer" campaigns, in which Visa paid merchants to discriminate against American Express (FOF ¶ 238.2), shows that Non-Discrimination Provisions have been used to impede competition on the merits. To the contrary, the evidence shows that those campaigns were anything but competition on the merits. (FOF ¶ 238.5.)

Fifth, the Government cannot rely on American Express's value recapture initiatives as evidence of actual adverse effects. For one thing, it is common for firms in highly competitive markets profitably to increase price. (FOF ¶ 185.) Here, the evidence shows that American Express implemented value recapture in response to factors that are common drivers of fee increases in competitive markets, including significant increases in American Express's costs and increases in the fees of American Express's dominant rivals during a decade-long period when American Express's fees remained flat or declining for many of its merchants. (FOF ¶ 239.) Moreover, prior to and throughout the value recapture period, American Express's two-sided price and average one-sided net merchant discount rate steadily decreased, and the evidence shows that competition for share of transaction volume continued to grow more intense over that time period. (Id.) These facts are flatly inconsistent with the claim that the Non-Discrimination Provisions have had actual adverse effects on competition. See KMB Warehouse, 61 F.3d at 128 (plaintiff could not prove adverse effects in light of evidence that, with the restraint in place, plaintiff continued to compete successfully with other distributors of the defendant manufacturer's products).

Sixth, Professor Katz's analysis of the but-for world is incomplete and highly flawed, and therefore cannot support the Government's claim that competition would be improved and prices would be lower with the Non-Discrimination Provisions removed. For example, Professor Katz does not properly take into account the many obstacles that merchants would face if they were to try to steer to the lowest cost credit or charge card, including that Visa could defeat any attempt at steering to the lowest-cost card simply by lowering its interchange rates and then making up the difference by increasing its flat network fees, a pricing structure it already employs. (FOF ¶ 235.) In such a case, the merchant would see a low variable rate on each transaction, and thus would have no incentive to steer away from Visa, yet, with the fixed fees, the merchant would be paying Visa an overall higher card acceptance fee than it pays for rival networks' cards. Professor Katz offers no explanation as to how merchants would overcome these issues or how he incorporated them into his but-for analysis.[7] Professor Katz also improperly assumes that American Express would not be allowed to cancel merchants who steered against it and instead would have to continue doing business with them in the but-for world in which the Non-Discrimination Provisions were no longer in force. (FOF ¶ 241.) This

[7] It is notable that although the Government called Professor Katz back to the stand as its sole rebuttal witness, he offered no rebuttal to Professor Bernheim's identification of this fundamental flaw in the Government's competitive-effects theory.

is erroneous and biases his analysis because it is well established that a firm has the "right to deal, or refuse to deal, with whomever it likes, as long as it does so independently". See Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 (1984); United States v. Colgate & Co., 250 U.S. 300, 306-07 (1919). Thus, to analyze the actual impact of the Non-Discrimination Provisions on competition, Professor Katz should have taken into account the fact that American Express would be able to mitigate the effects of steering to at least some extent by ceasing to do business with merchants who discriminated against it.[8]

2. The Government's Other Adverse Effects Theories Fail.

None of the other "adverse effects" theories articulated by the Government is supported by the record.

First, the Government's claim that the Non-Discrimination Provisions prevent "truthful price disclosures" to consumers was thoroughly debunked at trial. Nearly every merchant witness who testified at trial confirmed that Visa's and MasterCard's fees are highly complex and that, given this dynamic, it would be virtually impossible to post accurate information regarding their cost of payment card acceptance. (FOF ¶ 245.) Indeed, many of the merchant witnesses testified that they did not understand the fees they are paying to Visa and MasterCard. (FOF ¶ 245.4.) Many of those witnesses also testified that they would not want to post this information because they deem the fees they pay for card acceptance to be competitively sensitive information. (FOF ¶ 246.)

Second, the Government's claim that the Non-Discrimination Provisions have reduced output is wholly baseless. This claim rests entirely on the Government's assertion that

[8] This is not to say that American Express's exercise of its unilateral rights under Monsanto and Colgate would be a feasible alternative to the Non-Discrimination Provisions, as it is far more efficient for American Express to utilize contractual provisions to protect welcome acceptance at the point of sale than attempt to do so through a non-contractual cancellation policy.

fewer merchants accept American Express than would if the Non-Discrimination Provisions were removed. (FOF ¶ 194.) Even if that entirely speculative claim were a valid assertion,[9] however, it would not amount to a reduction of output because the relevant measure of output in this industry is transaction volume, not merchant acceptance locations (FOF ¶ 195; COL ¶ 38[10]) and any suggestion that an increase in American Express's merchant acceptance necessarily would result in more overall transaction volume is contradicted by the experience of Discover, which has three million more merchant locations accepting its card than American Express has but significantly less transaction volume running over its network (FOF ¶ 195.1).

Third, the Government's theory that the Non-Discrimination Provisions have impeded innovation crashed before it even got off the ground. The only support the Government offered for this theory was its claim that American Express used the Non-Discrimination Provisions to prevent OfficeMax from advertising Visa's and MasterCard's anti-fraud tools on the checkout page of its website. (Pls.' Br. at 12.) At trial, however, the Government's witness from OfficeMax conceded that American Express had no complaint—none—about OfficeMax's letting its customers know about the Visa and MasterCard anti-fraud tools, that American Express simply wanted its own logo also to appear on the OfficeMax checkout page and that OfficeMax continued to advertise the Visa and MasterCard products after the alleged incident referenced by the Government. (FOF ¶ 250.)

[9] The Government called no merchants who do not accept American Express to support this theory.

[10] Citations of the form "COL" are to the Proposed Conclusions of Law within Defendants' Proposed Findings of Fact and Conclusions of Law, filed herewith.

3. When Properly Analyzed from a Market-Wide Two-Sided Perspective, It Is Even Clearer That the Government's Competitive Effects Case Fails.

Even if the Government had shown that merchant fees would be lower across the board if the Non-Discrimination Provisions were eliminated (which it did not), that would not be enough to carry its burden on adverse effects. In the Second Circuit, the rule-of-reason analysis requires much more than a showing of a restraining effect on one expression of competition—instead, the effect must be "market-wide". KMB Warehouse, 61 F.3d at 128. In this two-sided market, that means that, for the Government to prevail, the evidence would have to show that the Non-Discrimination Provisions reduce overall competition for transaction volume taking into account both the consumer and merchant sides of the market. The evidence, however, is to the contrary—as set forth in detail in the accompanying Proposed Findings of Fact and Conclusions of Law and discussed below, the record evidence demonstrates that competition in this two-sided industry is more intense with the Non-Discrimination Provisions in place than it would be without them.

A world without the Non-Discrimination Provisions is a world in which American Express's differentiated business model does not exist and Visa and MasterCard have even more market dominance than they have today. (FOF ¶ 260.) As the head of American Express's U.S. issuing business, Josh Silverman, testified: in this marketplace, "you're either the biggest or you're the best". (FOF ¶ 39.3.) American Express simply cannot compete with Visa and MasterCard on the basis of ubiquity, so it must differentiate its products and services so as to give consumers a reason to want to carry and prefer to use an American Express Card despite the fact that, in the vast majority of cases, the consumer already has a Visa or MasterCard card in his or her wallet. (FOF ¶ 39.) Thus, American Express's differentiated model is critical to American Express's ability to compete effectively with Visa and MasterCard. (FOF ¶¶ 39, 259-60.) As a result, that model also is critical to competition in the industry—through differentiation, American Express forces Visa and MasterCard to respond to American Express's price/quality value proposition on both sides of the market by trying to enhance the value of their own merchant and consumer services, which in turn puts greater competitive pressure on American Express. (FOF ¶¶ 60.) The result is a vibrant, innovative market that has grown increasingly more competitive every year. (FOF ¶¶ 61-66.)

The importance of American Express's differentiated model to the competitiveness of the industry is virtually undisputed. Indeed, it was one of the Government's central themes in United States v. Visa, where the Government argued—and proffered Mr. Chenault to testify—that the Exclusionary Rules harmed competition in part because they stunted the growth of American Express's differentiated model. (FOF ¶¶ 58, 259.2.) It also is a key insight of the economic analysis on tipping effects discussed at trial by each of the economic experts. (FOF ¶¶ 259.3-259.4.) As Professor Katz's own writings explain, markets like this that are subject to network effects are especially prone to tipping effects, and a key safeguard against tipping is product differentiation, which tends to limit tipping and sustain multiple network competitors. (FOF ¶ 267.3.6.1.)

The evidence also demonstrates that the key to American Express's ability to pursue its differentiated business model—and therefore the key to maintaining the competitive pressure on Visa and MasterCard—is American Express's promise to the consumer that if she does choose American Express, she will have a welcome acceptance experience at the point of sale. (FOF ¶¶ 16-20, 265.) American Express has had Non-Discrimination Provisions since soon after it first introduced its Card in 1958, and, today, it invests billions of dollars a year in products and services designed specifically to deliver on the core promise of welcome acceptance because of its centrality to American Express's differentiated model. (FOF ¶ 21.) As Mr. Chenault explained to American Express's merchant services group in 1996—and as American Express witnesses explained at trial—without welcome acceptance, American Express's investments in the quality differentiation that has fueled competition on both sides of the market would have at most marginal value. (FOF ¶ 16.)

This is why the Non-Discrimination Provisions are critical to the competitive vitality of this market. As the experience of "We Prefer" demonstrated, the field of competition for point-of-sale steering is inherently tilted to Visa and MasterCard because of their ubiquity and scale. (FOF ¶ 268.1.) Merchants understand that most of their customers already carry the dominant networks' cards, while steering away from Visa and MasterCard to American Express would risk alienating the large portion of card users who do not carry American Express. (Id.) Thus, without the Non-Discrimination Provisions, American Express could not provide welcome acceptance, and without welcome acceptance, it cannot maintain the volume necessary to invest in providing a differentiated product. (FOF ¶¶ 265-66.) The result, were that to happen, would be increased market concentration in the hands of Visa and MasterCard, which would unquestionably lead to less competition, and higher prices. See Port Dock & Stone Corp. v. Oldcastle Ne., Inc., 507 F.3d 117, 123 (2d Cir. 2007) (cited in Pls.' Br. at 51).

II. THE NON-DISCRIMINATION PROVISIONS HAVE SIGNIFICANT PROCOMPETITIVE JUSTIFICATIONS.

Under the rule of reason, if the plaintiff satisfies its initial burden of proving actual adverse effects on competition as a whole, "the burden shifts to the defendants to offer evidence of the procompetitive effects of their agreements". See, e.g., Geneva Pharms. Tech. Corp. v. Barr Labs. Inc., 386 F.3d 485, 506-07 (2d Cir. 2004). Here, because the Government cannot satisfy its initial burden of proving an actual adverse effect caused by the

Non-Discrimination Provisions, the burden does not shift, and the Government's case fails. But even if the burden were to shift, American Express would satisfy its burden given the substantial evidence of the overall procompetitive nature of the Non-Discrimination Provisions.

A. **The Non-Discrimination Provisions Enhance Competition by Enabling American Express to Drive Competition in the Market.**

As discussed above, the evidence at trial showed that the Non-Discrimination Provisions are a critical part of American Express's ability to invest in providing a differentiated product, and that American Express's ability to differentiate itself in a market otherwise dominated by Visa and MasterCard is critical to its ability to compete effectively. Enabling differentiation is a plainly valid procompetitive justification, as it is widely recognized that vertical restraints can increase interbrand competition by facilitating product differentiation and competition on quality. See, e.g., Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 890 (2007) (recognizing that by "eliminat[ing] intrabrand price competition" vertical restraints can facilitate "invest[ments] in tangible or intangible services"); New York v. Anheuser-Busch, Inc., 811 F. Supp. 848, 874 (E.D.N.Y. 1993) (granting defendants' motion to dismiss and finding that purpose of vertical restraint was to "increase its interbrand competitiveness by causing its wholesalers to distribute more effectively and efficiently while also protecting the quality of its product"). This differentiation has even more procompetitive force here, where it allows American Express to drive competition itself in the market.

The Government argues that American Express's procompetitive justification amounts to a claim that the Non-Discrimination Provisions are necessary to protect American Express as a competitor and shield American Express's business model from competitive forces. These are gross mischaracterizations of the procompetitive justifications at issue here. American Express has never made such contentions about the procompetitive effects of the

Non-Discrimination Provisions; to the contrary, American Express's primary justification for the Non-Discrimination Provisions, which is strongly supported by the record, is that they allow it to provide a differentiated product in the market that functions at the point of sale and thereby effectively to compete with the dominant networks. (FOF ¶¶ 259-68.) In doing so, the Non-Discrimination Provisions facilitate competition and expose American Express, and all other networks and issuers, to more intense competitive forces than would exist if the Non-Discrimination Provisions were eliminated. (FOF ¶¶ 61-66.)

For this reason, the cases cited by the Government in its Pretrial Brief on "protecting a competitor from competition" are inapposite. (See Pls.' Br. at 40-44.) In those cases, the defendant's justification for the restraint at issue was that its product could not withstand the increased competition that would result from the removal of the restraint; here, by contrast, the justification for the Non-Discrimination Provisions is not that American Express's differentiated business model could not withstand increased competition but that, as the Government itself conceded at the time of United States v. Visa and as the evidence supports, competition would be considerably lessened if American Express's differentiated business model were destroyed. (FOF ¶¶ 259-68.)

B. **The Non-Discrimination Provisions Enhance Competition By Preventing Free-Riding on American Express's Investments.**

The Non-Discrimination Provisions also allow American Express to protect its substantial investments from merchants who could reap the rewards of those investments and then steer consumers to a different payment product. At trial, American Express demonstrated at least three key ways in which the Non-Discrimination Provisions prevent free-riding, all of which are exactly the kind of free-riding concerns the law recognizes as valid procompetitive justifications. See, e.g., Leegin, 551 U.S. at 890-91; Konik v. Champlain Valley Physicians

Hosp., 733 F.2d 1007, 1014 (2d Cir. 1984) ("[A]ntitrust analysis takes into account that some arrangements may be necessary in order to remedy 'market imperfections such as the so-called 'free-rider' effect.'") (quoting Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 55 (1977)).

First, the evidence showed that, absent the Non-Discrimination Provisions, merchants could free-ride on American Express's analytics-based services such as targeted marketing, which enhance competition among payment card networks and among merchants and which have positive effects well beyond particular campaigns. (FOF ¶ 272.) Even with the Non-Discrimination Provisions in place, some merchants have utilized these services to draw Cardmembers into their stores, only to steer them to other payment forms. (FOF ¶ 274.) Without the Non-Discrimination Provisions, this problem would become significantly worse. (FOF ¶ 272.)

Second, the evidence showed that, absent the Non-Discrimination Provisions, merchants could free-ride on American Express's investments in its Cardmember services, such as rewards. (FOF ¶ 272.3-272.4.) Although American Express does not incur liabilities for rewards and certain other Cardmember benefits unless the Cardmember uses his or her card, American Express must incur significant fixed expenses to run these programs, and it incurs those expenses regardless of whether a particular Cardmember uses his or her card or is steered to another payment form at the point of sale. (Id.)

Third, the evidence showed that, absent the Non-Discrimination Provisions, merchants could free-ride on all the various investments American Express makes on both sides of the market to enhance its brand value. (FOF ¶ 273.) American Express-accepting merchants benefit from this brand value because of the "brand association" that they receive through their acceptance of American Express payment cards. (Id.)

Preventing merchants from free-riding on these important investments, and thereby ensuring that American Express can continue to make them, is plainly a valid procompetitive justification that outweighs any of the Government's alleged (but unproven) adverse effects.

C. <u>**The Government Failed to Establish Less Restrictive Alternatives to the Non-Discrimination Provisions.**</u>

Under the rule of reason, once the defendant proves that the restraint at issue has procompetitive effects that outweigh any adverse effects on competition, the burden shifts back to plaintiff, who must prove that any legitimate competitive effects could have been achieved through less restrictive alternatives. (SJ Order at 13.) The Government presented virtually no evidence relating to less restrictive alternatives at trial, and any alternatives to which it might point are plainly insufficient to carry its burden.

<u>First</u>, any suggestion that American Express could continue to drive competition with its differentiated product by competing against Visa and MasterCard in the hypothetical market for steering envisioned by the consent decree is simply implausible. The evidence at trial demonstrates that Visa and MasterCard's ubiquity would pose an insurmountable obstacle preventing American Express from persuading merchants to steer to it, as the merchants risk alienating the millions of Visa and MasterCard cardholders who do not carry an American Express card. (FOF ¶ 268.1.) Put simply, a consumer cannot be steered to a card he or she does not have; thus, steering could, and would, go only one way—to Visa and MasterCard, and away from American Express (and Discover). (<u>Id.</u>)

<u>Second</u>, the evidence demonstrates that the Non-Discrimination Provisions are already narrowly tailored to prevent the type of steering most damaging to American Express. (FOF ¶¶ 277-78, 280.) The record contains ample evidence of American Express negotiating

exceptions when merchants demand further flexibility to promote competing payment forms that will not unduly damage American Express's ability to protect the Cardmember experience and compete with Visa and MasterCard. (FOF ¶ 279.) The record does not reflect similar flexibility of concessions made voluntarily by Visa, MasterCard or Discover.

Third, the Government's conclusory suggestion in its Pretrial Brief that American Express "could simply charge merchants separately for all of its marketing services, as it already does for many of them" (Pls.' Br. at 46-47) is insufficient to meet its burden. The law does not require a firm to adopt a different pricing structure to avoid free-riding if it would be sub-optimal to do so and would reduce the value of its services (see Three Movies of Tarzana v. Pac. Theatres, Inc., 828 F.2d 1395, 1399-1400 (9th Cir. 1987) (upholding vertical restraints where defendants had made a "sound business judgment" that the agreements were the best way to generate the most profits without free-riding)), and the evidence shows that charging merchants separately for targeted marketing and similar services would be sub-optimal (FOF ¶ 276).

Fourth, any claim that American Express could simply lower its discount fees and maintain the same level of investment in product differentiation by accepting less profits is plainly invalid. The Government's suggestion that American Express (or any public corporation) could operate and compete effectively without generating an acceptable return for its shareholders given the firm's capital at risk simply ignores the most basic elements of competition in a free market. (FOF ¶ 268.2.) And the Government has offered no evidence that American Express's returns are supracompetitive, i.e., are in excess of American Express's risk-adjusted cost of capital. In fact, the evidence is to the contrary—American Express has about $60 billion in capital at risk, and the evidence shows that it simply could not operate a viable business (because it would not attract shareholder investment), and thus continue to challenge Visa and MasterCard's dominance, with a lower rate of return. (Id.)

III. THE GOVERNMENT FAILED TO PROVE ITS ANTITRUST MARKETS.

In its Pretrial Brief, the Government described its burden of proving a relevant antitrust market as "[a]n alternative to proving directly" that the Non-Discrimination Provisions have actual adverse effects on competition. (Pls.' Br. at 12.) This is an incorrect statement of the law in the Second Circuit. As the Court indicated in the Summary Judgment Order, under both the "direct adverse effects" approach and the "indirect market power" approach to proving adverse effects, the first step in the analysis is to determine the relevant market in which the purported adverse effects on competition allegedly occur. (SJ Order at 10 ("To determine whether an antitrust violation has occurred the court must first define the scope of the relevant market.").) Second Circuit cases are in accord. See, e.g., City of New York v. Grp. Health Inc., 649 F.3d 151, 155 (2d Cir. 2011) (noting that "the applicable case law requires plaintiffs asserting a claim under the Sherman Act . . . to allege a market in which the challenged merger will impair competition"); Carell v. Shubert Org., Inc., 104 F. Supp. 2d 236, 264 (S.D.N.Y. 2000) ("As a prerequisite to any antitrust claim, plaintiff must allege a relevant product market in which the anti-competitive effects of the challenged activity can be assessed.") (citations omitted).[11]

A. The Evidence Establishes That Debit Cards Compete in the Same Relevant Market With American Express's Credit and Charge Cards.

Two products are in the same market if they are considered "reasonably interchangeable by consumers for the same purposes". Xerox Corp. v. Media Scis., Inc., 660 F.

[11] As explained in more detail in the accompanying Proposed Findings of Fact and Conclusions of Law, the Government's attempt to limit the relevant market to "network services to merchants"—an artificially constructed, tiny sliver of what goes on in handling transactions and a product that American Express does not separately offer—also fails. (FOF ¶ 70, 74.)

Supp. 2d 535, 543 (S.D.N.Y. 2009) (quoting United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 395 (1956)). In this case, the focus of the analysis is on reasonable interchangeability from the perspective of the consumer, because merchant demand is derived from consumer demand. (Joint Statement of Undisputed Facts, Dkt. No. 447-1, ¶ 4.) Accordingly, the analysis of whether debit competes in the same relevant antitrust market as American Express payment cards requires a "deeply fact-intensive inquiry" into whether consumers consider credit and charge cards reasonably interchangeable with debit cards. Todd, 275 F.3d at 199.

At trial, the Government attempted to ease its burden in proving a market without debit by suggesting a "perfect interchangeability" standard: debit is outside of the market if it is possible to identify examples of consumers who, in certain situations, would not perceive debit and credit as interchangeable. But the law requires reasonable, not perfect, interchangeability. "[P]roducts or services need not be identical in order to be part of the same market" and products can be in the same market "even when their prices or qualities differ". AD/SAT v. Assoc. Press, 181 F.3d 216, 227-28 (2d Cir. 1999) (internal citations and quotation marks omitted). In addition to being legally unsound, the Government's approach would lead to absurd results that even the Government and Professor Katz have not embraced. For example, the Government's suggestion that products must be near-perfect substitutes would allow one to define markets consisting of just a single network (e.g., a Visa-only, a MasterCard-only, a Discover-only and an American-Express-only market) since, for some consumers in some circumstances and for some purchases, the cards issued on one network are not interchangeable with the cards issued on another network. Nor could the Government's standard of perfect interchangeability allow for credit and charge cards to coexist in the market, despite the fact that even the Government includes them both in its alleged market. Professor Katz himself rejected the Government's perfect interchangeability standard when he conceded during its rebuttal case that "[y]ou've got to take a bigger perspective in terms of what's happening with customers overall and then you've got to see what it means in terms of the merchant's calculus". (FOF ¶ 82.5.)

The Government's focus on specific situations in which the interchangeability of debit cards and credit and charge cards is not readily apparent ignores the empirical facts in the record about debit use in the aggregate set of all merchants in the United States—which is the only relevant set of merchants for purposes of market definition in this case (despite the Government's failed attempt to define a T&E-only market, discussed infra in Part III.B). Those facts reflect that the overwhelming majority of American Express's purchase volume takes place at merchants where consumers are frequently using debit alongside credit and charge cards. (FOF ¶ 84.1.3.) And the Government's picture of a T&E market in which consumers essentially do not use debit is just not true, as demonstrated by the record. (FOF ¶ 84.1.3.3.)

The Government has also suggested that the Second Circuit's 2003 decision in United States v. Visa controls the market definition analysis in this case. (See Pls'. Br. at 13-14.) The Court correctly rejected this theory in its order on the Government's motion to exclude American Express's experts from presenting evidence and analysis on debit and credit and charge card interchangeability. As the Court held in that order, "Given the reasoning and authority relied upon by Amex's experts, it is at least conceivable that market conditions and customer behavior may have changed since the United States v. Visa decisions such that the relevant antitrust market could now be different". (Mem. & Order Regarding Mot. in Limine, Dkt. No. 510, at 26-27.)

As described in more detail in the accompanying Proposed Findings of Fact and Conclusions of Law, the evidence in the record firmly establishes that market conditions and customer behavior with regard to the acceptance and use of debit have, in fact, changed dramatically since United States v. Visa, to the point where it would defy reality to exclude debit from the relevant antitrust market in this case. That evidence includes:

- Market data and merchant testimony showing that debit usage has exploded in the past several years across all merchant segments, including at T&E merchants. (FOF ¶¶ 84.1-84.2.)
- Documents from all four major payment networks demonstrating that they view debit as a competitor to credit and charge cards. (FOF ¶¶ 91-98.)
- Documents and testimony demonstrating that merchants track a blended debit and credit rate in the ordinary course, use debit rates in negotiations with American Express over card acceptance terms, and have compared American Express and debit rates for internal purposes (including analyses showing diversion of customers from American Express to debit if the merchant were to cease accepting American Express Cards). (FOF ¶¶ 87-90.)
- Merchant loyalty card data, which demonstrate that consumers frequently switch between debit cards and credit and charge cards at the same merchant for similarly sized transactions, and that when American Express Cardmembers switch from American Express to another payment card, they switch to debit at least as frequently as they switch to competing credit cards. (FOF ¶ 85.3.)
- Newly available empirical data, including the Survey of Consumer Payment Choice conducted by the Federal Reserve Bank of Boston, which shows that consumers perceive debit cards and credit and charge cards to be similar to each other on key metrics (security, acceptance and convenience) and that consumers would respond to a perceived increase in the cost of credit and charge cards by increasing debit usage and decreasing credit and charge card usage. (FOF ¶ 85.1.)
- Recently published academic literature finding significant consumer substitution between debit cards and credit and charge cards, including an article concluding that antitrust regulators should take the nature and degree of that substitutability into account. (FOF ¶ 85.5.)

- Testimony and documents demonstrating that American Express's co-brand partners, notably including large T&E merchants, have strenuously (and successfully) sought to negotiate carve-outs in their agreements with American Express that allow them to partner with banks to issue co-brand debit cards and American Express has tried to restrict their partners from offering a debit co-brand card out of fear such a card will shift American Express co-brand use to debit. (FOF ¶¶ 98-102.)

In the face of this extensive empirical evidence, the Government relies on speculation and anecdote in maintaining that debit should be excluded from the market. None of this is sufficient to rebut the substantial evidence of interchangeability in the record.

First, the Government's Hypothetical Monopolist (or "SSNIP") test conducted by Professor Katz plainly does not prove that debit should be excluded from the relevant market. As Professor Katz acknowledged at trial, the Hypothetical Monopolist test is neither necessary to analyze reasonable interchangeability nor is it the most appropriate way to do in many cases; in fact, he acknowledged that the test has conceptual difficulties. (FOF ¶ 108.) Indeed, when he served as an expert opposing the Government in First Data, he did not use a Hypothetical Monopolist test and criticized the Government's expert for having done so. (FOF ¶¶ 81, 108.) The Second Circuit does not require use of the test and courts define markets without reference to it. See, e.g., Geneva Pharms., 386 F.3d at 495-500 (defining market without mentioning the Hypothetical Monopolist test and noting that "[t]he emphasis always is on the actual dynamics of the market rather than rote application of any formula"); PepsiCo, Inc. v. Coca-Cola Co, 315 F.3d 101, 105-09 (2d Cir. 2002) (same). As Professor Bernheim demonstrated, its use is particularly inappropriate where, as here, there is no quantitative data in the record with which one can quantify consumer and merchant responses to a small but significant increase in the price of credit and charge cards. (FOF ¶ 106.) Without such quantitative data on consumer response to price, the Hypothetical Monopolist test is nothing more than a qualitative assessment of the evidence that is expressed in a way to give the impression of mathematical precision. (FOF ¶ 106; COL at ¶ 10.) This is precisely what Professor Katz did: he assessed the qualitative evidence—without properly including within that assessment the overwhelming empirical evidence of interchangeability, discussed above—and expressed his qualitative conclusions in the framework of the test.

Moreover, Professor Katz's rendition of the Hypothetical Monopolist test begins by asking the wrong question. He suggests debit cards can be excluded from the market by asking whether merchants could drop all general purpose credit and charge cards in response to a small but significant nontransitory increase in price imposed by a hypothetical monopolist of general purpose credit and charge card network services. (FOF ¶ 107.1.) This is not the proper starting point for the analysis and leads to erroneous conclusions. (FOF ¶ 107.2.) The entire purpose of a market definition analysis is to allow for a "context-specific inquiry into" the alleged antitrust market power of American Express and the alleged effects of American Express's conduct. (SJ Order at 9.) In particular, Professor Katz's approach leads him to ignore the possibility that American Express's products are closer substitutes for debit cards than other credit and charge cards. But American Express views its "spend-centric" model, which does not emphasize revolving credit and is largely comprised of charge card products with limited or no ability to revolve,[12] as uniquely competitive with debit cards (FOF ¶ 95), and Professor Bernheim agreed that American Express confirmed that this model makes American Express more interchangeable with debit than other credit cards (FOF ¶ 96). Moreover, in the real world, merchants do not need to drop all credit and charge card acceptance; if they feel their costs are

[12]Approximately 60% of American Express's overall charge volume in the United States comes from charge cards. (FOF ¶ 95.1.)

too high, or are unprepared to accept the Non-Discrimination Provisions, they can and do drop American Express and rely on other credit and charge cards and debit. Therefore, the analysis must begin by asking what products are reasonably substitutable with American Express's credit and charge card services, not the services provided by a hypothetical monopolist. In short, Professor Katz's Hypothetical Monopolist Test adds nothing to the analysis, and the conclusion it reaches is flatly contrary to the evidence in the record.

Second, the fact that some of the Government's statistically insignificant set of merchant witnesses claimed that debit cards are not interchangeable with credit and charge cards is irrelevant in light of the empirical evidence in the record. (FOF ¶¶ 109-14.) An assessment of market definition must look beyond the views of a limited group of market participants and certainly beyond a limited group selected by advocates to advocate their position. The overwhelming empirical evidence of debit's interchangeability, including significant shares of debit even at testifying merchants (FOF ¶ 84.2), clearly trumps the merchant testimony offered by the Government as proof of the relevant market in this case.

Third, the Government's reliance on the Durbin Amendment is misplaced. As Professor Bernheim explained, the effects of Durbin on merchants do not support the Government's claims. (FOF ¶¶ 103-05.) For example, prices for many merchants went up as a result of Durbin, and across all merchants the all-in cost of accepting debit was unchanged by Durbin. (FOF ¶ 103.) These and other confounding factors make it impossible to draw reliable conclusions on market definition from the evidence relating to the Durbin Amendment.

B. **The Government Failed to Prove a Price Discrimination Market for T&E Merchants.**

The record at trial demonstrates that there is no separate market for credit and charge card services to T&E merchants. As an initial matter, the Government has failed even to identify which specific merchants are in and which specific merchants are out of this market, or to provide evidence sufficient to explain how to make that determination. (FOF ¶ 116.) The proponent of a relevant market must provide that information, and its failure to do so should be fatal to its claim. See Cupp v. Alberto-Culver USA, Inc., 310 F. Supp. 2d 963, 971-72 (W.D. Tenn. 2004) (rejecting market definition that was "so vague that it leaves the Court at a loss as to what sorts of products to include"). Even ignoring this critical flaw, the Government's T&E submarket fails because the evidence at trial clearly showed that no card network could survive serving only T&E merchants. (FOF ¶ 117.) Antitrust market definition must "recognize competition where, in fact, competition exists", Brown Shoe Co. v. United States, 370 U.S. 294, 326 (1962), and the fact is that T&E-only networks no longer compete in any market, as illustrated by the obsolescence of the Carte Blanche and Diners Club networks.

In any event, the Government's T&E price discrimination market also fails because it has not proven price discrimination that is adverse to competition. Price discrimination is only meaningful for market definition purposes if there is evidence that the different prices charged to different consumers are unrelated to differences in the costs incurred in serving those customers. United States v. Eastman Kodak Co., 63 F.3d 95, 106-07 (2d Cir. 1995) ("[E]vidence that Kodak film sells for different prices in different parts of the world is insufficient to establish price discrimination without proof that Kodak's *costs* are uniform throughout the world.") (emphasis in original). Professor Katz agreed with this point at trial. (FOF ¶ 193.1.)

The Government failed to present evidence at trial sufficient to demonstrate that the prices American Express charges to T&E merchants are not justified by cost differences. The internal American Express analyses on which Professor Katz bases his conclusions do not suffice to support an inference of price discrimination inconsistent with a high degree of competition, as they do not reflect all the costs associated with serving particular merchants in this industry. (FOF ¶ 193.4.) As Professor Bernheim explained, costs associated with serving each individual merchant are effectively joint costs of serving every other merchant, because of the importance of general acceptance and preventing the spillover effects of limited acceptance. (Id.) But Professor Katz's analysis confronts none of that economic reality, and instead purports to analyze American Express's margins by simply adopting the arbitrary accounting allocations of the internal documents on which he relies, which do not reflect these spillover-related costs and are not even GAAP-compliant accounting records. (FOF ¶ 193.3.)

IV. THE EVIDENCE ESTABLISHES THAT AMERICAN EXPRESS LACKS ANTITRUST MARKET POWER.

As an alternative to establishing actual adverse effects on competition, the Government may also satisfy its initial burden under the rule of reason by proving that American Express has market power in the relevant antitrust market and that other grounds exist to believe that the Non-Discrimination Provisions harm competition market-wide. See KMB Warehouse, 61 F.3d at 129. Antitrust market power is the power "(1) to price substantially above the competitive level *and* (2) to persist in doing so for a significant period without erosion by new entry or expansion". (SJ Order at 16 (emphasis in original; citations omitted).) Stated differently, antitrust market power is the power "to control prices or exclude competition". E.I. du Pont de Nemours & Co., 351 U.S. at 391. See also Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application ("Areeda & Hovenkamp") ¶ 501 (stating these formulations are equivalent). As discussed below and in the accompanying Proposed Findings of Fact and Conclusions of Law, the Government failed to prove that American Express has antitrust market power.

A. **American Express's Market Share is Inconsistent With Antitrust Market Power.**

The evidence at trial demonstrated that American Express's market share is simply far too low to support an inference that it has antitrust market power. Firms with market share under 30 percent are presumptively without antitrust market power in the Second Circuit. See Commercial Data Servers, Inc. v. Int'l Bus. Machs. Corp., 262 F. Supp. 2d 50, 74-75 (S.D.N.Y. 2003) (collecting cases). When debit is properly included in the relevant antitrust market, American Express's share of transaction volume is approximately 14 percent, and in decline. (FOF ¶ 121.) No case in the Second Circuit has ever found a firm with a similarly low share of the market to possess market power.[13] See Commercial Data, 262 F. Supp. 2d at 74 (finding evidence showing that defendant had a market share between 8 percent and 23 percent "dispositive" on the question of whether the defendant had market power). Even if debit is excluded from the market, American Express's share remains under the threshold at 26 percent. (Id.) The Government maintains that this low share is sufficient to support an inference of market power, relying entirely on the fact that MasterCard's share of transaction volume was approximately the same number at the time of United States v. Visa—the only Second Circuit case ever to find the 30 percent presumption rebutted. But as described in American Express's

[13] At trial, Professor Katz identified United States v. Von's Grocery Co., 384 U.S. 270 (1966), as an example of a case in which a firm was found to have antitrust market power with a share lower than 15 percent. Professor Katz is wrong—the Court in Von's Grocery, which involved a merger under Section 7 of the Clayton Act, did not even analyze, much less determine, that the merging parties had antitrust market power, because, at the time, Section 7 was interpreted as requiring that any "trend toward concentration" in an industry to be arrested "in its incipiency". 384 U.S. at 277-78; see also Hosp. Corp. of Am. v. FTC, 807 F.2d 1381, 1386 (7th Cir. 1986) (Posner, J.) (noting that the decisions of the 1960s, including Von's Grocery, "seemed, taken as a group, to establish the illegality of any nontrivial acquisition of a competitor".). That is because, as courts have more recently noted, at the time the case was decided there was a "gap" between the standards under Section 1 of the Sherman Act and Section 7 of the Clayton Act, the latter being far more favorable to the Government and far more abbreviated than the former. See United States v. Rockford Memorial Corp., 898 F.2d 1278, 1282 (7th Cir. 1990) (Posner, J.) (also noting that "[i]n recent years, a more moderate interpretation of section 7 has prevailed"); see also Cal. Dental, 526 U.S. at 794 (Breyer, J., concurring in part and dissenting in part, joined by Stevens, Kennedy, Ginsburg, JJ.) (describing Von's Grocery as relying upon "antitrust theories so abbreviated as to prevent proper analysis").

Proposed Findings of Fact and Conclusions of Law, the record in this case demonstrates that American Express in 2014 is nothing like MasterCard in 2001—in every metric other than share of transaction volume, American Express ranks last or next-to-last among the four networks. (FOF ¶¶ 123-29.) In this regard, the Government studiously ignores the history of American Express's prolonged share decline and the Government's own statement in the Exclusionary Rules case that a share of credit and charge transaction volume at or near 25 percent was the minimum necessary to be an effective competitor in this market—which is consistent with the current American Express share. (FOF ¶ 145.1.)

B. **The Government Failed to Prove That American Express Has the Ability to Price Above Competitive Levels.**

The Government failed to prove that American Express has "the ability to raise price significantly above the competitive level without losing all of [its] business". (SJ Order at 11 (internal quotation marks and citations omitted).) Indeed, American Express's prices across the market have declined over time, as established by uncontroverted evidence at trial which includes the conclusions of both parties' experts and evidence from many of the Government's own merchant witnesses. (FOF ¶¶ 167-73.) This decline in price is incompatible with any finding that American Express possesses market power on the basis of its ability to control price. See Commercial Data, 262 F. Supp. 2d at 74 (noting that declining prices "are entirely inconsistent with the exercise of market power").

As Professor Bernheim explained at trial, American Express's two-sided price has been in a steady and substantial decline throughout the 2000s. (FOF ¶ 168.) On the Cardmember side, it has been forced to increase rewards expenses because of competitive pressure from competing issuers who have been introducing ever-richer rewards through their own card products (in no small part due to competitive pressures from American Express). (FOF

¶¶ 59, 168.3, 171.) On the merchant side, American Express has been forced to lower its prices both to expand merchant acceptance and to maintain acceptance at large merchants who have demanded and won price concessions in negotiations fueled by American Express's need for access to those merchants' loyal base of customers. (FOF ¶ 172.2.) This same trend is depicted in American Express's ordinary-course documents, which show how the company routinely compares its average discount rate to its marginal rewards expense. (FOF ¶ 168.3.) At trial Mr. Silverman, the head of American Express's U.S. issuing business, described the trend as a "squeeze" that is a "tremendous challenge" to his business, as well as a reflection of the competition in the market. (FOF ¶ 171.1.)

American Express's "one-sided price" is also in decline. Both Professor Bernheim and Professor Katz agree that American Express's average net merchant discount rate has declined for nearly a decade. (FOF ¶¶ 169-70.) Professor Katz finds a similar, prolonged decline even while improperly refusing to include American Express's payments to partners for its co-brand products, which account for approximately 40 percent of American Express's consumer purchase volume, in his calculation. (FOF ¶¶ 170, 172.1.) The Government attempts to minimize this decrease by casting it as simply a function of "mix", or American Express's earning a larger proportion of its discount revenue from "everyday spend" merchants who typically pay a lower merchant discount rate. (FOF ¶ 172.2.) As an initial matter, contrary to the Government's suggestion, changes in the net merchant discount rate due to merchant mix are in fact further evidence of the competitive forces pressuring American Express's pricing: they reflect the fact that American Express had to give price concessions to everyday-spend merchants in order to get them to accept the Card, and American Express had to expand into those merchants or face the same reduction to irrelevance experienced by Carte Blanche and

Diners Club. (FOF ¶ 172.2.3.) Moreover, Professor Bernheim performed a calculation in which he froze American Express's merchant mix at 2002 levels and still found a price decline (FOF ¶ 172.2.1), and the data show that from [redacted] (FOF ¶ 172.2.2). This uncontroverted evidence of declining price is flatly inconsistent with the notion that American Express has acquired and exercised market power since United States v. Visa. See Commercial Data, 262 F. Supp. 2d at 74.

Finally, dispositive proof of the competitive nature of American Express's prices was demonstrated at trial by the uncontroverted evidence that its average mix-adjusted discount-rate premium over Visa and MasterCard has disappeared. (FOF ¶ 187.) American Express witnesses confirmed that American Express's average mix-adjusted premium—a weighted comparison of American Express's rate to that of a similar "mix" of Visa and MasterCard card products—no longer exists. (Id.) Even Professor Katz agreed that if there is no price premium, then price is not evidence of antitrust market power. (FOF ¶ 187.2.) And even comparisons without adjusting for card mix show a profound decrease in American Express's premium. (FOF ¶ 188.) Moreover, at the merchants where a premium remains, the Government failed to prove it was not justified by American Express's differentiated quality.[14] See Xerox Corp., 660 F. Supp. 2d at 549 ("Competitive markets are characterized by both price and quality competition, and a firm's comparatively high price may simply reflect a superior product.") (citation omitted). Differentiated products, although competitive, do not necessarily command the same price in the market.

[14] Many of the Government's witnesses who testified that they did not believe American Express's premium was justified worked in finance capacities and were not aware of the value provided by American Express beyond mere acceptance. (FOF ¶ 189.5.) But the record is replete with evidence that American Express's premium, where it exists, is justified by the substantial benefits it provides merchants. (FOF ¶ 190.3.)

The Government attempts to counter the evidence of American Express's decline in prices by pointing at value recapture, a program primarily between 2004 and 2011 during which American Express increased its discount fees for a subset of merchants. However, the evidence at trial showed that value recapture was American Express's response to a competitive challenge: its fees had decreased while its costs had increased, endangering its ability to differentiate itself from the market's dominant players. (FOF ¶¶ 175-76.) The company undertook an effort to identify industries in which it had not increased prices for many years to a level that came close to reflecting the increased value—and the costs related to that value—it had already been delivering. (FOF ¶ 176.5.) As the record reflects, American Express was able to retain its larger merchants during value recapture only through hard-fought negotiations, which often included substantial financial concessions, such as additional marketing funds, deferrals of fee increases and accelerations of volume based reductions. (FOF ¶ 180.) Notably, the value recapture program slowed, but did not reverse, the long-term decline in American Express's average discount rate. (FOF ¶ 175.)

Moreover, contrary to the internal profitability projections touted in the Government's Pretrial Brief (Pls.' Br. at 33),[15] the record at trial suggests that value recapture imposed significant costs on American Express. (FOF ¶ 181.) For example, Ed Gilligan, the President of American Express, testified at trial that a value recapture fee increase negotiated with Continental Airlines resulted in that airline's leaving American Express's Membership Rewards and Platinum Lounge Access programs. (FOF ¶¶ 181.3-181.4.) The result was severe:

[15] The accounting calculations reflected in these documents are entitled to little weight in the analysis of antitrust market power, and the Government makes no attempt to determine the economic (as opposed to accounting) profit American Express derived from value recapture. See Bailey v. Allgas, Inc., 284 F.3d 1237, 1252 & n.21 (11th Cir. 2002) (cautioning that accounting data "are more a reflection of various accounting conventions than true economic profit" and do not capture proper subjects of antitrust analysis such as spillover and the rate of return necessary to compensate shareholders for the opportunity cost of their investment) (citing Areeda & Hovenkamp ¶ 516(f)(1)).

American Express estimated it could lose as much [redacted] due to the spillover effects. (FOF ¶ 181.5.) Even after significant efforts to mitigate the damage with its Cardmembers, it still lost an estimated [redacted] annually in charge volume—[redacted] identified in an internal American Express document cited in the Government's Pretrial Brief (Pls.' Br. at 33) as representing the cumulative financial benefits of the <u>entire</u> value recapture program. (FOF ¶ 181.6.) And, as Mr. Gilligan explained, these loss figures do not even include the opportunity revenue lost to its competitors or spillover effects, such as the fact that American Airlines made a subsequent decision to follow Continental in leaving the Platinum Lounge Access program, with similarly deleterious results for American Express's card business. (FOF ¶ 181.7.) Glenda McNeal, the head of the group within American Express's merchant business responsible for is largest merchant accounts, similarly testified to the lasting losses that have been a result of the value recapture initiative. (FOF ¶ 183.1.) In the end, American Express ended the value recapture effort because of its negative impact on American Express's services and its relationships with key merchants. (FOF ¶ 183.)

Thus, value recapture is in fact additional proof that American Express lacks the power to control price, as it shows American Express's fee increases were motivated in large part by increases in American Express's costs, that throughout the program, American Express's overall fees were decreasing, and, in the end, American Express had to terminate the program because of the substantial economic harm it was causing American Express's business.

C. **The Record Evidence Confirms That Insistence is Not a Source of Antitrust Market Power.**

The trial record demonstrates the implausibility of the Government's theory that Cardmember insistence gives American Express antitrust market power, which must give a firm the power both "to raise prices substantially above the competitive level" and "to persist in doing so for a significant period without erosion by new entry or expansion". (SJ Order at 16 (emphasis added)); see also AD/SAT, 181 F.3d at 229 ("[T]ransitory power may be safely ignored by antitrust law. The social costs of antitrust intervention (including its error potential) are likely to exceed the gains when market forces themselves would bring the defendant's power to an end fairly quickly.") (internal quotation marks omitted); Areeda & Hovenkamp ¶ 501 ("Market power need not trouble the antitrust authorities unless it is both substantial in magnitude and durable.").

Here, the record is replete with evidence demonstrating that insistence, the alleged source of American Express's alleged antitrust market power, is anything but durable. (FOF ¶¶ 200-02.) The evidence at trial showed that American Express spends significant resources to earn and then maintain its Cardmembers' loyalty, that its competitors also compete hard for that loyalty, and that American Express often loses in this competition as its Cardmembers are constantly switching to competing products. (FOF ¶ 59, 60, 200, 218.) Indeed, the record contains uncontroverted evidence that American Express has continually increased its investments in Cardmember rewards over time in response to competition from other networks and issuers. (FOF ¶ 167.3, 171.) As Professor Katz himself agreed, American Express must continue to make these investments because it would see a significant decline in insistence and charge volume if it ceased offering a competitive rewards product. (FOF ¶ 202.) That is true both with respect to consumer cards and corporate cards—in each case, the moment American

Express ceases to provide competitive benefits to the Cardmember (or corporate account), any insistence American Express has earned will rapidly disappear. (FOF ¶ 221.) It simply cannot be that non-durable loyalty borne of procompetitive investments can form the predicate for a violation of Section 1 of the Sherman Act.

The evidence also refutes the Government's exaggerated portrayal of American Express's insistence calculations as scientific proof of the profits a merchant stands to lose by canceling acceptance. If American Express could charge discount fees based on its insistence calculations, it would be charging rates that are orders of magnitude higher than the rates American Express actually charges, not rates that have steadily declined. (FOF ¶ 203.3.) As Ms. McNeal noted, the rates implied by these calculations are simply implausible and not taken seriously by the American Express employees responsible for negotiating the economics of acceptance relationships with merchants. (FOF ¶ 203.3.1.) Instead, they use the insistence data as a marketing tool, and they recognize, as do the merchants with whom they negotiate, that even as a marketing tool it has its limits because the merchant has its own highly insistent customers whose business American Express would lose if the merchant chose not to accept American Express's cards. (FOF ¶¶ 203-05.) In short, the notion that insistence confers significant antitrust market power on American Express simply is not supported by the record.

For similar reasons, evidence adduced at trial makes clear that the brand loyalty cases addressed during the summary judgment phase of this case apply and support the conclusion that American Express cannot derive antitrust market power from the ephemeral insistence it earns through ongoing investment and competition. See Eastman Kodak Co., 63 F.3d at 108; see also Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp., No. 90-cv-1547, 1991 WL 149249, at *6 (3d Cir. Aug. 9, 1991), aff'd en banc, 959 F.2d 468 (3d Cir. 1992);

Grappone, Inc. v. Subaru of New England, Inc., 858 F.2d 792, 797 (1st Cir. 1988). In the Summary Judgment Order, the Court determined that Kodak and the other brand loyalty cases had "limited application" because the evidence in the summary judgment record showed only that consumers were price sensitive but did not contain evidence of price sensitivity on the merchant side. (SJ Order at 19-20.) Now, however, there is "empirical evidence" showing that merchants are also "price sensitive and willing to substitute to competing products". To wit: several million U.S. merchants have decided, often incorrectly, that American Express's prices are too high relative to its competitors, and exhibited their willingness to substitute competing products by accepting Visa, MasterCard and Discover rather than American Express. (FOF ¶ 129.) And American Express's discount rate has consistently trended downward over the last decade, both because American Express had to lower its rate to add merchants to its network and because existing merchants demanded lower fees to continue acceptance. (FOF ¶ 172.2.) Thus, the reasoning of Kodak applies, and American Express's brand loyalty cannot give rise to antitrust market power.

CONCLUSION

For the foregoing reasons, and in light of the evidence presented at trial, American Express respectfully requests that this Court enter judgment for American Express.

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Respectfully submitted,

/s/ Evan R. Chesler

Evan R. Chesler
(echesler@cravath.com)
Stuart W. Gold
(sgold@cravath.com)
Peter T. Barbur
(pbarbur@cravath.com)
Kevin J. Orsini
(korsini@cravath.com)
Members of the Firm

CRAVATH, SWAINE & MOORE LLP
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019
(212) 474-1000

Donald L. Flexner
(dflexner@bsfllp.com)
Philip C. Korologos
(pkorologos@bsfllp.com)
Eric J. Brenner
(ebrenner@bsfllp.com)

BOIES, SCHILLER & FLEXNER LLP
575 Lexington Avenue
New York, NY 10022
(212) 446-2300

Counsel for Defendants American Express Company and American Express Travel Related Services Company, Inc.