

No. 16-1454

IN THE
Supreme Court of the United States

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

v.

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

**On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Second Circuit**

**BRIEF FOR *AMICI CURIAE* JOHN M.
CONNOR, MARTIN GAYNOR, DANIEL
MCFADDEN, ROGER NOLL, JEFFREY M.
PERLOFF, JOSEPH A. STIGLITZ, LAWRENCE
J. WHITE, AND RALPH A. WINTER
IN SUPPORT OF PETITIONERS**

ANTHONY J. BOLOGNESE
Counsel of Record
BOLOGNESE & ASSOCIATES, LLC
1500 JFK Boulevard, Suite 320
Philadelphia, PA 19102
(215) 814-6750
ABolognese@Bolognese-Law.com
Counsel for Amici Curiae

July 6, 2017

TABLE OF CONTENTS

	Page
INTEREST OF <i>AMICI CURIAE</i>	1
SUMMARY OF ARGUMENT.....	1
ARGUMENT	5
I. “TWO-SIDEDNESS”	5
II. PLATFORM COMPETITION IN TWO-SIDED MARKETS.....	7
III. THE AMEX RESTRAINTS HARM HORIZONTAL COMPETITION AMONG CREDIT CARD PLATFORMS	12
IV. CROSS-MARKET EXTERNALITIES	20
CONCLUSION.....	23
APPENDIX A	1a-4a

TABLE OF AUTHORITIES

Cases	Page(s)
<i>Leegin Creative Leather Prods., Inc. v. PSKS, Inc.</i> , 551 U.S. 877 (2007).....	12
<i>Times Picayune Pub. Co. v. United States</i> , 345 U.S. 594 (1953).....	3
<i>U.S. Airways, Inc. v. Sabre Holdings Corp.</i> , 2017 U.S. Dist. LEXIS 40932 (S.D.N.Y. Mar. 21, 2017) 6	
<i>United States v. Microsoft Corp.</i> , 253 F.3d 34 (D.C. Cir. 2001).....	3
Other Authorities	
A. Boik & K. Corts, <i>The Effects of Platform Most- Favored Nation Clauses on Competition and Entry</i> , J. of Law & Econ. (2016).....	8
D. Carlton & R. Winter, <i>Vertical MFN's and the Credit Card No-surcharge Rule</i>	7, 8-9
G. Stigler, <i>Price and Non-Price Competition</i> , 76 J. Pol. Econ. 149 (1968).....	20
J. Johnson, <i>The Agency Model and MFN Clauses</i> (Jan. 25, 2017).....	8
Jean-Charles Rochet & Jean Tirole, <i>An Economic Analysis of the Determination of Interchange Fees in Payment Card Systems</i> , 2 Rev. Network Econ. 69 (2003).....	16
Jean-Charles Rochet and Jean Tirole, “Two-Sided Markets: A Progress Report,” <i>Rand Journal of Economics</i> 37(3) (2006).....	5

Lear, <i>Can “Fair” Prices Be Unfair? A Review of Price Relationship Agreements</i> , UK Office of Fair Trading, Paper #1438 (2012).....	8
Marc Rysman, “The Economics of Two-Sided Markets,” <i>Journal of Economic Perspectives</i> 23(3) (2009).....	6
S. Salop & S. Morton, <i>Developing an Administrable MFN Policy</i> , Antitrust (2013).....	8
S. Schuh et al., <i>An Economic Analysis of the 2011 Settlement Between the Department of Justice and Credit Card Networks</i> , <i>J. of Competition Law & Econ.</i> (2012).....	8

Treatises

P. Areeda & H. Hovenkamp, <i>Antitrust Law</i> § 562e, p. 101 (Supp. 2017)	12
--	----

INTEREST OF *AMICI CURIAE*

The *amici* are eight economists – scholars and experts in competition, industrial organization, and the economic analysis of antitrust issues.¹ *Amici* support the States’ Petition for a Writ of Certiorari. The Second Circuit’s ruling sets new antitrust standards for analysis in two-sided markets. However, the Second Circuit’s decision is based on an incorrect interpretation of the economics of two-sided markets and, as a result, will have serious and adverse impact on antitrust cases that involve or are alleged to involve two-sided platforms.

SUMMARY OF ARGUMENT

The court below erred by (1) assuming that that the characterization of the Amex service as a two-sided platform should fundamentally change the antitrust principles that govern the Amex restraints, (2) misunderstanding the nature of competition in two-sided markets, (3) placing the burden on plaintiffs to disprove that the harm from supracompetitive merchant fees are not outweighed by benefits to third parties (cardholders in this case), and most

¹ The Appendix to this Brief identifies the Amici. Counsel for *amici* provided counsel for the parties with timely notice of intent to file this brief, and the parties have consented. No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amici* or their counsel made a monetary contribution to its preparation or submission. The amici include Joseph Stiglitz, who is currently consulting and is a witness for a number of national supermarket and drugstore chains that have challenged Amex’s, Visa’s, and MasterCard’s restraints in related lawsuits pending in the District Court. *See* Appendix 3a.

importantly (4) disregarding the critical antitrust issue – the impacts of the Amex merchant anti-steering and pricing restraints on competition among credit card platforms.

A two-sided platform refers to a seller that brings together two different sets of consumers (the two sides), *and* where increased usage on each side benefits the other side (referred to in economics as two-sided externalities). When a credit card network is new, increased merchant acceptance increases the value to cardholders of having the network's card, and increased card holding makes merchant acceptance of the card more valuable. Such networks are therefore two-sided platforms, and they compete in a two-sided market. With two-sided platforms, pricing on one side of the platform impacts demand on the other, perhaps adding complexity to the analysis of the competitive impact of supra-competitive prices on one side. However, before such complexities are considered for a mature network like Amex, a careful analysis should be conducted to ascertain the significance and importance of any remaining two-sided externalities. The appellate court did no such analysis.

The appellate court ruling purports to be based on the economics of “two-sided markets” in the payments industry, but the ruling departs sharply from prior antitrust analyses and rulings involving two-sided markets. While formal economic analysis of two-sided platforms is relatively new, antitrust analysis of industries involving two-sided platforms is hardly new. For over fifty years, courts have analyzed the competitive impact of restraints on one side of a two-sided platform by focusing on how competition

among competing suppliers is affected.² In this case, the appellate court departs from this standard analysis by requiring a plaintiff to show that a competitive harm on one side of a platform (here the merchant side) is not offset by purported benefits on the other side of that same platform (the cardholder side). This is a difficult and unwarranted burden. Amex, as the proponent of and enforcer of the merchant restraints, is clearly in the best position to understand and quantify any relevant offsetting competitive benefits. Creating a new antitrust standard that requires the victim of a restraint of trade to prove that its harm is not offset by benefits to third parties is not sound policy or economics.

Credit card platforms (Amex, Visa, MasterCard, and Discover) compete against each other – or would, if not stymied by Amex’s anti-steering merchant restraints – through price competition. The price competition is on each side of the platform. Each credit card platform offers a price pair consisting of a price charged to merchants for the use of the platform’s card acceptance services, and also a price charged to cardholders (including benefits in the form of “rewards”). One platform may choose to compete by offering a high merchant price and high rewards to cardholders. Another platform may choose to offer lower merchant fees and lower cardholder rewards, expecting that merchants will steer its

² See, e.g., *Times Picayune Pub. Co. v. United States*, 345 U.S. 594, 610 (1953) (confining competitive analysis to “advertising market, not in readership” while noting that “every newspaper is a dual trader in separate though interdependent markets.”); *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (analysis of restraints on entry of competing browsers).

customers to that platform's cards by offering discounts or other incentives at the point of sale due to the comparatively low merchant fees.

With competition in the market, each network chooses its preferred price pair. Market forces, including merchant steering and the consumer's ability to choose merchant discounts or incentives over cardholder rewards, would sort out how much of that platform's services will be demanded – that is, its success in the market. The Amex anti-steering merchant restraints directly interfere with this competition among the credit card platforms. With Amex's restraints in place, a rival credit card platform or a new entrant that attempts to compete against Amex with a price pair of lower merchant fees and lower cardholder benefits will be unsuccessful because, under the Amex restraints, merchants are unable to incentivize the cardholders in any way. Thus, a credit card platform with the different pricing model than Amex will garner no additional sales from its competitively low merchant price; it will be driven by the Amex restraints to mimic the Amex pricing.

Competition requires that (1) credit card platforms are able to freely choose their prices, (2) consumers have choices for card network rewards versus the merchant-offered discounts and incentives, and (3) competitive market forces are allowed to determine how much of the platform's services will be demanded. The Amex merchant restraints hinder such competition.

The *amici* respectfully submit that the proper analysis of restraints imposed on one side of a two-sided platform is the established rule of reason

analysis previously recognized by the Second Circuit and adopted by many other Circuits. Under this standard analysis, the first step is to determine if a restraint, whether on one or both sides of a platform, *injures competition between and among platforms*. If a plaintiff satisfies this showing, the defendant can then show procompetitive benefits that may or may not offset the anticompetitive impacts.

If the ruling of the appellate court stands, the adverse competitive impact will be substantial. Credit card platforms process trillions of dollars of transactions in the United States annually. More importantly, firms operating in two-sided markets using the internet, such as Amazon, Uber, Facebook, Google, and Airbnb, are multiplying in number and size. The appellate court decision gives firms in these rapidly developing markets latitude to act anticompetitively on one side of their platform as long as they can point to some indirect or secondary benefit on the other side of the platform populated by a different set of consumers. The appellate court ruling will make analysis of such conduct needlessly complex and, perhaps, beyond the reach of the antitrust laws.

ARGUMENT

I. “TWO-SIDEDNESS”

As noted, a two-sided platform brings together two sets of consumers, and the prices to each set (“side”) significantly affect the other side (indirect two-sided externalities).³ Two-sided industries have

³ See Jean-Charles Rochet and Jean Tirole, “Two-Sided Markets: A Progress Report,” *Rand Journal of Economics* 37(3) (2006), pp. 645-67; Marc Rysman, “The Economics of Two-Sided

included newspapers, television and radio, computer operating systems, dating services, and flight reservation services.⁴

The appellate court emphasized that Amex must attract both cardholders and merchants to its network.⁵ But this does not distinguish Amex from any other firm that offers a service and must attract both retailers and end consumers. Nearly *any* firm dealing with merchants could offer the appellate court's improper analysis that a restraint that raises the firm's wholesale price to the merchants passes antitrust muster as long as the restraint provides the firm with revenue that it spends on enhancing the quality of the products it offers to the "other side." A new antitrust doctrine should not follow from a mere

Markets," *Journal of Economic Perspectives* 23(3) (2009), pp. 125-143.

⁴ We write "have included" because as two-sided platforms mature, the externalities from each side to the other can become unimportant and insignificant, rendering the two-sidedness of no relevance. For example, a mature flight reservation system may not attract another airline if it adds more users, and vice versa. If so, there are no remaining significant two-sided externalities. *See U.S. Airways, Inc. v. Sabre Holdings Corp.*, 2017 U.S. Dist. LEXIS 40932 at *32 (S.D.N.Y. Mar. 21, 2017).

⁵ *See* Pet. App. 49a-50a (stating that the district court should have considered the effect of the Amex restraints on both merchants and cardholders because: "[t]he revenue earned from merchant fees funds cardholder benefits, and cardholder benefits in turn attract cardholders. A reduction in revenue that Amex earns from merchant fees may decrease the optimal level of cardholder benefits, which in turn may reduce the intensity of competition among payment card networks on the cardholder side of the market").

labeling of a conventional setting as a two-sided market.⁶

Amex’s credit card network is a mature business in existence since 1958. By 2012, in the United States, Amex had over 50 million cardholders, was accepted by over 4 million merchants that account for about 95% of all retail sales, and had annual transaction volume of over \$590 billion. There is no evidence that significant two-sided externalities remain – that is, that merchant acceptance would increase if Amex increased its cardholding base, or vice versa. Nonetheless, *amici* focus on markets that are characterized by two-sided externalities in which “price changes on one side can result in demand changes on the other side.” Pet. App. 8a.

II. PLATFORM COMPETITION IN TWO-SIDED MARKETS

The economic literature analyzing two-sided platforms is new, complex, and evolving. Before courts adopt a new approach to the analysis of competitive impacts in two-sided markets, the extent to which such complexities are relevant to competitive

⁶ In a recent paper co-authored by one of the *amici*, the authors conclude that “[t]he two-sidedness of credit card markets does not require a new set of economic principles for assessing competition policy because the difference between the credit card setting and a conventional one-sided market is essentially a matter of labeling.... Creating different legal rules for the same economic conduct depending on whether the market can be described as one-sided or two-sided is a mistake that could lead to widespread confusion in the evaluation of vertical restriction.” D. Carlton & R. Winter, *Vertical MFN’s and the Credit Card No-surcharge Rule*, at 40 (working paper available at <https://goo.gl/kKd2Ck>).

analysis should be fully understood.⁷ This is especially important in the case of Amex. Only recently has the economic literature considered the impact of restraints on competition that allow a firm like Amex to charge higher prices to one side (here, merchants), which results in increased prices charged to all customers, and which, through competition on the other side (cardholders), may result in lower prices to that side.⁸ The appellate court's analysis and ruling fails to account for this recent learning.⁹

⁷ For example, the appellate court cites a 2013 working paper by Filistrucchi et al. *See* Pet. App. 7a n.3 (citing Lapo Filistrucchi et al., *Market Definition in Two-Sided Markets: Theory and Practice* 5). The analysis therein emphasizes a distinction for competitive analysis between two-sided transactions markets (where, as with payment cards, the two sides directly interact with one another), and two-sided non-transactions markets (where, like newspapers, the two sides do not interact with one another). While noting this paper, the appellate court simply disregards the distinction, providing no guidance for future cases involving two-sided platforms that may differ from the credit card platforms on this account.

⁸ Because the Amex restraints adversely impact entry into the credit card market, there can be no presumption that the restraints result overall in lower cardholder prices.

⁹ The recent economic literature finds that restraints such as the Amex restraints “typically raise platform fees and retail prices, and curtail entry or skew positioning decisions by potential entrants pursuing low-end business models.” *See* A. Boik & K. Corts, *The Effects of Platform Most-Favored Nation Clauses on Competition and Entry*, J. of Law & Econ., Abstract (2016); accord S. Schuh et al., *An Economic Analysis of the 2011 Settlement Between the Department of Justice and Credit Card Networks*, J. of Competition Law & Econ. (2012); S. Salop & F. Scott Morton, *Developing an Administrable MFN Policy*, Antitrust (2013); Lear, *Can “Fair” Prices Be Unfair? A Review of Price Relationship Agreements*, UK Office of Fair Trading, Paper #1438 (2012); J. Johnson, *The Agency Model and MFN Clauses* (Jan. 25, 2017) (available at <https://goo.gl/Vbj3tV>); D. Carlton &

In addition, the major impact of the Amex restraints is direct interference in price competition among credit card platforms. The appellate court puts no importance on this paradigmatic injury to competition.

Instead, the appellate court took a novel and unprecedented approach to analyzing the competitive impact of the Amex restraints. Rather than determining whether the restraints on merchants injured competition among platforms – that is, among competing credit card firms – the court ruled that the proper antitrust analysis must “consider the two-sided net price accounting for the effects of the [restraints] on both merchants and cardholders.” Pet. App. 49a. The court held that it was the plaintiffs’ burden to show that Amex’s restraints had an adverse net effect on competition defined as the sum of the prices to merchants and cardholders. Only after the plaintiffs had made such a showing would Amex be obligated to come forward with any evidence of a procompetitive justification.

If the appellate court were correct that different and new economic analysis is required in two-sided markets – a proposition with which *amici* disagree – it should be applied only after a rigorous and careful demonstration that two-sided market characteristics exist in the market, and are important to the competitive impact of a restraint. More importantly, if a market is demonstrated to consist of two-sided platforms, and if benefits to consumers using one side of a platform (here cardholders) result from restraints that harm the other side (merchants), then a simple

R. Winter, *Vertical MFN’s and the Credit Card No-surcharge Rule* (available at <https://goo.gl/kKd2Ck>).

summing of these benefits and harms is *not* informative as to the restraint's impact on competition. In addition, further examination of whether there are important cross-platform externalities from which the restraints at issue might harm other platforms needs to be conducted.

The correct approach is to determine whether a restraint on one side of a two-sided market interferes with competition among platforms in the market. The competitive impact of restraints such as those imposed by Amex – restraints that directly alter and impede horizontal competition among platforms – is properly demonstrated only by the impact on the competition among those platforms. The appellate court disregarded this most critical economic issue – how the Amex restraints affect competition among Amex, Visa, MasterCard, Discover, and potential new entrants.¹⁰

In order to better understand competition in two-sided markets, consider the example of platforms intermediating between hotels and travelers. These platforms can be two sided because the demand for the services by travelers can depend on the number and quality of the hotels that use the service, and vice versa. If a platform lowers its price to travelers, then it can increase the number of travelers using the platform, which may make the platform more valuable to hotels. Similarly, lowering the platform fee charged to hotels can increase the number of

¹⁰ Visa and MasterCard operate as what is called four-party systems (cardholders, merchants, issuers, and acquirers, *see* Figure 2 at Pet. App. 55a-56a) in which the Visa and MasterCard platforms deal with acquiring banks that compete for merchants and issuing banks that compete for cardholders. This difference from Amex and Discover does not impact our analysis.

hotels using the platform, making the platform more valuable to travelers – the booking service providers are competing in a two-sided market.

Two-sided platforms compete, in part, via the prices offered by each platform to the two sides. For example, one hotel booking service may charge a high price to hotels and a relatively low price to travelers, while other platforms may expect more equal prices to be more profitable, resulting in a better mix of hotels and travelers. Competition is likely to result in competing platforms offering different price pairs, and those offering the price pairs that best satisfy consumer preferences will thrive.

The important economic point is that in two-sided markets, the relevant competition occurs at the *platform level* (i.e., competition among the credit card companies). A competitive two-sided market, through consumers' choices, will effectively decide the preferred and competitive price relationships (the price pair) and, as an incidental matter, the overall "price level" (the sum of the prices) in the two sides. It is this platform competition that is directly interfered with by the Amex restraints on the merchant side of the Amex platform.

Rather than asking whether the Amex rules prevented competitive market forces from determining the price pairs offered by the competing platforms, the appellate court considered only the impact on the Amex prices to both sides of the platform. The court ruled that the competitive metric is whether the *sum* of the two prices increased. This is a fundamental economic error. Whether the sum of the prices goes up or not does not relate to whether

restraints are or are not anticompetitive. Nor does it relate to how the restraints might distort and interfere with the competition among platforms in two-sided markets. When restraints hamper the process of platform competition, anticompetitive harm follows because the restraints alter the price pairs themselves, regardless of whether the sum of the prices increases, decreases, or remains unchanged.¹¹

III. THE AMEX RESTRAINTS HARM HORIZONTAL COMPETITION AMONG CREDIT CARD PLATFORMS

The Amex restraints bar merchants purchasing Amex services from differentially pricing the Amex card versus other credit cards. The restraints even bar merchants from providing their customers with accurate information about the prices charged to merchants by Amex and alternative cards. The Amex restraints are vertical restraints, imposed by a supplier on its customers. However, the Amex vertical restraints have direct horizontal effects because they interfere with horizontal competitors' pricing.

The required competitive analysis of a vertical price restraint is set forth in *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007), and summarized in the appellate court's decision.¹² *Leegin* concerned resale price maintenance (RPM). Unlike the appellate court's ruling, this well-established analysis of RPM finds the first stage of the rule of

¹¹ See P. Areeda & H. Hovenkamp, Antitrust Law § 562e, p. 101 (Supp. 2017) (stating that the Amex court erred because "competition should choose the optimal mix of revenue between the two sides").

¹² Pet. App. 30a-31a.

reason satisfied by showing an increase in the retail price. The burden then shifts to the supplier imposing the restraint to show offsetting procompetitive benefits. The failure of the appellate court to follow this approach is not justified by sound economic principles.

With RPM, the suppression of competition at the retail/merchant level is a cost to the supplier imposing the restraint, as the direct effect is reduced demand for the supplier's product from the higher retail price. Therefore, to be of benefit to the supplier, the decision to impose RPM can be presumed to have some non-price, demand-enhancing effects. In contrast, with Amex, the suppression of price competition at the retail/merchant level by Amex provides first-order benefits to Amex, as its competitors are effectively restrained from undercutting its price. Because of this direct reduction in horizontal price competition, Amex's merchant restraints cannot be presumed to be motivated by non-price, overall demand-enhancing effects.

Additionally, the direct impact of RPM on competing suppliers is to increase the demand for their products. In contrast, the Amex restraints provide no direct benefits to Amex's platform competitors; rather, the restraints directly interfere with the other platforms' ability to compete with Amex in pricing to merchants. Yet for analysis of RPM, simply showing an increase in the retail prices to the buyers is sufficient to satisfy the first prong of the rule of reason analysis – an anticompetitive impact. Absent the presumed demand-enhancing impact and the benefit to competitors from RPM, it is not sound economic policy to reject such an

anticompetitive showing in the Amex case simply because the platform may be two-sided.

The practical effect of the Amex restraints is to drive merchants purchasing from Amex to set equal prices for the use of all cards, regardless of their relative cost to the merchant. The result is that merchants' customers paying with credit cards perceive no difference in selecting one credit card versus another, and the customers will be motivated to choose the card considered to offer the highest cardholder benefits. Consequently, as the district court below correctly found, if a payment card platform seeks to compete for transactions with Amex by offering an identical net price, but with lower prices on the merchant side along with higher prices (less rewards) for card users, then its effort will be impeded, not because there is no demand for the platform's services, but because the Amex restraints effectively suppress the demand for such a card on the merchant side. *See* Pet. App. 194a-203a. Therefore, platforms (such as Discover) that attempt to compete with Amex by charging lower merchant fees and equal or possibly lower rewards will realize little benefit from the low merchant fees.¹³ As a consequence, the Amex restraints suppress horizontal competition among credit card platforms to increase transactions by charging lower merchant prices. Similarly, the Amex restraints impede competition on the cardholder side by preventing platforms from offering lower prices to merchants in exchange for merchants

¹³ *See* Dist. Ct. Op., Pet. App. 203a-207a (holding that Amex's merchant restraints effectively deny other networks the opportunity to pursue a business model that differentiates itself by offering merchants a low price for greater volume).

offering more immediate and more valuable rewards or discounts to cardholders at the point of sale.

As a result, with the Amex restraints in place, competing platforms will be motivated to raise their merchant price – that is, they will be driven to the Amex business model. In so doing, the platforms have to abandon other competitive business models that they, the retail consumers, the cardholders, and the merchants might prefer.¹⁴ The Amex restraints directly interfere with competitors' ability to compete with alternative platform models offering different and potentially efficient price pairs. This is regardless of whether such competitive price pairs have equal, lower, or even higher total two-sided net prices.

The competitive impact of merchant pricing restraints on entry is also far reaching. The Amex restraints result in all credit card networks competing for transactions only through cardholder benefits provided by the networks at some future point in time. Cardholder benefits and rewards are a way to reduce the net prices paid by the cardholders. But at best, the rewards are a discount on the credit card bill, and the discount accomplishes a price reduction only with a lag in time. The Amex rules prohibit a merchant from accepting payment cards from a competing network that offered rewards in the form of a point-of-sale discount or other benefits received at the time of the sale such as a preferred checkout line. Under the Amex rules, any such point-of-sale benefits

¹⁴ See Dist. Ct. Op., Pet. App. 216a-217a (finding that without Amex's restraints, all four card networks' merchant prices would decrease).

would be considered differential pricing, which is not allowed. Thus, the Amex restraints directly interfere with innovative and potentially efficient alternative platform pricing systems. This important anticompetitive impact was not considered by the appellate court.

With restraints in place that impede horizontal competition regarding pricing to merchants, competition on the cardholder side may or may not increase, and such competition might or might not result in a change to the net prices summed over the two sides. However, such a reduction in the cardholder price, if it occurs, is not a “pro-competitive” or an efficiency-enhancing benefit that offsets the interference with competition on the merchant side. It is, rather, a further economic distortion and inefficiency directly due to the Amex restraints.

The appellate court recognized that in two-sided markets, a platform must “find an effective method for balancing the prices on the two sides of the market.”¹⁵ This is the essence of competition in two-sided markets – identifying and offering a price pair that attracts both sides to use the platform. Selecting and offering a preferred price pair, however, is quite different from the situation in which restraints on one side of the market allow for price increases that, through competition on the other side, may lead to price reductions to the second side. While the total two-sided price may be unaffected as the price reduction on one side may completely offset the

¹⁵ Second Circuit Op., Pet. App. 8, n.4 (citing Jean-Charles Rochet & Jean Tirole, *An Economic Analysis of the Determination of Interchange Fees in Payment Card Systems*, 2 Rev. Network Econ. 69, 71 (2003)).

increase on the other side, the resulting price pair has nothing to do with the competitive search for a preferred price pair.

The potential adverse consequences of the appellate court's approach – in which indirect effects on the second side of a two-sided platform must be taken into account in the first step of a rule of reason analysis – can be readily understood by viewing the court's analysis through the lens of traditional and well understood anticompetitive conduct. Consider a case in which Amex, Visa, MasterCard, and Discover agree to fix prices by charging equal and high merchant fees. The obvious anticompetitive harm is the direct interference in platform competition regarding the merchant price. And with merchant restraints in place like those of Amex, which do not allow other credit card platforms to offer lower merchant prices, competition through entry cannot solve the problem. However, if this hypothetical cartel of credit card platform suppliers does not control competition on the cardholder side, then the result is likely to be increased cardholder benefits with reduced cardholder prices, and in the long run, perhaps full dissipation of all the profits earned from the high merchant fees.

No reasonable antitrust scholar would consider the dissipation of profits from price fixing through competition in other markets to be an offsetting procompetitive benefit. Nothing is different about the dissipation of profits from merchant fees propped up by Amex's merchant restraints compared to the dissipation of profits from price fixing. In addition, the hypothetical collusive price fix among credit card platforms would not be considered benign if the “net”

price were unchanged because of the full dissipation of the cartel profits extracted from the merchant side through competition on the cardholder side. Of course, such a price fix would likely be judged under a *per se* standard. But that does not change the fact that the approach taken by the appellate court is economically flawed and unfounded. The outcome of “competition” with restraints such as those imposed by Amex is little different from what would emerge from the collusion example – a non-competitive *price pair* that may or may not alter the sum of the prices.

Whether from collusion or from vertical restraints on differential merchant pricing, Amex and its competitors may benefit during the transition to long-run equilibrium and the full dissipation of profits earned from the supra-competitive merchant prices. Those consumer cardholders that are fortunate enough to meet the credit and income requirements for high rewards cards may also benefit. However, the merchants paying higher prices to Amex, and the merchants’ customers using other payment means, are harmed. More importantly, economic efficiency is impeded as price signals are distorted regarding choice of payment means. Customers will be motivated to use their rewards cards even when cash, debit, or check would otherwise benefit them, and customers will be motivated to take inefficient actions to qualify for the high rewards cards.

The appellate court decision imposes on the plaintiffs, the victims of the high prices supported by the merchant restraints, the burden of disproving that the harm they suffer is not outweighed by any benefits to the other side of the platform. This requirement will have substantial adverse impacts on

antitrust enforcement. First, as we have emphasized, the effects on cardholders should not be considered offsetting *procompetitive* effects. Any such benefits to cardholders flow from the merchant restraints that support the supracompetitive merchant fees. Foreclosure of competition effectuated on some consumers should not be justified by an increase in competition somewhere else that the foreclosure motivates.

Second, the merchant restraints are imposed by Amex, the very party best able to understand and quantify any relevant offsetting competitive benefits for the restraints. Perverse incentives will be created if a platform can avoid antitrust liability for harm to one side of the platform, as long as the victim cannot prove that the spoils from that harm are not passed on to the other side. Amex and cardholders control the information concerning cardholder rewards programs – how the programs work, what they cost, and what value they might provide to the cardholders. Amex and cardholders will have no incentive to cooperate with merchants' efforts to show that restraints transferring benefits to Amex and cardholders should not be allowed. Indeed, Amex and cardholders will have incentives to create cardholder programs designed to obfuscate the benefits, increasing plaintiffs' burden.

Third, the appellate court's overly broad conception of two-sided markets could allow any supplier suppressing retail competition through a vertical restraint to point to the possibility of incentives for higher quality, thus shifting the burden back to the plaintiff. Because any suppression of competition in any context carries the possibility of

higher quality resulting from higher prices,¹⁶ antitrust enforcement may become needlessly complex, expensive, and uncertain.

IV. CROSS-MARKET EXTERNALITIES

The Amex restraints increase the price that merchants pay to Amex and thereby raise the costs to merchants for those customers using Amex. The Amex restraints prevent the merchants from differentially raising retail prices to only Amex cardholders to cover that cost increase. The Amex restraints then motivate other credit card platforms to raise their prices to merchants, further increasing the merchants' costs. Dist. Ct. Opp., Pet. App. 207a-209a. Merchants incurring higher costs in turn raise their prices to all their customers.¹⁷ The result is higher retail prices to all the merchants' customers, including those who use low-cost cash or debit cards. These customers, who tend to have incomes or credit scores too low to qualify for rewards credit cards, will thus end up subsidizing the rewards of more affluent cardholders. *Id.* at 210a-212a. This is further evidence of inefficient pricing and a negative externality. These harms occur even if Amex passed on all of its high merchant fees to cardholders through higher rewards, and they are amplified when other credit card platforms increase their merchant prices and

¹⁶ See G. Stigler, *Price and Non-Price Competition*, 76 J. Pol. Econ. 149, 149-54 (1968).

¹⁷ The appellate court's ruling does not rely on market power in the retail sectors facing Amex's restraints. Rather, the retail markets mainly impacted by the Amex restraints are competitive to a first approximation such that the cost increase caused by higher merchant credit card fees can be presumed to be fully, or nearly fully, passed on to consumers.

cardholder benefits in response to the Amex restraints.

The appellate court requires that analysis in two-sided markets must go beyond the direct effects on competition on the side of the platform where a restraint is imposed. If it is economically relevant to consider the competitive impact beyond the side of the platform where the restraint is imposed, then proper analysis must also consider effects beyond the platform itself, as the restraint can have broad effects on consumers who do not participate on either side of the platform that imposes the restraint.

However, there is a sound economic basis to retain the standard rule-of-reason analysis in which the plaintiff focuses on the direct effects of the restraint in a two-sided market. If the plaintiff succeeds in demonstrating that the challenged merchant restraints adversely impact competition among platforms – here higher platform prices to the merchants from all platform competitors – then the plaintiff’s burden should be satisfied. With this initial burden satisfied, the defendant should be required to demonstrate not simply that the other side of the platform is affected, but that there is a beneficial impact on competition among platforms.

Finally, the appellate court suggests that Amex might justify its merchant restraints by a showing that Amex’s “output” – that is, the volume of Amex transactions – increased.¹⁸ However, if the Amex restraints have effects beyond the Amex platform, as is the case here, then the Amex output alone is not a

¹⁸ Pet. App. 52a.

proper indicator of the welfare effect of the restraint. A relevant analogy is an exclusive dealing contract. An exclusive dealing vertical restraint may increase the “output” of the firm imposing this restraint, but at the expense of the firm’s competitors. The proper measure of output would then be the size of the market served by all competitors.

Here, the fundamental product at issue is “payment.” If one desired to determine indirectly through market size the procompetitive or anticompetitive nature of a credit card platform’s vertical price restraints, then the proper metric is all payment transactions whether accomplished by credit card, debit card, cash, check, or other means. The effect of the restraint is to increase the subsidization of the users of credit card platforms by customers paying by other means. With increased cardholder benefits resulting from competition on the cardholder side in the face of high credit card merchant fees, customers will be motivated to switch from other payment forms to credit cards. Thus, the usage of credit cards may increase. But this is only evidence of distortion in the competitive process, not that the restraint is procompetitive. For those customers switching to credit cards only because of increased rewards, credit card use can be presumed less efficient than the prior preferred means of payment. As a consequence of the use of less efficient means of payment, the cost of transacting will increase and the total of transactions – the proper measure of output in this context – will be expected to decline.

CONCLUSION

Based on the foregoing analyses, the Amici respectively ask the Court to grant the States' Petition for a Writ of Certiorari.

Respectfully submitted,

ANTHONY J. BOLOGNESE

Counsel of Record

BOLOGNESE & ASSOCIATES, LLC

1500 JFK Boulevard, Suite 320

Philadelphia, PA 19102

(215) 814-6750

ABolognese@Bolognese-Law.com

Dated: July 6, 2017

APPENDIX

APPENDIX

Amicus **John M. Connor** is a Professor of Industrial Economics emeritus at Purdue University. Professor Connor specializes in research and teaching of empirical industrial economics and antitrust policy. His research has been cited in five court decisions and more than 75 law review articles. Professor Connor is also Senior Advisor to the American Antitrust Institute.¹

Amicus **Martin Gaynor** is a Professor of Economics and the E.J. Barone Chair in Health Systems Management at Carnegie Mellon University. Professor Gaynor has consulted for the Federal Trade Commission and the U.S. Department of Justice, and also consulted for the Netherlands Competition Authority on issues involving vertical restraints and market definition.²

Amicus **Daniel McFadden** is a Nobel Laureate in economics (2000) and the E. Morris Cox Professor Emeritus of Economics and the Director of the Econometrics Laboratory at the University of California at Berkeley. Among his many honors, Professor McFadden received the John Bates Clark Medal from the American Economics Association (1975) and the Frisch Medal from the Econometrics Society (2000).³

¹ Purdue University, John M. Connor, <https://goo.gl/ZaQdzU>

² Martin Gaynor Curriculum Vitae, <http://bit.ly/2fFTvQO>

³ University of California at Berkeley, Faculty Profiles, McFadden, <http://bit.ly/2eoJMk9>

Amicus **Roger Noll** is Professor of Economics emeritus at Stanford University and a Senior Fellow and member of the Advisory Board at the American Antitrust Institute. Before coming to Stanford, Professor Noll was a Senior Economist at the President's Council of Economic Advisers, a Senior Fellow at the Brookings Institution, and Institute Professor of Social Science and Chair of the Division of Humanities and Social Sciences at the California Institute of Technology.⁴

Amicus **Jeffrey M. Perloff** is a Professor in the Department of Agricultural and Resource Economics at the University of California at Berkeley. Professor Perloff has authored textbooks on economics including *Modern Industrial Organization* (with Dennis Carlton), *Microeconomics*, *Microeconomics: Theory and Applications with Calculus*, and *Estimating Market Power and Strategies* (with Larry Karp and Amos Golan).⁵

Amicus **Joseph A. Stiglitz** is a Nobel Laureate in economics (2001) and is University Professor at Columbia University. He is a former senior vice president and chief economist of the World Bank and a former member and chairman of the U.S. President's Council of Economic Advisors. Based on academic citations, Professor Stiglitz is the fourth-most influential economist in the world today.⁶

⁴ Stanford University Public Policy Program, Roger Noll <http://stanford.io/2fFUOiP>

⁵ University of California at Berkeley Department of Agricultural and Resource Economics, Jeffrey M. Perloff Brief Bio, <http://bit.ly/2emKIWc>

⁶ Columbia University, Brief Biography of Joseph E. Stiglitz, <https://goo.gl/s6tCkb>

Professor Stiglitz currently consulting and is a witness for a number of national supermarket and drugstore chains that have challenged Amex's, Visa's, and MasterCard's restraints in related lawsuits pending in the District Court.⁷

Amicus **Lawrence J. White** is Robert Kavesh Professor of Economics and Deputy Chair of the Economics Department at New York University's Leonard N. Stern School of Business. He has served on the Senior Staff of the President's Council of Economic Advisers, and has also served as the Director of the Economic Policy Office in the Antitrust Division of the U.S. Department of Justice. Professor White is also the General Editor of the Review of Industrial Organization, a journal that focuses on competition and monopoly in their many forms and their effects on efficiency, innovation, and social conditions.⁸

Amicus **Ralph Winter** holds the Canada Research Chair in Business Economics and Policy at the Sauder School of Business at the University of British Columbia.⁹ He was previously a Professor of Economics at the University of Toronto, and has also served as President of the Canadian Economics

⁷ Those merchants are: Ahold U.S.A., Inc.; Albertson's, Inc.; BI-LO, LLC; CVS Health, Inc.; The Great Atlantic & Pacific Tea Company, Inc.; H.E. Butt Grocery Co.; Hy-Vee, Inc.; The Kroger Co.; Meijer, Inc.; Publix Super Markets, Inc.; Raleys Inc.; Rite Aid HDQTRS Corp.; Safeway Inc.; Supervalu, Inc.; and Walgreen Co.

⁸ New York University Stern School of Business, Lawrence J. White Biographical Summary, <https://goo.gl/zCwff1>

⁹ University of British Columbia Sauder School of Business, Ralph Winter, <https://goo.gl/ennG6B>

Association. Professor Winter has also consulted for the U.S. Department of Justice and the Canadian Competition Bureau.¹⁰

¹⁰ University of British Columbia Sauder School of Business, Ralph Winter Curriculum Vitae, <http://bit.ly/2fPyrG9>