UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

IN RE AMERICAN EXPRESS ANTI-STEERING RULES ANTITRUST LITIGATION (II)	Master File No: 11-MD-02221 (NGG)(RER)
This Document Relates to: *Rite Aid Corporation, et al. v. American Express Travel Related Services Co., Inc.*, Case No: 08-cv-2315-NGG-RER *CVS Pharmacy, Inc. v. American Express Travel Related Services Co., Inc.*, Case No: 08-cv-02316-NGG-RER *Walgreen Co. v. American Express Travel Related Services Co., Inc.*, Case No: 08-cv-2317-NGG-RER *BI-LO, LLC v. American Express Travel Related Services Co., Inc.*, Case No: 08-cv-02380-NGG-RER *H.E. Butt Grocery Co. v. American Express Travel Related Services Co. Inc.*, Case No: 08-cv-02406-NGG-RER *The Kroger Co., Safeway, Inc., Ahold USA, Inc., Albertson's LLC, Hy-Vee, Inc., The Great Atlantic & Pacific Tea Company, Inc. v. American Express Travel Related Services Co., Inc.*, Case No: 11-cv-0337-NGG-RER *Meijer, Inc., Publix Super Markets, Inc., Raley's, and Supervalu v. American Express Travel Related Services Co., Inc.*, Case No: 11-cv-0338-NGG-RER	**PLAINTIFFS' RESPONSE TO DEFENDANTS' MOTION TO DISMISS OR IN THE ALTERNATIVE FOR SUMMARY JUDGMENT WITH RESPECT TO THE INDIVIDUAL PLAINTIFFS' ONE-SIDED AND AMEX-ONLY RELEVANT MARKETS**

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Introduction

The Merchant Plaintiffs' ("MPs") First Amended and Consolidated Complaint alleges four relevant markets or submarkets. First, the MPs allege a "two-sided" credit card relevant market in which both merchants and cardholders are customers. Second, the MPs allege a one-sided credit card relevant market in which merchants are the sole relevant customers. Third, the MPs allege an Amex-only two-sided relevant submarket. Fourth, the MPs allege an Amex-only one-sided relevant submarket. Amex has filed a motion for partial summary judgment seeking dismissal of the one-sided relevant market and both of the Amex-only relevant submarkets. Amex does not attack the allegation of a two-sided credit card relevant market. As explained below, Amex's motion has no merit and should be denied.

Amex incorrectly contends the Supreme Court held, as a matter of law, that credit cards must be evaluated in a two-sided relevant market. To the contrary, the Supreme Court has long held that relevant market analysis involves a deeply factual inquiry and cannot be decided as a matter of law. In keeping with that view, the Supreme Court decision in the Government case set forth specific factual criteria that must be met in order to justify a two-sided relevant market definition. Specifically, the Court held that a two-sided market definition is warranted where there are indirect network effects; where the indirect network effects operate in both directions; where the indirect network effects are "pronounced," as opposed to weak or nonexistent; and where there are interconnected, balanced prices on the two sides of the defendants' platform.

In its case, the Government did not dispute the existence of indirect network effects flowing in both directions. The MPs, however, have always asserted that because the credit card market is mature, it no longer exhibits indirect network effects or balanced pricing. The MPs are not bound by the factual record in the Government case and there is a genuine dispute of material fact as to

whether the factual criteria that justifies a two-sided relevant market analysis are present in this case. As a result, Amex's request for summary judgment on the MPs' one-sided relevant market allegations has no merit.

Amex's contention that there cannot be an Amex-only submarket – either one-sided or two-sided – is similarly deficient. The question of whether other credit cards must be included in the relevant product market depends on whether there is cross-elasticity of demand between Amex and other credit cards and whether the existence of those other cards constrains Amex's ability to raise price.

With regard to the one-sided market in which Amex sells services to merchants, there is substantial – indeed, overwhelming – evidence that there is no cross-elasticity of demand between Amex and the other credit cards and that the other credit cards do not constrain Amex's ability to price its merchant services above a competitive level. As a result, there is an Amex-only one-sided relevant submarket for the sale of services to merchants.

With regard to the two-sided market in which Amex sells services to both cardholders and merchants, Amex contends that it competes for two-sided "transactions" against the other credit card platforms and that those credit cards must be included in the relevant market. There is substantial evidence, however, that in this two-sided market Amex has the ability to raise the net two-sided price without facing cross-elasticity of demand from the other credit cards and that Amex's net two-sided price is not effectively constrained by the existence of the other credit cards. As a result, Amex's motion for summary judgment on the two-sided Amex-only relevant submarket should be denied.

Below, the MPs first demonstrate that they are not bound by the factual record in the Government case (Sec. I). The MPs then demonstrate that the Supreme Court has set forth a fact-

intensive inquiry for determining whether a market should be defined as one-sided or two-sided (Sec. II). In Section III, the MPs demonstrate that whether the criteria necessary to a two-sided relevant market definition are met in this case is a disputed issue of material fact for trial. In Section IV, the MPs demonstrate that whether there is an Amex-only submarket – either one-sided or two-sided – is determined by cross-elasticity of demand and whether alternative products constrain the defendants' ability to raise price. The MPs have come forward with substantial evidence to meet that test and demonstrate an Amex-only relevant submarket.

I. The Merchant Plaintiffs Are Not Bound by the Facts in the Government Case

Relevant market analysis requires "a deeply fact-intensive inquiry." *Todd v. Exxon Corp.*, 275 F.3d 191, 199-200 (2d Cir. 2001); *U.S. v. American Express Co.*, 838 F.3d 179, 196 (2d Cir. 2016) ("market definition is a deeply fact-intensive inquiry"); *Eastman Kodak Co. v. Image Tech Services, Inc.*, 504 U.S. 451, 482 (1992) (market definition "can be determined only after a factual inquiry into the 'commercial realities'"). The required factual inquiry "preclude[s] a finding as to relevant market as a matter of law" because "a pronouncement as to market definition is not one of law, but of fact." *Hayden Pub. Co. v. Cox Brand Corp.*, 730 F.2d 64, 70, n.8 (2d Cir. 1984).

The MPs accept that *stare decisis* applies to propositions of law decided by the Supreme Court. The MPs are not, however, bound by factual determinations reached in the Government case. The principle of *stare decisis* is not applicable to cases based on different facts. *Complaint of Tug Helen B. Moran, Inc.*, 607 F.2d 1029, 1031 (2d Cir. 1979) ("We find no merit in the State's attempt to invoke the doctrine of *stare decisis*, since the doctrine is not applicable to determinations of fact … *stare decisis* is concerned with rules of law…"); *U.S. v. Nolan*, 136 F.3d 265, 269-70 (2d Cir. 1998) ("The principle of *stare decisis* is applicable only where the facts in the two actions are the same"); 1B Moore's Fed. Prac., 0.402(2) at 1D ("the doctrine of *stare decisis* is not

applicable to determinations of fact … *stare decisis* is concerned with rules of law, a decision depending on the facts is not controlling precedent as to a subsequent determination of the same question on different facts and different record").

Here, the MPs have come forward with different relevant market facts than those upon which the Supreme Court Opinion is based. Due process requires that MPs be able to rely on these facts. *Taylor v. Sturgel*, 553 U.S. 880, 884 (2008) (one is not bound by a judgment "in a litigation in which he is not designated as a party"); *Allen v. McCurry*, 449 U.S. 90, 94-95 (1980) (a party cannot be bound if it "did not have a 'full and fair opportunity' to litigate that issue in the earlier case"). Indeed, in *Taylor*, "the Supreme Court unanimously found that due process prohibited a court from binding [a] second party [suing the same defendant on the same cause of action] through preclusion." Trammel, *Precedent and Preclusion*, 93 Notre Dame Law Rev. 565, 566 (2017).

Amex's assertion that the MPs are barred from proving different facts than those recited by the Supreme Court is particularly inappropriate here, as the Government did not dispute the existence of indirect network effects, which, as explained below, are the critical factual determinant underlying the Supreme Court's two-sided relevant market analysis. The Government argued that legally a relevant market encompasses only the affected side of a two-sided platform. With regard to the facts, however, the Government economist, Prof. Katz, conceded that credit card platforms exhibit indirect network effects (sometimes referred to as externalities). Specifically, Prof. Katz stated: "the three economic experts retained by American Express and I all agree that the credit and charge card networks are subject to what are known as network effects." Resp. to Defs.' Rule 56.1 Statement and Plaintiffs' Statement of Additional Material Facts ("SAMF") ¶111; *accord id.* ¶110 (Katz/Government) ("There is agreement among the economic experts in this matter that credit card and charge card networks are subject to network

effects."); *see generally id.* §II.D.[1] Unlike the Government, the MPs have always denied the existence of indirect network effects in the credit card industry and continue to do so. *See id.* §II.E. (collecting proof from both Amex and MPs' experts showing that MPs dispute the two-sided nature of the market). Amex concedes this difference in factual assertions made by the Government and those made by the MPs. *See*, *e.g.*, *id.* ¶113 (Gilbert/Amex) ("Unlike Prof. Katz [the MPs' experts] explicitly deny the existence of externalities between the cardholder and merchant sides of the market.").[2]

Because the Government did not factually dispute these issues, the questions of whether indirect network effects actually exist in the credit card industry or whether Amex actually "balances" the prices that it charges merchants and cardholders were not litigated in the Government case. Nor did the Government dispute whether Amex connects customers and merchants, or whether it makes "simultaneous" sales to both cardholders and merchants. The MPs will introduce proof that these factual issues, which were assumed to be true in the Government case, are, in fact, false. *See* SAMF § II.A-C. Furthermore, even if those facts had been litigated (which they were not) – *stare decisis* would not prevent the MPs from relitigating those facts and having the issue determined on the factual record in their own case.

II. Supreme Court Opinion

The Supreme Court granted *certiorari* to review whether the Government had carried its

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[1] Amex admits that Prof. Katz did not dispute the existence of indirect network effects in the credit card market. *See*, *e.g.*, SAMF ¶ 109 (Gilbert/Amex) ("Prof. Katz acknowledged that payment networks are two-sided markets subject to network effects"); *id.* ¶114 (Bernheim/Amex) (stating that Dr. Katz "explicitly acknowledges the existence of these externalities").

[2] *See also* SAMF ¶ 114 (Bernheim/Amex) ("[Plaintiffs' experts] Drs. Stiglitz and Vellturo flatly contradict Dr. Katz concerning the two-sided nature of payment services…. Drs. Stiglitz and Vellturo deny the existence of externalities between cardholder and merchant sides of the market. In doing so … they contradict Dr. Katz, who explicitly acknowledges the existence of those externalities.").

"burden of proving that Amex's anti-steering provisions have an anticompetitive effect." *Ohio v. American Express Co.*, 138 S.Ct. 2274, 2284 (2018). The Court held that for vertical agreements, proof of an anticompetitive effect requires a relevant market definition because "without a definition of the market there is no way to measure the defendant's ability to lessen or destroy competition." *Id*. at 2285.

Based on the record before it, the Supreme Court held that the market should be viewed as a two-sided relevant market, including both merchants and cardholders. *Id*. at 2287. The Court did not, however, hold that credit card platforms are two-sided markets as a matter of law – or as Amex euphemistically argues, as a matter of "fundamental economic principle." Amex Br. 5. Rather, consistent with its long-standing view that a relevant market "can be determined only after a factual inquiry" (*Kodak*, 504 U.S. at 482), the Supreme Court set forth a fact-intensive inquiry for determining whether a two-sided relevant market definition is warranted.

The Supreme Court explained that "indirect network effects" are present when "the value of the two-sided platform to one group of participants depends on how many members of a different group participate." 138 S.Ct. at 2280-81. As applied to Amex, the Court then held that indirect network effects require that "a credit card … is more valuable to cardholders when more merchants accept it, *and is more valuable to merchants when more cardholders use it*." *Id*. at 2281 (emphasis added). The Court reiterated that, where indirect network effects are present, "increasing the number of cardholders increases the value of accepting the card to merchants" (*id*.) and that credit card platforms "balance [the] pricing" between both sides of the platform (*id*. at 2286) and "must be sensitive to the prices that they charge each side" (*id*. at 2281). This is because two-sided markets exhibit a "feedback loop of declining demand" which occurs if an increase in the price on side A will cause less participation on that side, which then causes a drop in demand

on side B. *Id.*

The Supreme Court made very clear that not all markets including two-sided platforms should be treated as two-sided relevant markets. The Court specifically stated that "[a] market should be treated as one-sided when the impacts of indirect network effects and the relative pricing in that market are minor." *Id.* at 2286. The Court reiterated that where a two-sided platform has only "weak network effects" it should be evaluated in the one-sided relevant market. *Id.* The Court also held that where the indirect network effects do not flow in both directions of a two-sided platform, the relevant market should be treated as one-sided. Specifically, the Court stated that where "the indirect networks effects operate in only one direction" the market "behaves much like a one-sided market and should be treated as such." *Id.* at 2286. As a factual matter, the Court held that the test for a two-sided relevant market definition was met because it found "pronounced indirect network effects and interconnected pricing and demand." *Id.* In its motion, Amex does not ever mention this critical factual criteria for when a two-sided relevant market definition is proper.

Based on the record before it, the Supreme Court further explained that two-sided credit card platforms involve a simultaneous transaction on both sides of the platform and that to "optimize sales" the platform "must find the balance of pricing … between cardholders and merchants." *Id.* at 2286. The Court concluded that "[f]or all these reasons" both sets of Amex's customers should be defined "as only one market." *Id.* at 2287. Contrary to Amex's bold contention, the Supreme Court did not hold, as a matter of law, that transaction platforms are always two-sided relevant markets simply because they purportedly involve a simultaneous transaction by a merchant and a cardholder, regardless of the existence of indirect network effects or balanced and interconnected pricing. In an effort to support that incorrect claim, Amex is able

to point only to Justice Breyer's dissent. Amex Br. 5. But the majority opinion says no such thing – and if the dissent's analysis was correct, Amex would have lost the appeal. The Supreme Court did state that two-sided platforms like Amex "are different" than two-sided platforms such as newspapers that exhibit only "weak indirect network effects" and should be analyzed within a one-sided market. *Id*. at 2286. But that factual observation was made in a case where the Government conceded the existence of indirect network effects and did not dispute the simultaneity of the transactions or the notion that Amex brings merchants together with their customers. *Id*. at 2280. Furthermore, *stare decisis* does not bind the MPs to factual determinations made in the Government case. Due process requires that the MPs be given the opportunity to generate their own factual record and prove that the Amex platform does not, in fact, exhibit (1) indirect network effects; (2) balanced and interconnected relative pricing; or (3) that any indirect network effects flow to the merchant side of platform from greater Amex cardholder use.

III. Amex's Motion for Summary Judgment with Regard to a One-Sided Relevant Market Has No Merit

Amex contends that a credit card platform competes in a two-sided relevant market simply because the transaction between a cardholder and a merchant is allegedly "simultaneous." Amex Br. 4. According to Amex, the Supreme Court held, as a matter of law, that simultaneous transaction platforms exhibit "pronounced indirect network effects and interconnected pricing." *Id*. Whether a platform actually involves a "simultaneous" transaction and exhibits indirect network effects or interconnected balanced pricing are not questions of law. They are classic questions of fact and explain why relevant market analysis is "a deeply fact-intensive inquiry." *Kodak*, 504 U.S. at 482. In the Government case, these facts were not disputed. Here, the MPs vigorously dispute the existence of indirect network effects and balanced or interconnected pricing and will introduce abundant evidence that those factual tests for whether a two-sided relevant

market definition is appropriate are not met in this case.

A. There Is Substantial Evidence that the Amex Platform Does Not Exhibit Indirect Network Effects

The Amended Complaint specifically alleges that "indirect network effects in the credit card market are weak or non-existent." Compl. ¶57. This is because Amex, like Visa, MasterCard and Discover, has existed for decades and is mature. Initially, it is a benefit to cardholders if more merchants accept the card *and* it is a benefit to merchants if more cardholders use the card. *Id.* This is because more consumers wanting to use the card justifies the high fixed costs that a merchant must incur in order to purchase card reading machines and install the computer systems that are necessary to accept credit cards. *See* SAMF § II.F (collecting evidence that Amex is a mature system that does not exhibit positive network externalities). This is often referred to as the "chicken and egg" problem. Consumers do not want to carry a card unless enough merchants accept it and merchants do not want to incur the costs to accept a card unless enough consumers want to use it. As a result, in the beginning stages of credit card use, it was a benefit to merchants if more cardholders used the card. *See id.* Once a system is mature, however, with tens of millions of people already using the card and the fixed costs of accepting cards already incurred, there is no additional indirect network effect flowing to the merchant side of the platform from the increased use of Amex cards. *See id.* In its motion, Amex does not dispute any of these facts.

There is abundant evidence that Amex has reached this stage of maturity and does not exhibit indirect network effects, which creates a genuine issue of fact for trial. For example, the MPs' economist, Prof. Stiglitz, states: "In a mature payment system like American Express there is unlikely any significant externality on either side of the market." SAMF ¶119.[3] Prof. Stiglitz

[3] Dr. Jean-Charles Rochet, who received the Nobel Prize for first explaining how two-sided markets function and was favorably cited by the Supreme Court (138 S.Ct. at 2281), agrees with

further testified at his deposition that "merchants do not benefit from increased Amex card use and would be 'happier if [consumers] used an [alternative card]." SAMF ¶116; *accord id.* ¶115 (Vellturo/MPs) (stating that the "feedback loop" asserted by Amex's economists "is illusory" and that "[i]n the absence of significant fixed costs, a merchant's decision to accept (or continue accepting) Amex is not dependent on the number of Amex cardholders").

Amex, itself, admits that the credit card industry is "mature" and that greater use of Amex cards is of no added benefit to the merchants. Joshua Silverman, President of U.S. Consumer Services for Amex, testified that Amex operates in "a very mature market, so no one gets an extra dollar of revenue except at the expense of their competitors." *Id.* ¶120. For the merchant, this means that any additional Amex card use comes from a customer switching from Card X to Amex. That additional Amex card use does not provide the additional value or benefit to the merchant that is the touchstone of indirect network effects. The number of card users does not change. The fixed cost of accepting cards does not go down. Because Amex is more expensive to accept than the other credit cards, the customer switch from card X to Amex merely costs the merchant money. That is why Prof. Stiglitz states that once a merchant agrees to accept Amex cards, it would be just as happy if no one ever used it. Thus, once the market is mature it is no longer true that the card "is more valuable to merchants when more people use it" or that "increasing the number of cardholders increases the value of accepting the card to merchants." 138 S.Ct. at 2281. The evidence shows, and Amex admits, that exactly the opposite is true.

Prof. Stiglitz: "Payment card networks are also characterized by a more classical externality…. This externality becomes less and less important as the market matures … when virtually all potential users have joined." SAMF ¶117; *accord id.* Oz Shy, *A Short Survey of Network Economics*, 38 Rev. of Indus. Org., 119, 136 (2011) ("[N]o additional network effects can be generated once most buyers already use payment cards and most merchants accept payment cards. Therefore, policy conclusions of two-sided market models should be confined to immature markets.").

The Supreme Court held that "a market should be treated as one-sided" where indirect network effects "are minor," or where "the indirect network effects operate in only one direction." *Id*. at 2286. Here, because the market is mature, there are no indirect network effects flowing to the merchant side of the platform from additional Amex use. *See* SAMF § II.F. Additional use of Amex cards only costs the merchant more money. As a result, indirect network effects are either weak or non-existent and operate, at best, in only one direction. According to the Supreme Court test, the market therefore "behaves much like a one-sided market and should be analyzed as such." 138 S.Ct. at 2286.

The manner in which a mature two-sided transaction platform behaves was analyzed in *U.S. Airways, Inc. v. Sabre Holdings Corp.*, 2017 WL 1064709 (S.D.N.Y. 2017). Sabre operated a two-sided transaction platform and argued that, as a matter of law, it had to be treated as a two-sided relevant market. *Id*. at *10. The plaintiff countered that the market was "mature" and did not exhibit the two-sided externalities that would call into play a two-sided relevant market definition. *Id*. at *9-10. The court agreed. Like the Supreme Court, it held that "market definition is deeply fact-intensive" (*id*. at *5-10) and pointed out that the Second Circuit *Amex* decision (like the Supreme Court Amex decision) "does not address or appear to consider market maturity, which was not a factual consideration in that case." *Id*. at *10. The *Sabre* court then held (1) that "whether the two sides of a platform are interdependent such that the relevant market is two-sided is a factual, not a legal issue" (*id*. at *11) and (2) that the jury's conclusion that the two-sided transaction platform did not exhibit indirect network effects because it was mature was supported by the evidence (*id*. at *10).

Amex responds to the MPs' market maturity facts by asserting that the "theory … was actually presented to the Supreme Court, which declined to accept it." Amex Br. 5-6. Amex is

referring to the fact that one of the 22 *Amicus* Briefs submitted to the Supreme Court argued that Amex is mature and does not exhibit "significant two-sided externalities." *See* Amex Br. 6, n.6. The Supreme Court did not reject this analysis, as Amex incorrectly suggests. The Court made no mention whatsoever of the *Amicus* Brief or its mature market analysis. That is hardly surprising as the Government, itself, did not dispute the existence of two-sided indirect network effects. The Supreme Court has made clear that "questions which merely lurk in the record, neither brought to the attention of the Court nor relied upon, are not considered as having been so decided as to constitute precedents." *Cooper Industries, Inc. v. Aviall Serv., Inc.*, 543 U.S. 157, 170 (2004) (Thomas, J.). Furthermore, the MPs are not asserting a "theory." They are asserting evidentiary facts, including admissions by Amex, that demonstrate that the credit card market does not exhibit indirect network effects running in both directions. *See* SAMF § II.C-F (collecting evidence).

Amex's only other response is to insist that the commercial realities of how the credit card industry actually behaves, whether it is mature or actually exhibits indirect network effects, is all irrelevant. According to Amex, the "factual inquiry into the commercial realities" that has long been the touchstone of "the proper market definition" (*Kodak*, 504 U.S. at 482), is no longer necessary. Instead, Amex asserts that with regard to its two-sided transaction platform that a two-sided relevant market definition is required, as a matter of law, by a case in which the relevant facts were not even disputed. The MPs respectfully submit that is not even a remotely reasonable reading of the Supreme Court Opinion.

B. There Is Substantial Evidence that the Amex's Two-Sided Price Is Neither Balanced Nor Interconnected

One of the Supreme Court's criteria for determining whether a platform should be treated as two-sided relevant market is whether it "balances" the pricing between the two sides and exhibits "relative" or "interconnected pricing." 138 S.Ct. at 2286. The Supreme Court reasoned

that platforms that need to coordinate the pricing on the two sides of the platform and be "sensitive to the prices that they charge each side" so as to "optimize" its total number of transactions are candidates for being treated as two-sided. *Id.* at 2281, 2286.

In the current case, there is abundant evidence that Amex does not "balance" the prices on the two sides of its platform and that those prices are not "relative" to each other or "interconnected." It is Amex's theory that the cost of cardholder rewards is a negative price charged to the cardholder side of the platform. Amex Resp. Br., Sup. Ct., 7. But Elizabeth Langwith, the V.P. of Merchant Pricing, testified at her 30(b)(6) deposition that in setting merchant prices, her group did not even receive information about the cost of rewards. *See* SAMF ¶92 (Langwith/Amex) ("No, that would not be something that we would typically see or have data on."). Ms. Langwith further testified that the costs of the loyalty program "are part of the issuer side of American Express so we don't – they don't usually look at our costs and we don't usually look at their costs." *Id.* When asked whether rewards costs "are relative to how you set your prices to merchants," Ms. Langwith answered that "is not a factor." *Id.* Ms. Langwith did not testify in the Government trial and this evidence was not considered by the Supreme Court.

Mr. Silverman, whose group was responsible for setting cardholder rewards, testified to the same effect. When asked whether merchant prices were reduced when "Amex reduced … cardholder benefits" he answered that "I wouldn't know." *Id.* ¶93 (Silverman/Amex). Far from "balancing" or setting the prices on both sides of the platform "relative" to each other, the Amex executives who are responsible respectively for cardholder and merchant prices do not even stay informed as to what the "price" level is on the other side of the platform. Furthermore, during his testimony, Mr. Silverman could not recall anyone at Amex ever trying to calculate "a net effective price across the two businesses." *Id.* ¶94. Nor could he recall a conversation where someone said

that an increase in cardholder benefits required an adjustment to merchant prices. *Id.* There is clearly a genuine issue of disputed fact as to whether Amex "balances" the prices on each side of its platform, sets them "relative" to each other or whether they are "interconnected."[4] *See generally* SAMF § II.C (collecting evidence that Amex does not operate as if it competes in a two-sided market).

The Supreme Court's finding of a two-sided market also rested on the unchallenged assumptions that Amex brings merchants and cardholders together and that credit card transactions occur simultaneously on both sides of the platform. The MPs will submit substantial evidence that

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[4] With regard to a significant portion of its volume, it is indisputable that the Amex prices on both sides of its platform are not balanced or interconnected. Over 42% of all Amex-branded cards are issued by third-party banks. SAMF ¶197. [redacted] SAMF ¶101. [redacted] It should also be noted that the banks that issue Amex cards also issue MasterCard and Visa cards and are horizontal card issuer competitors of Amex. Compl. ¶38; SAMF ¶195. [redacted] SAMF ¶¶ 198-201. For vertical agreements, the Supreme Court held that the plaintiff must define a relevant market in order to determine whether an anticompetitive effect has occurred in that market. 133 S.Ct. at 2285. But where the conduct is horizontal and "involve[s] agreements between competitors," the plaintiff may carry its burden of proof by presenting evidence of "actual … adverse effects on competition," and does "not need to precisely define the relevant market" at all. *Id.* at 2285, fn.7, quoting *Indiana Federation of Dentists v. FTC*, 476 U.S. 447, 460-61 (1986). With regard to the horizontal agreements between Amex and the third-party issuing banks, two things are true: (1) if the MPs introduce direct evidence of anticompetitive effects, they do not need to define a relevant market at all; and (2) if the MPs prove that these horizontal agreements impede price competition between MasterCard, Visa and Amex, they are *per se* illegal. *See* SAMF § IV.D (collecting evidence that Amex has entered into horizontal agreements for the merchant restraints, which have resulted in supra-competitive prices, suppressed output, and limited consumer choice and raised barriers to entry).

neither assumption is factually accurate. *See* SAMF §II.A (evidence that merchants are already connected to their customers and credit cards merely facilitate payment) and §II.B (evidence that Amex transactions do not occur simultaneously on both sides of the platform – merchants are not paid for up to 30 days, annual cardholder fees are paid up to a year before a purchase, rewards cannot be used until longer after a purchase, etc.).

Finally, there is the Australian yardstick. In Australia, Amex was forced to give up its anti-steering rules. In order to persuade merchants not to steer consumers away from Amex cards, Amex had to agree to lower its merchant discount fee. *See* SAMF § IV.D.4. Over time, the Amex average merchant discount rate dropped from 2.48% to 1.41% – a 43% rate reduction. SAMF ¶245 (citing data collected by the Reserve Bank of Australia). If Amex rewards were actually "balanced," "relative to" or "interconnected with" the merchant discount rate, the rewards level should have gone down as merchant prices precipitously dropped. But they did not. The rewards level stayed the same or went up. *Id.* ¶251 [redacted] The assertion that these two "prices" are "balanced," or "relative to each other," or "interconnected" is factually disputed and clearly presents a genuine issue of fact for trial. *See, e.g.*, *id.* § II.C (collecting proof that Amex does not balance prices).

IV. Amex's Motion for Summary Judgment on Plaintiff's Assertion of "Amex-Only" Relevant Submarkets Has No Merit

The MPs have alleged that there is a relevant "Amex-only" submarket within the two-sided relevant market or, in the alternative, an "Amex-only" submarket within the one-sided relevant market. In its motion, Amex does not differentiate between the Amex-only one-sided and two-sided relevant submarkets. The analysis of these two submarkets, however, is different in important respects. These differences are noted below.

A. Relevant Markets and Submarkets Are Determined by Cross-Elasticity of Demand

Amex argues that credit card services offered by MasterCard, Visa and Discover are interchangeable substitutes for the services offered by Amex and necessarily must be included in the same relevant market or submarket. Amex Br. 8-10. Amex is mistaken.

Functional interchangeability is not alone sufficient to require that substitute products be placed in the same relevant market. *See FTC v. Swedish Motor*, 131 F. Supp. 151, 158-59 (D.D.C. 2000) ("finding two products to be functionally interchangeable, however, does not end the analysis"); *Telcor v. Southwestern Bell Tel. Co.*, 305 F.3d 1124, 1132 (10th Cir. 2002) (finding cell phones and pay phones not to be in the same relevant market). Instead, the relevant market includes only "products that have reasonable interchangeability … price, use and qualities considered." *U.S. v. E.I. DuPont de Nemours and Co.*, 351 U.S. 377, 394 (1956). Reasonable interchangeability in this context means "the cross-elasticity of demand between the product itself and the substitute for it." *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 325 (1962); *Todd v. Exxon*, 275 F.3d 191, 200 (2d Cir. 2001) (the methodology prescribed for defining a relevant market is "the cross-elasticity of demand"). As stated by the Supreme Court:

> For every product substitutes exist. But a relevant market cannot meaningfully encompass that infinite range. The circle must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn; in technical terms, products whose "cross-elasticities of demand" are small.

Times-Picayune Publi'g Co. v. U.S., 345 U.S. 594, 612, n.31 (1953).[5]

[5] Amex cites *City of N.Y. v. Group Health, Inc.*, 649 F.3d 151, 155 (2d Cir. 2011), for the proposition that "all 'substitute products'" must be included in the relevant market. Amex Br. 9. *Group Health*, however, holds that the relevant market includes all substitutes that "restrain a firm's ability to raise price above the competitive level" and must be defined "with reference to the rate of interchangeability and cross-elasticity of demand." *Id.*

Cross-elasticity of demand measures "the extent to which consumers will change their consumption of one product in response to a price change in another." *Kodak*, 504 U.S. at 469; *AD/SAT v. Associated Press*, 181 F.3d 216, 227 (2d Cir. 1999) ("cross-elasticity of demand exists if consumers would respond to a slight increase in the price of one product by switching to another product"). It is only such switching by purchasers in response to a change in the relative price of the products in question that "restrains the [defendant's] ability to raise price above the competitive level" and justifies the inclusion of both products in the relevant market. *Geneva Pharm. v. Barr Labs., Inc.*, 386 F.3d 485, 496 (2d Cir. 2004); *U.S. v. Microsoft Corp.*, 253 F.3d 34, 53-54 (D.C. Cir. 2000) ("reasonable interchangeability" requires inclusion "only [of] substitutes that constrain pricing" by competing firms).

In *Geneva*, the Second Circuit considered whether a brand name drug and its chemically identical generic equivalent should be placed in the same relevant market. The Court pointed out that there was little chance that consumers would switch between the two chemically-identical drugs based on changes in price and held that the inelastic demand for the higher-priced brand name drug meant that the two products did not exhibit cross-elasticity of demand and were not in the same relevant market. *Id*. at 496-97. The Second Circuit held that evidence that the demand for a product stays constant even when its price goes up relative to the price of the purported substitute constitutes substantial evidence that the product is in its own relevant market. *Id*.

Although the nomenclature is different, the test for measuring whether there is a relevant market or a relevant submarket is the same – *i.e.*, cross-elasticity of demand. As stated in *PSKS, Inc. v. Leegin Creative Leather, Inc.*, 615 F.3d 412, 418 (5th Cir. 2010), "the requirements for pleading a submarket are no different from those for pleading a relevant broader market." Similarly, in *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1080 (D.D.C. 1997), the court found a

relevant submarket because the products in question and their purported substitutes "exhibit a low cross-elasticity of demand" are because the substitutes "are not able to effectively constrain the [defendant's] prices." *See also H.J. Inc. v. Int'l Tel. & Tel.*, 867 F.2d 1531, 1540 (8th Cir. 1989) ("the same proof which establishes the existence of a relevant product market also shows (or … fails to show) the existence of a product submarket").

The critical question then is whether Amex card services show a high degree of cross-elasticity of demand with the alternative services offered by MasterCard, Visa and Discover. If there is low or no cross-elasticity between Amex and those alternative credit card services, then there is an Amex-only relevant submarket. Below, the MPs analyze this question, first under the assumption that the market is one-sided (meaning that no indirect network effects are found) and then under the assumption that the market is two-sided.

1. Assuming the Relevant Market Is One-Sided There Is an Amex-Only Submarket

If the relevant market is determined to be one-sided, the analysis is simple. The one-sided market covers the sale of credit card services to merchants and the question is whether Amex can raise its merchant discount rate without merchants switching to only MasterCard, Visa and Discover. If Amex can raise its price without merchants dropping its cards, then there is low cross-elasticity between Amex and the other card networks and Amex is in its own relevant submarket. This is because the existence of these other card networks would not constrain Amex's ability to raise price above the competitive level. There is substantial evidence that Amex can increase its merchant prices without losing any significant number of merchants or any significant sales to MasterCard, Visa or Discover. *See* SAMF § III.A-F (collecting proof). In its motion, Amex does not even dispute this evidence.

Nevertheless, Amex argues that the MPs' relevant submarket analysis is somehow

precluded by the Second Circuit's discussion of cardholder insistence and *market power*. Amex Br. 12-14. This argument is a complete *non sequitur*. The Second Circuit said nothing about the effect of insistence on *relevant market*.[6] Furthermore, if the MPs directly prove an anticompetitive effect within a defined relevant market or submarket, it is not even necessary for them to separately prove market power.[7] *See K.M.B. Warehouse v. Walker Mfg.*, 61 F.3d 123, 129 (2d Cir. 1995) ("if plaintiff can show actual adverse effects on competition … we do not require a further showing of market power"); *Geneva*, 386 F.3d at 509 (if plaintiff "can demonstrate an actual adverse effect on competition" then "there is no need to show market power in addition"); *Todd*, 275 F.3d at 206-07 ("in this Circuit a threshold showing of market power is not a prerequisite for bringing a §1 claim.… If a plaintiff can show an actual adverse effect on competition … we do not require a further showing of market power").

Here, the MPs will not need to separately prove market power because they will introduce direct evidence of adverse effects on competition, including the elimination of horizontal price competition from MasterCard and Visa, the exclusion of competition from Discover, the establishment of barriers to entry or expansion and the destruction of consumer choice. SAMF § IV.D. Furthermore, even if the MPs needed to separately prove market power they can easily do so by showing that Amex has the power to force merchants to agree not to steer, which merchants would not do in a competitive market. *See id.* § III.D-F (attempts by MPs to negotiate with Amex have been unsuccessful), § IV.D.1-3 (expert opinions regarding Amex's anticompetitive use of

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[6] The Second Circuit's discussion of the relevant market appears in Section B.1 of its Opinion (838 F.3d at 196-200) and does not even mention cardholder insistence. The Court's discussion of insistence occurs in Section B.2 of the Opinion (*id.* at 200-204), which addresses "Market Power" – not relevant market. *Id.* at 200.

[7] In support of its position, Amex cites to the MPs' expert reports, the First Amended Complaint and the MPs' Opposition to Amex's 2013 Motion for Summary Judgment. Amex Br. 12. *All* of the material cited discusses market power – not relevant market.

market power); *see also Kodak*, 504 U.S. at 464 ("Market power is the power to force a purchaser to do something that he would not do in a competitive market"); *American Express*, 838 F.3d at 200 (same).

The Second Circuit's discussion of insistence and market power does not prevent the MPs from asserting an Amex-only relevant submarket. It does not even prevent the MPs from demonstrating market power – which they do not have to separately prove in any event.

2. Assuming the Relevant Market Is Two-Sided, there Is an Amex-Only Submarket for the Conduct in Question

If the relevant market is determined to be two-sided, the analysis is somewhat different. While there is still no cross-elasticity of demand between Amex and other credit cards on the merchant side of the platform, we assume there is cross-elasticity on the cardholder side. Thus, if Amex raises its net two-sided price by increasing the price on the cardholder side (*i.e.*, by reducing rewards), we assume there is cross-elasticity of demand and it will lose cardholders and sales to MasterCard, Visa or Discover. However, there is substantial evidence that Amex can raise its net two-sided price by increasing merchant fees while leaving rewards alone without losing sales to other credit cards as cross-elasticity on the merchant side of the platform is weak or non-existent. The Supreme Court acknowledged this evidence. 138 S.Ct. at 2288.

Whether there is cross-elasticity of demand between Amex and the other credit cards and whether the other credit cards constrain Amex's ability to raise the net two-sided price therefore depends on how Amex raises the net two-sided price. If it does so by raising the merchant price while leaving the cardholder price unchanged (or changed less than the merchant price), there is little or no cross-elasticity of demand and the existence of the other credit cards does not constrain Amex's ability to raise the net two-sided price. Amex, of course, wants to determine cross-elasticity of demand by looking exclusively at an increase to the net two-sided price due to a price

increase on the cardholder side of the platform, but in a case where the anticompetitive restraint is directed only at the merchant side of the platform, the MPs can think of no rational basis for that approach. Instead, the MPs submit that the Court should look to whether the existence of the other credit cards constrains the defendant from increasing the net two-sided price by engaging in the conduct in question. Here, that conduct is intended to increase the net two-sided price by increasing merchant price. There is substantial evidence that the existence of the other credit card platforms does not constrain Amex from doing so. SAMF §III.A-F. As a result, there is substantial evidence that the conduct here in question should be judged in an Amex-only two-sided relevant submarket.

B. Amex-Only Submarkets Are Not Contrary to the Supreme Court Opinion

The Government did not assert an Amex-only submarket and the Supreme Court had no occasion to analyze such a submarket. Nonetheless, Amex claims that the Supreme Court opinion forecloses that which it never considered.

Amex first argues that the Supreme Court held that credit card platforms sell "transactions" and do not separately sell services to merchants and cardholders. Amex Br. 8. Amex then states that due to the platform competition for "transactions," an Amex-only submarket is not possible. *Id*. The Supreme Court recognized, however, that the credit card platforms actually sell "separate but interrelated services to both cardholders and merchants" and "offer[] different products or services to two different groups." 138 S.Ct. at 2280. The Court's conclusion that Amex sells "transactions" in competition with other platforms is merely reflective of the Court's conclusion that the facts in the Government case warranted a two-sided relevant market in which both sides of the platform could be combined into one "transaction." The MPs, however, are not bound by that factual conclusion and will present substantial evidence that the criteria for a two-sided

relevant market is not met in this case.

If the facts show that the relevant market should be defined as one-sided, then the proper analysis is to look only at the "separate" sale of services to merchants. If there is no cross-elasticity of demand between the services offered to merchants by Amex and the services offered by other credit card platforms, then Amex is in its own relevant submarket. There is substantial evidence to support this conclusion (*see* SAMF § III.A-F (collecting proof)) and nothing in the Supreme Court Opinion to preclude that analysis.

Amex's contention that there is necessarily "demand elasticity and substitution" for "transactions" in the two-sided market (Amex Br. 10) is similarly flawed. In making this argument, Amex points exclusively to substitution "on the cardholder side" of the market (*id.*) and completely ignores the merchant side of the equation. *Id.* at 9-11. Amex thus violates the Supreme Court's admonition that where the market is two-sided one must look to "both sides of the platform – merchants and cardholders – when defining the relevant market." 138 S.Ct. at 2286.

It may be that Amex is constrained from raising the net two-sided price by increasing the price to cardholders, but that is not the challenged conduct in this case. The challenged conduct here is that Amex is increasing the net two-sided price by increasing the price paid by merchants on the side of the market where there is no cross-elasticity of demand and Amex's ability to raise the net two-sided price price in that manner is not constrained by the existence of other credit card platforms. As a result, an Amex-only two-sided relevant submarket is warranted in this case.

C. *Queen City Pizza* Does Not Prevent an Amex-Only Submarket

Amex claims that the MPs' allegation of an Amex-only submarket is "based on the contractual restraints at issue" and is precluded by *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430 (3d Cir. 1997). Amex Br. 14. As explained below, Amex misreads both *Queen City*

and the MPs' position.

In *Queen City* a Domino's franchisee agreed to exclusively purchase supplies from the franchisor. The franchisee then sued, alleging a relevant market that included only supplies purchased from the franchisor. *Id*. at 435. The court held that there had been competition to be the supplier/franchisor "at the pre-contract stage"; that the plaintiff was not compelled by Domino's market power to accept the contract terms; and that the terms of the competitively entered franchise agreement did not define the relevant market. *Id*. at 440-41.

In *Hack v. Pres. of Yale College*, 237 F.3d 81, 85 (2d Cir. 2000), *Queen City* was interpreted to mean that the "[e]conomic power derived from contractual arrangements … cannot serve as a basis for [defining a relevant market]." In *Smugglers Notch Homeowners Assn. v. Smugglers Notch Management Co.*, 414 Fed. App'x 372, 376 (2d Cir. 2011), the Second Circuit again interpreted *Queen City* to mean that "economic power derived from contractual arrangements" could not define a relevant market and that the power to force the plaintiff to accept anticompetitive terms had to "stem from the market" – not from the contract. Most recently, it was held in *U.S. Airways v. Sabre*, 2017 WL 1064709 at *6, that "critical to the [*Queen City*] analysis was that the plaintiff franchisees voluntarily accepted the contractual restraints and were not forced to accept them as a consequence of defendant's market power." *Sabre* further holds that in *Queen City* the defendant's pre-contract power was constrained by competition from other franchisors and that "*Queen City* thus prohibits a market definition narrowed by contractual restraints that a counterparty willingly assumes in a competitive market." *Id*.

In the current case, the MPs do not assert that Amex's economic power originates from its merchant contracts. To the contrary, the MPs assert that Amex has pre-contract market power that emanates from critical loss analysis that forces the MPs and all other merchants to accept Amex's

anticompetitive terms. *See* SAMF § III.A-G (collecting proof). Critical loss analysis describes the power that Amex derives from the fact that a merchant's gross margin on the sale of goods is far greater than the amount of the anticompetitive overcharge imposed on the merchant by Amex. As a result, a small loss of sales causes the merchant a greater loss than does the Amex anticompetitive overcharge. *Id*. The Supreme Court agrees with this analysis and recognized that merchants cannot afford to be sensitive to increases in the merchant discount rate because "they are likely to lose profitable incremental sales if they do not take all the major payment cards" and because "refusing to accept a major card may cost the merchant substantial sales." 138 S.Ct. at 2281 and n.2.

Thus, unlike *Queen City*, it is Amex's pre-contract economic power that gives it the ability to compel merchants to accept its cards and agree to the anti-steering rules. The anti-steering rules are not the source of Amex's power – they are the exercise of its preexisting power derived from critical loss analysis. *Queen City* therefore has no applicability to this case.

D. A Single Brand Can Constitute a Relevant Market

Amex contends that a single brand cannot constitute a relevant market. The Supreme Court, however, has stated that "this Court's prior cases support the proposition that in some instances one brand of a product can constitute a separate market." *Kodak*, 504 U.S. at 482. Contrary to Amex's assertion, the Supreme Court did not limit this holding to cases where the plaintiff is "locked in" to defendant's after-market parts. *See* Amex Br. 17-18. In support of its holding, the *Kodak* Court cited three cases – *NCAA v. Board of Regents of the Univ. of Oklahoma*, 468 U.S. 85, 101-02, 111-12; *International Boxing Club of N.Y. v. U.S.*, 358 U.S. 242, 249-52 (1959); and *IBM v. U.S.*, 298 U.S. 131 (1936) – none of which involved a lock-in scenario. The Supreme Court even differentiated the cited cases from cases that did involve a lock-in scenario.

504 U.S. at 482, n.31. Furthermore, Amex ignores the most directly applicable authority, *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litig.*, 562 F. Supp. 2d 392, 404-05 (E.D.N.Y. 2008). In that case, Judge Gleeson followed *Kodak* and held that the anticompetitive injury caused by MasterCard's anti-steering rules "plausibly support the existence of a cognizable market that is confined to MasterCard's network services." *Id.* at 404-05.[8]

Conclusion

For all the foregoing reasons, the MPs respectfully submit that Amex's motion should be denied in all respects.

[8] The only case Amex cites in support of its contention that single-brand markets are limited to lock-in spare parts cases is *PSKS v. Leegin*. Amex Br. 17. In *PSKS*, the Court held that the plaintiffs' alleged relevant market was defective because it did not "recognize[] the cross-elasticity of demand for [defendant's] goods." 615 F.3d at 418. Here, it is Amex, not the MPs, who want to ignore cross-elasticity of demand.

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