No. 16-1454

In The Supreme Court of the United States

OHIO, et al.,

Petitioners,

v.

AMERICAN EXPRESS COMPANY, et al.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

BRIEF OF *AMICUS CURIAE* SOUTHWEST AIRLINES CO. IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICUS CURIAE*[1]

Southwest Airlines Co. ("Southwest") carries more domestic airline passengers than any other airline in the United States. It has built its business by driving prices downward and capacity upward. Southwest not only offers lower fares but also forces its competitors to lower their fares in response. As a result, the pro-competitive effects of Southwest's entry are enjoyed by all customers of air travel.

As a low-cost air carrier, Southwest's business model and success depend on its ability to reduce expenses. Southwest has been able to reduce expenses by availing itself of competitive market forces that require suppliers to compete for Southwest's business. Southwest is able to reward suppliers that compete on price and quality with greater sales.

Unfortunately, one area of services has insulated itself from such competitive market forces: credit card services. For this reason, Southwest served as a source of factual information during the proceedings below to illustrate the real-world impact of American Express ("Amex") merchant restraints.

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[1] No party's counsel authored any part of this brief. No party or party's counsel contributed money to fund preparing or submitting this brief. No persons or entities other than the *amicus* or its counsel contributed money that was intended to fund preparing or submitting the brief. Counsel of record received 10-days' notice of the intent to file this brief. Consent to file this brief was granted by all parties.

Some of the more significant costs incurred by Southwest are the fees it pays to credit card issuers. The overwhelming majority of airline tickets are purchased with credit cards. This means that Southwest – and its customers – are particularly exposed to the supra-competitive prices charged by credit card networks.[2]

Due to Amex's merchant restraints, Southwest is barred from rewarding networks who competitively price credit card services with greater sales. Insulated from such normal market forces, the prices for credit card services, and those of Amex in particular, have risen dramatically even as the cost of providing such services has decreased. The decision below perpetuates this broken market by insulating Amex from having to compete for merchant business. This results in hundreds of millions (if not billions) of dollars in excess costs incurred by Southwest, other merchants, and their customers. When Southwest's costs increase, its fares increase as well, which in turn increases the prices paid not only by Southwest customers, but also by customers on competing airlines who may elect not

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[2] The trial record reflects, for example, that Southwest paid approximately \$353 million in credit card fees in 2011. Of those fees, Amex represented approximately \$112 million. The record reflects that Amex consistently has far and away the highest cost of payment compared to its competitors. Southwest's payments to Amex have increased dramatically over time, both in raw dollar volume and in terms of discount rate, even as the cost of providing credit card merchant services has decreased.

to compete with the lower fares that would be offered by Southwest.

Southwest has an interest in competing in a market free of the anticompetitive restraints posed by Amex's merchant restraints. When these restraints are in force, credit card issuers like Amex are free to increase their prices and need not engage in meaningful negotiations about those prices. Without such restrictions, credit card issuers like Amex are required to compete for business – for example, by offering substantial price concessions in exchange for a commitment not to pit Amex against other credit card networks at the point of sale. In short, if the merchant restraints did not insulate Amex from normal market demands, Amex would be required to actually compete.

Simply put, merchant restraints lead to higher prices, less output, and fewer alternatives. Southwest has an interest in seeing them eliminated.

STATEMENT OF THE CASE

As the district court found, in a normal competitive market "[m]erchants routinely attempt to influence customers' purchasing decisions, whether by placing a particular brand of cereal at eye level, discounting last year's fashion inventory, or offering promotions such as 'buy one, get one free.'" Pet. App. 67a. But the district court further found that Amex's antisteering provisions cause this dynamic to be "absent in the credit card industry." *Id.*

With that background, the court properly concluded that the " 'market is broken' because the GPCC [general purpose credit and charge] networks do not compete on the basis of merchant pricing." Pet. App. 198a. Simply stated, the person who decides what product to use (the customer) is not the person who directly pays the costs of that decision (the merchant). Amex competes not by offering more favorable prices or terms to merchants, but by offering inducements to cardholders to use higher-priced cards. Amex's merchant restraints – including its anti-steering rules – are designed to maintain that separation, insulating Amex from competing on prices charged to merchants. *Id.* 197a.

The district court determined that Amex's anti-steering provisions "vitiat[e] an important source of downward pressure on Defendants' merchant pricing, and result[] in higher . . . prices across the network services market." *Id.* 196a. The court also found that "inflated merchant discount rates are passed on to all customers – Amex cardholders and non-cardholders alike – in the form of higher retail prices." *Id.* 210a-211a.

These findings were supported in part by the testimony of Southwest Director of Payment Strategies Christopher Priebe, who was subpoenaed by the Government to testify at trial. Mr. Priebe testified that Southwest does not have a practical business alternative to purchasing credit card services offered by the major networks, especially Amex. Amex is second (behind Visa) in annual charge volume with Southwest, but it wields a unique amount of market power and does so aggressively. The trial record reflects that payments via Amex represented roughly one-fourth of Southwest's customer revenue. Southwest's payments to Amex dramatically increased over time, both in raw dollar volume and as expressed in terms of discount rate, the percentage of each charge owed to the card network. In other words, Amex's price to Southwest has steadily increased relative to its competitors despite Southwest's Amex charge volume increasing dramatically. This outcome is the opposite of what occurs in a properly functioning market where discounts or other benefits are provided for increased purchase volumes.

Amex attracts cardholders by offering benefits such as reward points and other cardholder perks. Amex claims it attracts high-value customers by offering its customers greater inducements, which they perceive as free – when in fact the rewards granted to Amex card members come at the expense of higher fares for all consumers. Amex can do this because merchants, with rare exceptions, have no economic ability to refuse Amex's terms. The trial record shows that Amex actually measures this market power and calls it "cardholder insistence."

Amex uses that insistence to threaten to turn consumers away from merchants who try to inject competition into the credit card market or even inform their own customers as to the relative prices of various payment forms. As Mr. Priebe testified, Southwest is forced to consent to Amex's supra-competitive price increases because it does not have the practical business alternative of not purchasing from Amex. Thus, because Southwest and other merchants cannot refuse to purchase card services from Amex, Amex is able to essentially impose contract terms, including the merchant restraints, at will.

Amex's merchant restraints are an important, if not essential, tool for Amex to protect itself from horizontal inter-brand price competition. Without them, customers of Southwest (and other merchants) could decide to use less-expensive cards or non-card payment methods, and could even receive economic incentives from merchants to do so. Mr. Priebe testified that if Southwest were permitted to educate and incentivize its own customers to make informed payment choices, it would consider offering customers an incentive for using alternate, less expensive payment methods, such as Rapid Rewards points (the currency for Southwest's loyalty program). Any given customer would therefore be able to choose between using Amex (and receiving the Amex rewards) or using the alternate method (and receiving the rewards attached to that method). Customers would be better off by definition: they would be free to choose the more valuable reward for them. Further, merchants could send price signals to customers, making credit card companies compete for merchant business just like every other supplier.

If enough customers chose the Rapid Rewards option, Southwest would materially lower its costs. Consistent with its business philosophy as a low cost carrier, lower costs permit Southwest to lower its fares, which benefits not only Southwest's customers but also the customers of competing airlines. The history of the American aviation industry also shows that lower costs for Southwest permit it to increase capacity for air passengers in the United States, thereby generating more passengers on more routes. A fully-informed choice to pay with an alternate method and receive a different reward would also inherently increase consumer satisfaction, the very justification Amex offers for its own rewards program. Again, all of this would result from a simple and inherently pro-consumer choice of payment and reward options in a properly functioning market.

Amex's merchant restraints bar Southwest from offering this choice or even communicating with its own customers about such a choice. Instead, merchants like Southwest are prevented from offering alternative payment options to customers who state an initial desire to pay with Amex, and are barred from even providing customers truthful information about the costs of various cards and the effect of those costs on prices. Simply put, the merchant restraints are designed to, and do, insulate Amex from price and quality competition. Based on evidence like this from Southwest and other market participants, the district court entered an injunction that enabled merchants to steer consumers to lower cost forms of payment and to use the prospect of steering to negotiate lower rates with card issuers. Pet. App. 298a-300a, 303a-309a.

The Second Circuit panel reversed and remanded with an instruction to find in favor of Amex. Notably, the panel did not set aside the findings described above as clearly erroneous; rather, it determined that the government had not properly defined and proven harm in a single "market" that includes both network services purchased by merchants and cardholder services purchased by consumers. *See id.* 49a-51a ("Here, the market as a whole includes both cardholders and merchants" and "the Plaintiffs' initial burden was to show that NDPs made all Amex consumers on both sides of the platform – i.e., both merchants and cardholders – worse off overall.").

SUMMARY OF THE ARGUMENT

Certiorari should be granted for two reasons.

1. The panel's decision is in direct tension with this Court's precedents (a) establishing that each side of a two-sided platform is a separate product market and (b) defining relevant product markets. No less an authority on antitrust law than Professor Hovenkamp has criticized the decision as "incorrect."

2. Whether a market participant can impose anticompetitive restraints on customers in one market in order to gain an advantage over customers in another market is a question of exceptional importance that impacts millions of U.S. consumers. This Court should have the last word on this important issue of federal antitrust law.

ARGUMENT

I. The panel's decision conflicts with relevant decisions from this Court.

In two ways, the panel "decided an important federal question in a way that conflicts with relevant decisions of this Court." Supreme Court Rule 10(c).

First, the panel held that the relevant antitrust market consists of services on both sides of a "two-sided market" involving "both merchants and cardholders." Pet. App. 49a-50a. This decision conflicts with this Court's longstanding precedent that each side of a two-sided platform constitutes a separate product market. *See, e.g.*, *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 610 (1953) (newspaper's news sales and advertising sales are in "separate though interdependent markets").

As Professor Herbert Hovenkamp explains in his just-released 2017 supplement to his treatise, "the court [in *Amex II*] failed to see . . . that under antitrust policy *competition* should choose the optimal mix of revenue as between the two sides, an issue obfuscated by the incorrect finding that these two elements of revenue were within the same antitrust market." P. Areeda & H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, 2017 Supp. § 562e. Professor Hovenkamp surmises that the appellate panel "was apparently misled by the fact that Amex obtained revenue from sources, merchant fees and consumers, but the fact that a firm obtains its profits from two different, non-substitutable groups does not serve to place the two groups into the same market." *Id.* § 565.

Second, by holding that the relevant antitrust market included services to both merchants and cardholders, Pet. App. 49a-50a, the panel's decision conflicts with this Court's precedent on how to define the relevant product market. A product market is "determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962); *accord United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956) (holding that although substitutes need not be identical, they must be "reasonably interchangeable by consumers for the same purposes" to be included in the same product market). While the panel decision combined these markets, it was wrong to do so. It is undisputed that the services and inducements Amex offers to its cardholder consumers are not reasonably interchangeable with the services, prices, and terms that Amex offers to merchant consumers.

II. The panel decided an important question of federal law that has not been, but should be, settled by this Court.

In addition, the panel's decision involves the exceptionally important question of whether a market participant can impose anticompetitive restraints on one set of customers in one market in order to gain an advantage over customers in another market. This is "an important question of federal law that has not been, but should be, settled by this Court." Supreme Court Rule 10(c). The answer to this question affects tens (and perhaps hundreds) of millions of consumers. This Court should have the last word on this issue.

The district court found that Amex's anti-steering provisions were anticompetitive restraints on merchants, and that finding is not clearly erroneous. Amex's merchant restraints destroy the price signals between sellers and buyers that would otherwise exist in a competitive market. Specifically, the merchant restraints prevent merchants from communicating price signals to consumers. Thus, the panel's decision permits Amex to use anticompetitive restraints to extract supra-competitive prices in one market while growing its market power (which it calls "insistence") in another.

The panel's decision also implicates another exceptionally important question of antitrust law: how the rule of reason applies in two-sided transactions. Although it is highly doubtful that the Amex platform even constitutes a two-sided market (because merchants do not gain from increased output on the cardholder side of the market, as such growth is actually to their detriment), the panel's decision suggests the proper analysis is to compare the costs of anticompetitive restraints on one side with the gains on the other. Pet. App. 49a-53a. But that approach is unworkable as courts would have to pick winners and losers among different economic actors, would have to find a way to compare anticompetitive burdens on one side (such as merchant fees) with effects on the other (such as cardholder costs and benefits), and would have to determine how much of the anticompetitive costs must be transferred from one set of customers to the other to make the restraint lawful. This Court should not permit such an unworkable rule to gain traction in the federal courts.

Amex correctly told the Second Circuit in a separate lawsuit that comparisons like these cannot be made.[3] Lower courts would have to compare the apples of anticompetitive costs with the oranges of inducements to cardholders, but without any guidance about how to determine if the oranges outweigh the apples. This is not the hallmark of a rule that will stand the test of time.

Finally, the great importance of this issue is underscored by its impact on innovation. The district court found that Amex's anti-steering rules cause a "stunting [of] innovation" in the market for payment networks: "anti-steering rules . . . are responsible for inhibiting the development of several proposed merchant-owned payment solutions," including the MCX system in which Southwest was a participant. Pet. App. 213a. In short, the development of competitive low-cost payment solutions is restrained by Amex's merchant restraints because those restraints restrict

[3] *See* Br. *Amicus Curiae* of American Express in Supp. of Affirmance at 6, *United States v. Visa U.S.A., Inc.*, 344 F.3d 229 (2d Cir. 2003) (No. 02-6074), available at 2002 WL 32828497 (stating that "no amount of [card] issuer competition can eliminate" the anticompetitive effects at the network level).

merchants from offering those alternatives to customers on more attractive terms (i.e., lower price).

CONCLUSION

Southwest respectfully submits that certiorari should be granted.

July 6, 2017

Respectfully submitted,

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