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 Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE MERCHANT ADVISORY GROUP AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

JAMES A. WILSON*
*Counsel of Record
ROBERT N. WEBNER
KENNETH J. RUBIN
NATHAN L. COLVIN
VORYS SATER SEYMOUR AND PEASE, LLP
52 E. Gay Street
Columbus, OH 43215
(614) 464-5606
jawilson@vorys.com

Counsel for Amicus Curiae The Merchant Advisory Group

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INTEREST OF AMICUS CURIAE[1]

The Merchant Advisory Group ("MAG") was founded in 2008 by a small forward-looking group of merchants dedicated to driving positive changes in the payments field through multi-stakeholder collaboration. Today, MAG represents more than 100 of the largest merchants in the United States. MAG's members employ nearly 11.5 million people and account for nearly $2.6 trillion in annual sales online and at over 430,000 brick and mortar locations across the United States. Of those annual sales, more than half—approximately $1.5 trillion—are conducted via payment cards, representing more than 41 billion individual payment card transactions.

Every year, U.S. merchants collectively pay tens of billions of dollars in payment card transaction fees. MAG's mission is to create an improved and equitable payments ecosystem. Consequently, MAG is a key participant in industry events and ensures that the merchant voice is a part of the dialogue surrounding evolving payments and related matters. MAG also regularly monitors pending cases (like this one) that present legal issues that significantly impact the merchant industry.

MAG's members have a strong interest in the legal standards that protect merchants from the

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[1] All parties have consented to the filing of this brief. Pursuant to Supreme Court Rule 37.6, no counsel for a party authored this brief in whole or in part, and no party or counsel for a party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than amicus, its members, or its counsel made a monetary contribution intended to fund this brief's preparation or submission.

anticompetitive practices of Respondents American Express Company and American Express Travel Related Services Company, Inc. (collectively, "Amex"). MAG submits this brief to assist the Court in understanding how payments work in the real world in which merchants operate, and to highlight the Second Circuit's failure to recognize the harm that MAG's members and other merchants actually experience as a result of Amex's anticompetitive practices. If the Second Circuit had considered these market realities evidenced in the trial court record—as it should have done under basic antitrust jurisprudence—it would have affirmed the District Court's decision. Instead, the Second Circuit relied on abstract economic theories and papers from outside the record to support Amex's decision to use non-discrimination provisions ("NDPs") to prevent merchants from creating a competitive payment ecosystem. If Amex is successful in exempting its anticompetitive practices from antitrust liability, it will be the merchants, their employees, and American consumers who literally pay the price.

SUMMARY OF ARGUMENT

In *Eastman Kodak Co. v. Image Technical Servs., Inc.*, this Court made clear that antitrust claims should be resolved based on actual market conditions established by the record. *See* 504 U.S. 451, 466-67 (1992). The Second Circuit's decision in this case departs from that precedent in two key respects.

First, in defining the relevant market for antitrust purposes, the Second Circuit declined to follow this Court's oft-expressed guidance that the market must include those products or services that are "reasonably interchangeable by consumers for the same purposes" and that exhibit "cross-elasticity of demand" between the product itself and substitutes for it. *United States v. E.I. DuPont de Nemours & Co.*, 351 U.S. 377, 394-95 (1956). Without citation to any precedent, the Second Circuit instead defined the relevant market in this case to include *other* non-interchangeable products and services whose prices *might* be affected by the product and services allegedly restrained. The net result of the Second Circuit's decision is to ignore the actual market realities that affect merchants, by including very different sets of customers, products, and competitors into a single market, without regard to whether the companies or products actually compete with one another. There is no basis in antitrust law for defining a market in such a way.

Second, in assessing whether Amex has market power, the Second Circuit declined to follow this Court's guidance that market power "is the power 'to force a purchaser to do something that he would not do in a competitive market.'" *Kodak*, 504 U.S. at 464 (quoting *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 14 (1984). The District Court reviewed the evidence presented and identified numerous ways in which market realities demonstrate the market power wielded by Amex over merchants. But the Second Circuit did not consider, much less overturn, these factual findings. Instead, it decided that any market power and anticompetitive behavior wielded by Amex against merchants is justified because it *might* result in a savings for Amex cardholders. This sort of balancing of proven, anticompetitive market realities in one area, with hypothesized favorable market effects in another area, is wholly inappropriate under the Sherman Act. *See United States v. Topco Association, Inc.*, 405 U.S. 596, 609-12 (1972) ("If a decision is to be made to sacrifice competition in one portion of the economy for greater competition in another portion, this too is a decision that must be made by Congress and not by private forces or by the courts."). However, even if the Court finds such a balancing appropriate when a two-sided platform is at issue, the traditional Rule of Reason burden-shifting approach to weighing anti-competitive and procompetitive effects—which the District Court followed, and the Second Circuit eschewed—is the appropriate framework to apply.

The Court should reverse the decision below.

ARGUMENT

The Second Circuit's decision reflects the danger of courts relying on abstract economic theory rather than on actual market realities established by evidence presented at trial.

In *Eastman Kodak Co. v. Image Technical Servs., Inc.*, this Court made clear that antitrust claims should be resolved based on real-world market conditions established by the record: "Legal presumptions that rest on formalistic distinctions rather than *actual market realities* are generally disfavored in antitrust law. This Court has preferred to resolve antitrust claims on a case-by-case basis, focusing on the 'particular facts disclosed by the record.'" 504 U.S. 451, 466-67 (1992) (quoting *Maple*

Flooring Manufacturers Assn. v. United States, 268 U.S. 563, 579 (1925)) (emphasis added). *See also United States v. Concentrated Phosphate Export Ass'n*, 393 U.S. 199, 208 (1968) ("In interpreting antitrust laws, . . . [w]e must look at the *economic reality* of the relevant transactions.") (emphasis added); *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 325-27 (1961) (explaining that the Court has repeatedly explained that it must discern the "practical effect" of contracts under antitrust law).

The District Court respected these admonitions. It held a seven-week trial that included testimony from more than thirty fact and four expert witnesses (resulting in nearly 7,000 transcript pages in testimony) and the acceptance of more than 1,000 exhibits into the record. Pet. App. 72a. The District Court's opinion reflects its careful evaluation of the actual evidence presented, as each of its factual findings is supported by too many citations to the record to count. Pet. App. 63a-293a.

In contrast, the Second Circuit's decision ignores the record (and the District Court's factual findings regarding the same). Instead, the Second Circuit relies almost entirely on academic articles that have not been subjected to cross-examination or the rules of evidence. Pet. App. 1a-54a. In fact, the Second Circuit's decision contains just three citations to the trial record, but more than *29* citations to academic articles—essentially adopting the contents of those articles as unverified and undisclosed expert testimony. Pet. App. 1aa-54a. In particular, the Second Circuit erroneously ignored the market realities established by the record, and experienced by MAG's members on a daily basis, in favor of abstract economic theory on two critical points discussed below: (1) the relevant market and (2) the existence of Amex's market power.

I. The Second Circuit's Collapse of a Two-Sided Platform Into a Single Market Ignores the Market Reality That Merchants are Distinct Customers of Amex

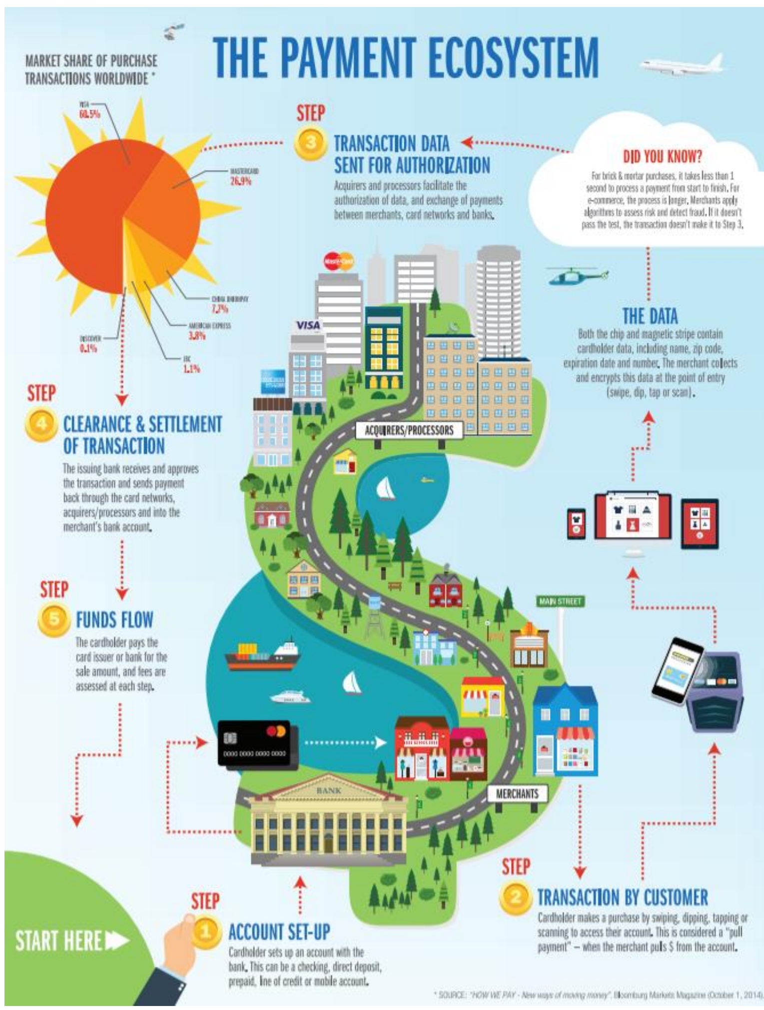
Amex operates in what is called a "two-sided platform" or "two-sided market" in that it provides distinct services to two different (but interrelated) categories of customers. Pet. App. 70a. On one side, Amex sells the extension of credit and issuance of credit cards to consumers; on the other side, Amex sells card acceptance services to merchants. Pet. App. 70a.[2] Consistent with this Court's prior decisions, the District Court treated each side of this platform as a separate market for purposes of antitrust analysis. The Second Circuit, however, improperly defined the "relevant market" in this case by collapsing both sides of the platform into a single market. This decision is unmoored from this Court's jurisprudence and the everyday market realities experienced by MAG's members.

A. The Realities of the Payment Card Ecosystem

Defining the relevant market in this case requires an understanding of the payment ecosystem for

[2] Amex abandoned any argument that debit cards and other alternative payment types should be considered a part of the relevant market for purposes of this case. Pet. App. 5a.

credit cards in the United States, through which trillions of dollars flow on an annual basis. Pet. App. 74a. In 2016 Amex, Visa, MasterCard, and Discover processed more than $3 trillion in purchases. *See* Nilson Rep. Issue 1103 (HSN Consultants Inc., Carpineria, Cal., Feb. 2017). An illustration of the platform can be found at MAG's website:



The Merchant Advisory Group, *Know Your Payments: Transaction Basics*, available at http://www.knowyourpayments.com/transaction-basics/.

On one side of the platform, consumers obtain credit cards by applying for a line of credit from an issuing bank, which in this case is Amex. Pet. App. 75a-76a, 81a-82a. (Visa and MasterCard rely on other actors to serve as the issuing bank for cards that utilize their networks. Pet. App. 75a-76a, 81a-82a.) In turn, these cardholders may then access their line of credit by using the card to make purchases at merchants. Pet. App. 75a-76a.[3]

On the merchant side of the platform, however, a cardholder's card can only be used for payment if the merchant has agreed to accept cards from the network associated with the card (i.e., Amex, Visa, MasterCard or Discover). Pet. App. 75a-83a. If the merchant has agreed to accept the card, it collects cardholder data from the card at the point of sale (i.e., the swipe, dip, tap, or scan of the card), and transmits that data to the acquiring bank, which in this case is also Amex. Pet. App. 82a.-83a.[4] (Unlike Amex, Visa and MasterCard also rely on other actors to serve as acquiring banks to facilitate transactions within their card networks. Pet. App. 81a-82a.)

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[3] *See also* The Merchant Advisory Group, *Know Your Payments: Transaction Basics*, http://www.knowyourpayments.com/transaction-basics/

[4] *See also* The Merchant Advisory Group, *Know Your Payments: Transaction Basics*, http://www.knowyourpayments.com/transaction-basics/

At this point, the acquiring bank effectively has a receivable (the amount owed by the cardholder), and a payment obligation (the amount owed to the merchant), and the acquiring bank discharges the payment obligation by sending payment to the merchant's bank account. Pet. App. 82a-83a. That payment to the merchant, however, is reduced by the fees charged to the merchant by the acquiring bank, the issuing bank, and the network for the "privilege" of accepting the card. This bundle of fees imposed upon merchants is called the "merchant discount fee." Pet. App. 82a-83a.

Merchants pay billions of dollars every year in such fees. In 2014, merchants paid more than $52 billion in merchant discount fees. *See* Nilson Rep. Issue 1041 p. 12 (HSN Consultants Inc., Carpineria, Cal., May 2014). Merchant discount fees represent one of the most significant costs a merchant faces. Pet. 221a-222a. The record in this case bears this out. A witness from Alaska Airlines, for example, testified that merchant discount fees cost the company approximately twice as much as its U.S. labor costs. Pet. App. 222a. And a witness from Ikea testified that merchant discount fees are its fourth highest cost after labor, advertising, and rent. Pet. App. 222a.

Returning to the cardholder side of the platform, the transaction culminates with the issuing bank (again, Amex in this case) invoicing the cardholder for purchases on a monthly basis, and the cardholder paying the issuing bank pursuant to the terms of the agreement between the cardholder and issuer (which may include additional fees and charges assessed to the cardholder). Pet. App. 75a.-76a.[5]

B. The Second Circuit Ignored Market Realities Experienced by Merchants When it Collapsed the Two-Sided Platform Into a Single Market

1. The Evidence Provided No Basis upon which to Collapse the Two Sides of the Platform into a Single Market

The Second Circuit's decision is detached from the market realities experienced by MAG's members and other merchants as disclosed in the trial record. In every aspect of their businesses—*except for credit card acceptance*—merchants bargain for the goods and services they acquire by seeking more favorable pricing and/or terms. Pet. App. 216a. A merchant might, for example, negotiate a volume discount with a supplier. Pet. App. 216a. Or a merchant could issue a request for proposal to obtain a broad range of solicitations for different quality services or solutions at different prices. Pet. App. 216a.

As demonstrated by the record, however, the competition for merchant payment card acceptance differs from every other segment of a merchant's business—*because there is no competition*. The lack of competition, in turn, eliminates any bargaining power merchants might otherwise have with Amex.

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[5] *See also* The Merchant Advisory Group, *Know Your Payments: Transaction Basics*, http://www.knowyourpayments.com/transaction-basics/

As the evidence presented at trial demonstrated, the card acceptance services side of the platform is highly concentrated. There are just four companies offering such services: Visa has 45% market share, followed by Amex with 26.4%, MasterCard with 23.3%, and Discover with 5.3%. Pet. App. 151a. Further, as acknowledged by the Second Circuit, this independent side of the platform is "characterized by formidable barriers to entry." Pet. App. 17a. And with respect to Amex in particular, its cardholders are highly loyal and insist that merchants accept Amex cards. Pet. App. 156a-165a. Consequently, and as discussed in further detail in the following section, the record in this case establishes that merchants have little choice but to engage Amex's card acceptance services on Amex's terms.

In contrast to the inert and highly concentrated merchant-facing side of the platform—as Amex admitted, the District Court found, and the Second Circuit declined to disturb—the card issuance side of the platform is fragmented and "fiercely" competitive. Pet. App. 233a, 238a. On this side of the platform, Amex's competition is not with Visa and MasterCard, but rather with ***thousands*** of other issuing banks, which include JPMorgan Chase, Bank of America, Citibank, Wells Fargo, HSBC, Discover, Barclays, U.S. Bank, and Capital One among many others. Pet. App. 70a, 84a; *see also* ValuePenguin, *Largest Credit Card Issuers: 2017 Market Share Report*, available at https://www.valuepenguin.com/largest-credit-card-issuers.

The trial record reflects the many ways in which Amex and its thousands of competitors battle for cardholders by attempting to differentiate themselves. For example, the issuing banks offer different incentives to cardholders that can take the form of rewards (e.g., cash back, "points" that can be redeemed for value, frequent flyer miles, statement credits, gift cards, etc.), airport lounge access, purchase protection, rental car insurance, statement credits, and other items. Pet. App. 81a-82a, 89a. Similarly, Amex and its competitors also co-brand their cards with certain merchants (e.g., the Delta SkyMiles Credit Card issued by Amex, or the Marriot Rewards Premier Credit Card issued by Chase Bank) to entice customers with the possibility of earning rewards and benefits from the merchant. Pet. App. 76a, 238a. Card issuers constantly compete to offer the most attractive or innovative rewards package to their customers. *See* Aaron Back, *Competition Over Cards Runs Too Hot*, THE WALL STREET JOURNAL Jan. 26, 2017, at B12 ("Rewards costs are climbing as card issuers scramble to keep up with each other's cash back and travel point offers."). And at a more fundamental level, Amex and its fellow issuing banks must also compete with one another on the prices they charge cardholders for the extension of credit, i.e., the interest rate, annual fees, and float periods charged to cardholders. Pet. App. 81a-82a.

That Amex and its competitor issuing banks fiercely compete is perhaps illustrated no better than by their ubiquitous advertising campaigns for cardholders. Pet. App. 92a. Consider, for example, the card issuers' steady stream of television commercials or the constant credit card offers that the public encounters on a daily basis through the mail, online, or in print. Potential cardholders are inundated with these advertising campaigns because competition for their business is so fierce.

The sharp contrast between the merchant-facing side of the platform and the cardholder-facing side of the platform—all of which was shown by evidence presented at trial—establishes that the Second Circuit had no basis in the record upon which to collapse the two sides of the platform into a single market. The services offered by Amex on each side of the platform are not interchangeable (and the Second Circuit did not conclude otherwise). And the "commercial realities faced by consumers" on the *card issuance* side of the platform are wholly different from those faced by merchants on the *card acceptance* side of the platform. *Kodak*, 504 U.S. at 482. On one side cardholders have thousands of choices and benefit from fierce competition, while on the other side merchants have few to no choices and face escalating costs instead of competition for their business. The mere fact that cardholders and merchants are both customers of Amex does not make them part of the same market for purposes of antitrust analysis.

In short, the Second Circuit's decision to define the relevant market in this case, in contravention to this Court's guidance and the undisturbed factual findings of the District Court, should be reversed. By conflating two different markets, the decision of the Second Circuit protects Amex from having to compete for merchant acceptance—as it should, and just as it competes vigorously with other card issuers for cardholders. The Second Circuit's decision also strips merchants of the ability to use the tools of competition to reduce their cost of acceptance—tools that merchants successfully use to promote competition, and hold down costs, in every other facet of their businesses. That real-world result is not only unfair to merchants; it is at odds with the basic premise of the Sherman Act.

2. The Second Circuit's Disregard for the Record Led to an Erroneous Reliance on Abstract Economic Theory that Bears Little Similarity to the Reality Merchants Face

This Court has explained that the relevant market for purposes of antitrust analysis must include those products or services that are "reasonably interchangeable by consumers for the same purposes" and that exhibit "cross-elasticity of demand" between the product itself and substitutes for it. *E.I. DuPont*, 351 U.S. at 394-95. Importantly, "market definition . . . can be determined ***only*** after a factual inquiry into the 'commercial realities' faced by consumers." *Kodak*, 504 U.S. at 482 (emphasis added).

Remarkably, the Second Circuit tossed this inquiry aside. It (incorrectly) held instead that the two sides of the platform should be collapsed into one simply because they are interrelated, in that prices or restraints implemented on one side of the platform can affect price and demand on the other side (and vice versa). Pet. App. 39a-40a. Even if this finding were true and supported by the record, *interrelatedness* is inherent in every two-sided platform. Pet. App. 77a ("In a two-sided platform, a single firm or collection of firms sells different products or services for two separate but interrelated groups of customers who, in turn, rely on the platform to intermediate some sort of interaction between them."). And prior decisions of this Court dealing with such two-sided platforms nevertheless treated each side of the platform as a distinct market for antitrust purposes. *See, e.g. Times-Picayune Publ'g Co. v. United* States, 345 U.S. 594, 610-13 (1953) (distinguishing the market for newspaper advertisers from the market for newspaper readers). The mere interrelatedness of the two sides of the platform is thus no reason to depart from the traditional treatment of two-sided platforms as two distinct markets, and the Second Circuit offered no rationale for why it should.

Indeed, two leading economists have recently explained that there is no economic or legal reason to treat two-sided platforms any differently:

> The 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. We show that many of the claims about two-sided markets, such as the claim that interchange fees maximize output, are in fact exactly the

> same as the features of one-sided markets with promotion. The reasoning used in Amex to exonerate Amex's use of a no-steering rule and to justify a departure from the usual litigation procedure for evaluation of vertical restrictions in one-sided markets lacks economic foundation. 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 restrictions.

Dennis W. Carlton & Ralph A. Winter, *Vertical MFN's and the Credit Card No-surcharge Rule*, at 40 (working paper available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2982115). (Of course, these are not among the economists the Second Circuit decided to credit in lieu of the evidence that was actually presented to the district court at trial.)

What is more, the Second Circuit's decision to collapse the two markets into a single market departs from this Court's guidance on measuring the relevant market. For decades, this Court has made clear that the goal of defining a market is to include those products and services that compete with one another: "Interchangeability of use and cross-elasticity of demand are not to be used to obscure competition but to 'recognize competition where, *in fact*, competition exists.'" *United States v. Cont'l Can Co.*, 378 U.S. 441, 453 (1964) (quoting *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 326 (1962)) (emphasis added). The Second Circuit, however, undertook no analysis of whether the products on the two sides of the platform are interchangeable and actually compete.

From the perspective of MAG and its members, card issuing services and card acceptance services plainly are *not* interchangeable. There is simply no set of circumstances under which card issuance services *compete* with card acceptance services. These two services are directed at different potential customers, involve different services, and have different purposes. *See* Phillip Areeda & Herbert Hovenkamp, *Antitrust Law*, (2017 Supp.), ¶ 565, p. 104 (The Second Circuit "incorrectly conclud[ed] that the relevant market . . . was not limited to the market for [card acceptance] services but also included consumers . . . . [T]hose two groupings are not substitutes for one another but rather behave more as complements.").

II. The Existence of Market Power Should Be Determined by Actual Evidence, Not by Abstract Economic Theory

Market power "is the power 'to force a purchaser to do something that he would not do in a competitive market.'" *Kodak*, 504 U.S. at 464 (quoting *Jefferson Parish*, 466 U.S. at 14. Market power can be evidenced by the ability of the defendant to control prices or exclude competition. *Fortner Enters. v. United States Steel Corp.*, 394 U.S. 495, 503 (1969). Alternatively, the existence of such power can be inferred from the possession of a predominant share of the market. *See Jefferson*

Parish, 466 U.S. at 17. In this area, too, the Second Circuit eschewed this Court's precedent and favored ivory tower ruminations over the brick and mortar realities confronted by merchants.

A. The Market for Card Acceptance Services is Highly Concentrated and Features Significant Barriers to Entry

The District Court quite properly found that the market for card acceptance services is highly concentrated and "remarkably static." Pet. App. 154a. As discussed above, there are just four companies in the market. Three of those companies (Visa, Amex, and MasterCard) have collectively captured 94.7% market share, and each has in excess of 23% market share. Pet. App. 151a.

The record in this case regarding the fourth company's efforts to enter the market illustrates the significant barriers to entry that exist. Discover launched in 1985 and, in an attempt to break into the market, offered a number of features that were novel at the time. Pet. App. 154a, 203a-204a. These features included a card featuring no annual fee, the very first rewards component, and pricing network services "very aggressively for merchants." Pet. App. 154a, 203a-204a. Notwithstanding these innovations, in more than three decades Discover has obtained just 5.3% market share on the merchant acceptance side of the market. Pet. App. 151a.

What is more, no other company has made a meaningful attempt to enter the market since

Discover did so in 1985. Pet. App. 165a. This is because there are significant setup costs associated with developing a card network infrastructure and branding to attract customers. Pet. App. 153a-154a. Indeed, as the Second Circuit recognized (and Amex admitted), a potential market entrant would face a classic "chicken and egg problem" wherein "a firm attempting entry into the [payment-card] network market would struggle to convince merchants to join a network without a significant population of cardholders and, in turn, would also struggle to convince cardholders to carry a card associated with a network that is accepted at few merchants." Pet. App. 17a-18a, 154a. Discover was able to survive in large part because it had an advantage not available to other potential market entrants: Discover initially was owned by Sears Roebuck and Company, which marketed Discover cards to its already significant population of private label cardholders. Pet. App. 154a-155a.

And finally, the strength of Amex's market power is exhibited by the fact that Amex admitted that it does not view newer digital payment options (e.g., PayPal or Google Wallet) as a threat to its card acceptance services. Pet. App. 155a. The absence of any competitive threat from these participants in the payments ecosystem only serves to strengthen Amex's market power.

In light of these realities, the District Court was correct to find that Amex's "26.4% share of a highly concentrated market with significant barriers to entry suggests that the firm possesses market power." Pet. App. 155a-156a.

B. The Pernicious Effects of Amex's Restraints on Merchants Demonstrate the Overwhelming Strength of Its Market Power

From the merchant's perspective, the Second Circuit's market power decision also erred in disregarding evidence establishing a multitude of pernicious ways in which Amex's market power affects merchants.

1. In a Competitive Market, Merchants Would Behave Differently

Although the Second Circuit acknowledged Amex's relatively large share of the market, it discounted the strength of Amex's market power by attributing it to cardholder satisfaction. Pet. App. 48a. Put another way, the Second Circuit concluded that Amex's market power is justified because it is derived from cardholders' insistence on utilizing Amex cards to obtain its rewards, even if Amex generates cardholder loyalty by utilizing NDPs that quash competition and inflate prices charged to merchants. Pet. App. 48a. The Second Circuit's analysis is fundamentally wrongheaded, because the notion that a company is permitted to behave anti-competitively in one area, in order to incentivize customers in another area, has been long rejected under antitrust law.

The Sherman Act does not authorize courts to make distinctions between good forms of competition and bad forms of competition, but rather reflects the judgment "that ultimately [all forms of] competition will produce not only lower prices, but also better goods and services." *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 423 (1990). The Second Circuit is not authorized to approve of anticompetitive behavior on the merchant side of the platform in exchange for competition on the cardholder side of the platform and thereby substitute its judgment for the results that actual competition would achieve. *See United States v. Topco Association, Inc.*, 405 U.S. 596, 609-12 (1972) ("If a decision is to be made to sacrifice competition in one portion of the economy for greater competition in another portion, this too is a decision that must be made by Congress and not by private forces or by the courts.").

Even if the Court were to find that Amex could use the interrelatedness of the two markets to attempt to justify its anticompetitive restraints, the District Court was correct in finding that the traditional Rule of Reason approach is the best course by which to evaluate the market realities of the two markets.

Merchants know, and can be expected to prove, the harm merchants suffer from the types of rules Amex has imposed. However, to conflate the markets on the two sides of the platform as the Second Circuit did, and thereby to require merchants to prove not only the harm to themselves, but to engage in balancing that harm with a purported "benefit" only Amex claims, impermissibly imposes upon merchants the burden of disproving a speculative argument without having the information possessed only by the party engaging in the anticompetitive conduct. The traditional Rule of Reason framework applied by the District Court requires the party with the best information regarding real market realities to seek to prove the claim or defense. The Second Circuit's novel approach forces merchants to fight unproven speculation as to market power and claimed competitive benefits without even requiring an explanation from the defendant as to those speculative benefits. As the Second Circuit's decision illustrates, such a departure from the well-established Rule of Reason framework is a sure recipe for substituting theoretical economic opinions for actual proof regarding the impact of anticompetitive practices on the real world marketplace.

Moreover, the Second Circuit's focus on whether cardholders benefit from merchants' payment of higher prices—which is a dubious proposition at best, since merchants necessarily must price their goods and services to account for such costs, Pet. App. 220a-221a—ignores the proper measure of market power, which in this case is the ability of Amex to force a merchant to do something "that he would not do in a competitive market." *Kodak*, 504 U.S. at 464. The record reflects that Amex's market power does just that, by forcing merchants like MAG's members to accept Amex when they would otherwise prefer to accept other, much less expensive methods of payment.

Amex's market power is evidenced by its ability to prevent merchants from steering their customers to less expensive forms of payment by forcing merchants to accept its NDPs. Merchants like MAG's members routinely engage in what is called "steering" in order to influence their customers' purchasing decisions. Pet. App. 67a. For example, merchants might alter the way certain products are placed on a shelf, offer discounts on inventory, or offer "buy one get one free" promotions. Pet. App. 67a. In the credit card space, however, merchants are prohibited from steering customers to a preferred and less expensive card network due to Amex's NDPs. Pet. App. 67a. These NDPs prohibit merchants from doing things like indicating a preference for other payment products or attempting to persuade customers to use a different payment product. Pet. App. 94a-95a.

The record shows that in a competitive market merchants would eliminate or limit the NDPs through negotiation and other competitive tools, like the threat of declining to accept Amex credit cards. Pet. App. 217a-218a. The evidence presented at trial showed, however, that such efforts routinely fail due to Amex's market power. For example, an Amex email explained that United Airlines "insists on [the] right to preference Amex competitors that have lower discount rates and this of course is unacceptable to us." Pet. App. 218a. In fact, out of Amex's nearly 6.4 million merchant customers, only 139 (very large) merchants have successfully negotiated a non-standard NDP that permits *any* steering. Pet. App. 94a-97a. And the nature of the steering permitted by the non-standard NDPs is quite limited—the merchants are only permitted to steer toward co-branded cards (e.g. Southwest Airlines can steer customers to the Southwest

Airlines Rapid Rewards Visa) or in one-off promotions, such as a statement credit for using a certain card. Pet. App. 97a-99a.

If merchants were not forced to accept the NDPs, the record shows that they would engage in steering and other tactics to discourage Amex use unless and until Amex reduced its cost of acceptance. Pet. App. 222a. Such steering could take multiple forms. A merchant could, for example, charge customers the actual cost associated with the form of payment they choose (i.e., the merchant could charge a customer one price for cash, a slightly higher price for debit, a higher price for using Visa or MasterCard, and the highest price for using Amex). Pet. App. 101a-102a, 219a. Merchants could also offer other discounts or perks such as free shipping or additional "rewards points" on the purchases made with a credit card that the merchant agreed to favor. Pet. App. 219a. Or a merchant could simply inform its customers about the costs associated with using one form of payment over another. Pet. App. 101a-102a, 219a. Or, simply, a merchant could put a sign up saying "we prefer that you do not use American Express." Pet. App. 101a-102a. But as things stand, merchants are prohibited from even educating their customers, much less in engaging in any steering, because Amex's market power forces them to accept the NDPs.

2. The Realities of How Cardholders Use Credit and Charge Cards Leaves Merchants With Little Choice But to Accept Amex

The evidence presented at trial correctly showed that merchants like MAG's members have no practical choice in deciding whether to accept Amex, largely due to Amex's highly insistent cardholder base.

The trial record established that Amex's cardholder insistence is largely driven by its lavish rewards programs. Pet. App. 157a-158a. For example, an Amex presentation noted that cardholder loyalty is "[d]riven by [the] ability to earn points, miles, or cash rebates" and that many cardholders "use American Express exclusively to consolidate rewards." Pet. App. 157a. Indeed, some of Amex's card offerings encourage centralized spending or "single-homing" by offering bonuses when a cardholder achieves a given level of spending. For example, a holder of Amex's Platinum Delta SkyMiles Card will achieve bonus frequent flyer miles upon surpassing spending thresholds of $25,000 and $50,000.[6]

Amex has also been able to secure significant cardholder loyalty in the space of company cards issued by corporations to employees for travel and other spending purposes. Pet. App. 157a-158a. In

[6] *See* https://www.americanexpress.com/us/credit-cards/card/platinum-delta-skymiles/?eep=25330&linknav=US-Acq-CCSG-Cardmember-SideBySideDelta-DeltaPlatinum-ViewCardDetails-Top.

2013, Amex captured 64.3% of this market, and approximately 70% of Amex's corporate card customers mandate their employees to use Amex cards for business expenses. 158a.

Because cardholder insistence dramatically amplifies Amex's existing market power, the reality is that merchants are practically forced by business considerations to accept Amex and its significant price premiums or risk losing sales they otherwise would make to Amex cardholders. Pet. App. 158a-159a. The trial record amply supports the District Court finding in that regard. A witness from Hilton testified, for example, that it would likely lose approximately two-third of its Amex charge volume if it rejected Amex. Pet. App. 158a-159a. A witness from Ikea testified that it explored dropping Amex, but that surveys of its customers indicated that doing so would result in "suffering a loss in sales." Pet. App. 159a And witnesses from Enterprise Rent-A-Car and Sprint Corporation testified that their companies concluded that they could not drop Amex because they would lose too many sales to insistent Amex cardholders, and Amex corporate card holders in particular. Pet. App. 159a.

There are still other concrete, real-world examples of the effect of cardholder loyalty on Amex's market power. In 2004, The Walgreen Company—which was the ninth largest retailer in the country at the time—decided to terminate acceptance of Amex cards due to the costs associated with Amex's 50-basis point premium over Visa and MasterCard acceptance costs. Pet. App. 162a-164a. After doing so, however, Walgreen had to ultimately reverse course in the face of widespread public outcry from its customers. *Id.* More recently, in 2008, Murphy Oil—a chain of gas stations—ceased accepting Amex cards. Pet. App. 162a-163a. Amex tracked the effects of this decision, and concluded that Murphy Oil's decision was "irrational" because the rate of Amex card insistence among its customers was twice as strong as expected—and in fact Murphy Oil later resumed accepting Amex cards. *Id.*

3. Amex Charges Merchants a Premium When Compared to its Competitors and Price Increases Have Not Caused Loss of Merchant Customers

As the trial record established, Amex carefully tracks cardholder insistence and estimates the incremental volume that brings to merchants who accept Amex. Pet. App. 160a-162a. Because cardholder insistence leaves merchants with little choice but to accept Amex cards, Amex has determined that it can charge merchants a premium price. *Id.* The data in the record shows that, on average, Amex charges merchants significantly more than Visa and MasterCard. In 2013, Amex charged merchants 8 basis points more than Visa, and 3 basis points more than MasterCard. Pet. App. 175a. In certain industries, like travel, that premium is even higher. Pet. App. 176a. While there was some testimony at trial that the difference in cost between Amex and other card brands has eroded over time, the evidence in the record reveals that such erosion is largely attributable to Visa and MasterCard "catching up" to Amex by adopting specific credit card products that carry higher rates that are charged to merchants – higher rates that are comparable to those charged by Amex. Pet. App. 178a-180a.

Amex's market power is further illustrated by merchant response to Amex's price increases. As the District Court found, Amex enacted at least twenty separate and significant price increases that affected millions of merchants between 2005 and 2010, as part of what Amex euphemistically called "Value Recapture initiatives." Pet. App. 166a-172a. Merchants in certain industries with especially high rates of cardholder insistence bore the brunt of these prices hikes. Airline merchants, for example, experienced a 7%-15% increase in prices between 2007 and 2010, which brought in an additional $90 million in revenue for Amex. Pet. App. 167a. Similarly, Amex targeted hundreds of thousands of merchants in the restaurant industry with a 5-15 basis point increase in the discount rate. Pet. App. 168a.

As the District Court found, these significant price increases resulted in little to no attrition of merchants accepting Amex cards. Pet. App. 168a-169a. In fact, Amex witnesses testified that Amex experienced 100% retention among its largest global merchants, and 99.9% retention among its merchants with annual Amex volume of $3-$100 million. Pet. App. 169a. The net result was an additional $1.3 billion in incremental revenue for Amex between 2006 and 2010. Pet. App. 170a. While not dispositive on its own, the District Court's undisturbed conclusion that Amex can control prices that were already at a premium in this manner strongly weighs in favor of finding that Amex wields market power. *See Fortner*, 394 U.S. at 503.

4. The NDPs Further Increase Amex's Market Power Over Merchants

The entire premise of the Sherman Act is that competition will yield improvements in allocation of resources, lower prices, and quality. *See N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 4 (1958). As the trial record in this case shows, the NDPs only serve to increase Amex's already significant market power by reducing interbrand competition and preventing merchants from injecting any downward price pressure into the market.

This real-world consequence of the NDPs is best illustrated by Discover's attempts to gain market share by pricing its services "very aggressively for merchants." Pet. App. 203a-204a. Discover ultimately abandoned its competitive pricing model because the NDPs prevented merchants from steering consumers to Discover. Pet. App. 196a-197a. Without steering by merchants, cardholders had no incentive to switch cards, because they could not see or feel the effects of Discover's lower merchant pricing. *Id*. Thwarted in its attempt to compete for market share via increased volume, Discover took a different course and decided to increase its revenue by raising its prices to merchants. Pet. App. 206a ("Recognizing that its lower prices would not drive incremental volume to its network in a market subject to limitations on merchant steering, Discovery abandoned its low-price business model in 2000 and began raising discount rates in order to more closely align its merchant pricing with that of Visa and MasterCard.").

In fact, Discover's President and CEO testified that the elimination of Amex's anticompetitive NDPs would cause it to once again "aggressively pursue a strategy of lowering [its] prices" for merchants *if* merchants were permitted to steer. Pet. App. 219a. But as things stand, it is Amex's position that there is no reason for it to compete on price. Pet. App. 118a. As one Amex document stated: "We should not compete on costs with [Visa and MasterCard]." *Id*. And the record demonstrates that Amex views the rates charged by Visa and MasterCard as a floor when considering its own merchant discount pricing. *Id*.

As the District Court found (and the Second Circuit did not disturb), Amex and its competitors in the market for merchant acceptance are "largely insulated from the downward pricing pressure ordinarily present in competitive markets" and "the NDPs create a competitive environment in which there is virtually no check on the networks' incentives or ability to charge higher prices to merchants." Pet. App. 197a. In reality, the market for merchant acceptance is not at all true market in which competitors vie for market share by offering lower costs or better services.

* * *

Remarkably, the Second Circuit's analysis of Amex's market power disregarded all of these findings by the District Court – all of which are fully supported by evidence largely offered by merchants, who must bear the brunt of Amex's anticompetitive depredations. These market realities increase prices, decrease competition, and force merchants to engage in behavior and swallow outlandish costs that they would otherwise avoid in a competitive market. *Kodak*, 504 U.S. at 464. The Second Circuit's decision to disregard these factual findings, and the concrete evidence supporting them, because academics postulate that cardholders ***might*** reap some benefits from this non-competitive market is without basis and should be reversed.

CONCLUSION

For the foregoing reasons, the Court should reverse the Second Circuit's decision and reinstate the injunction issued by the District Court in order to level the playing field in the credit card industry.

Respectfully submitted,

JAMES A. WILSON*
*Counsel of Record
ROBERT N. WEBNER
KENNETH J. RUBIN
NATHAN L. COLVIN
VORYS SATER SEYMOUR AND PEASE, LLP
52 E. Gay Street
Columbus, OH 43215
(614) 464-5606
jawilson@vorys.com

Counsel for Amicus Curiae The Merchant Advisory Group