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Expert Analysis

From Credit Cards to Internet Platforms: Examining Two-Sided Markets

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On May 18, 2015, Bloomberg News reported that the European Commission (EC) is planning to file an antitrust statement of objections against MasterCard for the company's allegedly anticompetitive credit card policies. The statement of objections, which regulators may serve by July, would open another chapter in the history of antitrust challenges to credit card industry policies. The EC's most recent investigation in 2013, for example, focused on allegedly excessive fees charged to travelers shopping in the European Union.

A new statement of objections by the EC would come only a few months after the Eastern District of New York found that American Express, one of MasterCard's competitors, violated the Sherman Act. In *U.S. v. American Express*, the court found that American Express' anti-steering rules—rules that allegedly prevented merchants from incentivizing or "steering" consumers to use cheaper credit cards—were anticompetitive under Section 1 of the Sherman Act. The court in that case issued an injunction which, contrary to American Express' rules, allowed merchants to steer customers away from using American Express cards, including by encouraging customers to use cards with cheaper fees for the merchant. Most recently, the court refused to stay its injunction while the parties appealed to the U.S. Court of Appeals for the Second Circuit.

Two-Sided Markets

Both cases address a familiar but increasingly important issue at the forefront of antitrust law: two-sided markets. Simply defined, two-sided markets are ones in which a single firm, or single platform, connects two separate but related groups of consumers at the same time. Credit cards and their underlying networks for payment processing, for example, serve two groups at the same time: the purchasing consumers and the selling merchants. Every credit card transaction has a consumer on one side and a merchant on the other, and both of these groups are joined by a credit card company's network. The groups rely on that network—a two-sided platform—to consummate their purchases.

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The court in *U.S. v. American Express* reasoned that credit card companies compete against one another in two distinct but related markets: (1) the cardholder market (consumers using credit cards as payment), and (2) the merchant market (firms accepting credit cards as payment).[1] Further, these two markets directly impact each other in a symbiotic way (in economic terms, so-called "positive externalities"): As the number of cardholders grows, so too does the number of merchants willing to accept that type of card (and vice versa: as more merchants accept a certain type of card, so too will more consumers consider using that card).

Such two-sided markets pose challenges for courts to the extent they complicate the traditional framework employed to analyze antitrust claims. Typically, when assessing an antitrust challenge under the rule of reason standard, courts proceed in three phases. First, the court will identify a relevant product and geographic market in which the defendant operates. Second, the court will determine whether the defendant may be viewed as having true "market power" in that market. Third, assuming the defendant has market power, the court will assess the effects of the alleged misconduct, weighing the anticompetitive effects of the conduct against the conduct's procompetitive benefits, which may (but not always) include a look at potential, less restrictive ways to achieve the same procompetitive objectives. But because cases involving conduct in two-sided markets naturally impacts multiple markets, such cases can defy easy classification and analysis.

Court's Treatment

The court in *U.S. v. American Express* recognized this difficulty and attempted to surmount it by appearing to consider the implications of two-sided markets in all phases of its decision, beginning with the question of market definition.

Market Definition. American Express defined the relevant "market" in terms of credit card "transactions."[2] It claimed that because credit card purchases occur in a two-sided market, the market must be defined to incorporate the parties on both sides of the credit card platform (cardholders and merchants). The only way to account accurately for this reality, American Express argued, was to consider one market for "transactions" in which both merchants and cardholders participated. In effect, according to the court, American Express wanted to "collapse all services provided to merchants and cardholders" into "a single antitrust market."[3]

The court disagreed with American Express,

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finding that defining the market in this manner would take the "concept of two-sidedness too far."[4] The court found that neither authority nor (in its view) a compelling reason justified defining the relevant product market in a way that necessarily considered "the entire multi-side platform."[5] Instead, reasoning that American Express' anti-steering rules impacted merchants' ability to drive down price, the court found that the merchant market was the relevant market for assessing the restraint at issue.

Anticompetitive Effects and Procompetitive Justifications. While the court in *American Express* observed that courts should "account for the two-sided features of the credit card industry" throughout its antitrust analysis, it did very little of that when weighing the purportedly anticompetitive effects of American Express' policies against the procompetitive benefits.[6]

American Express argued that any anticompetitive effects impacting merchants were offset by procompetitive justifications occurring in the cardholder market. According to American Express, as a result of the anti-steering rules, credit card companies were forced to compete more fiercely to "acquire new cardholders and capture share of wallet."[7] In American Express' view, strong competition among credit card companies aimed at winning cardholders—like offering cardholders more robust suites of rewards or competing to sign corporate card clients—evidenced increased competition in the cardholder market that would not be as strong absent the rules on the merchant side of the market.

In other words, any harm to merchants caused by the anti-steering rules was more than offset because those same rules created increased, robust competition among companies competing for cardholders on the other side of the market. The argument relied on the premise that procompetitive benefits in one side of a two-sided market could overcome anticompetitive effects in the other—a position the government opposed.

Ultimately, the court agreed with the government. While the court noted that harm in one market generally cannot be justified by greater competition in a different market, it also recognized that the Second Circuit had not explicitly addressed the issue in the context of interrelated markets tied together though a two-sided platform. Absent explicit authority on how to assess two-sided markets, the court declined to follow the approach presented by American Express.

Going Forward

The *U.S. v. American Express* opinion is currently being appealed to the Second Circuit, so the scope of its impact is unknown. It would be most useful, however, if the Second Circuit were to recognize the implications that two-sided markets can have for antitrust law and provide clear guidance on how to analyze two-sided markets in the context of the rule of reason.

Such guidance is particularly needed in a world in which two-sided online platforms grow more popular—and more economically relevant—by the day. Google, Facebook, Expedia, Open Table, Seamless, Uber, and Airbnb are all companies whose business models rely on two-sided platforms to succeed. Seamless, the website and mobile application that connects people seeking to order food to restaurants in the area, is a readily understandable example of a two-sided market. On one side of the Seamless platform are consumers looking for food delivery; these people receive access to the Seamless platform for free. On the other side of the platform are restaurants looking for consumers; these restaurants pay Seamless in order to be listed on its platform.

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Much like cardholders and merchants, these two groups—consumers and restaurants—are inherently tied as a result of the platform. The platform connects two groups that need each other in high numbers to be successful. Restaurants will prefer to use a platform in which there are more people looking for food whereas consumers would prefer to search on a platform that has more restaurants listed.

But the Seamless business model, like the business model for many two-sided Internet platforms, poses yet another critical issue for courts hearing antitrust challenges: One side of their market (the consumer side) receives a product for free. Thus, in addition to issues like market definition and weighing anticompetitive effects against procompetitive benefits in two-sided markets, courts must assess a company's alleged "market power" when the price the company charges—evidence traditionally used to inform market power in antitrust claims—is free on one side of the market.

Two-sided markets also have implications for traditional monopoly claims like predatory pricing. After all, how should a court evaluate claims that a company is pricing below cost when the company's entire business model is based on giving away the product on one side of the market for free? These are only some of the issues that have surfaced, and will continue to be debated, in the context of antitrust claims against defendants operating two-sided platforms. More specifically, both points highlight the need for courts, including the Second Circuit, to articulate in a clear and grounded way how to apply the antitrust laws to claims involving two-sided markets.

Conclusion

There is no doubt that two-sided platforms have exploded in recent years, and that this explosion will continue to lead to new innovations for two-sided businesses on the Internet and mobile devices. And it is no surprise that courts can struggle in determining how to apply the traditional antitrust frameworks to these new platforms. After all, it is often said that technology outpaces the law, which can be particularly confounding in dealing with new or evolving technologies and platforms.

Courts also must continue to remember that their decisions impact real clients and real markets, and that the reality of the marketplace cannot be ignored when assessing claims challenging the efficient operations of these platforms.

1, The court referred to the cardholder market as "a general purpose card market" and the merchant market as "general purpose card network services market." For the sake of brevity and clarity, we refer to the two markets as the cardholder market and the merchant market in this article.

2. *U.S. v. American Exp. Co.*, 2015 WL 728563 at *21 (E.D.N.Y. Feb. 19, 2015). American Express also unsuccessfully argued that the relevant product market should be defined to include debit cards as well as general credit cards. That argument is not discussed here because it is not relevant to the two-sided market discussion in *U.S. v. American Express* or this article.

3. *U.S. v. American Exp. Co.*, 2015 WL 728563 at *22 (E.D.N.Y. Feb. 19, 2015).

4. *U.S. v. American Exp. Co.*, 2015 WL 728563 at *22 (E.D.N.Y. Feb. 19, 2015).

5. *U.S. v. American Exp. Co.*, 2015 WL 728563 at *23 (E.D.N.Y. Feb. 19, 2015).

6. *U.S. v. American Exp. Co.*, 2015 WL 728563 at *23 (E.D.N.Y. Feb. 19, 2015).

7. *U.S. v. American Exp. Co.*, 2015 WL 728563 at *69 (E.D.N.Y. Feb. 19, 2015).