New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 259—NO. 29
TUESDAY, FEBRUARY 13, 2018

Antitrust Trade and Practice

Expert Analysis

The Supreme Court Takes On Two-Sided Markets


By
Shepard Goldfein

And
Karen Hoffman Lent

On Feb. 26, 2018, the U.S. Supreme Court will hear oral arguments in *Ohio v. American Express*. The case was originally filed in 2010 by the U.S. Department of Justice and 17 states,[1] alleging that American Express' use of anti-steering rules—provisions that prohibit merchants from encouraging their customers to use credit cards with lower merchant fees—were anticompetitive under Section 1 of the Sherman Act. Analyzing the restraint under the rule of reason, the district court held that the provisions reduced price competition among credit card networks and led to higher merchant fees and retail prices. The Second Circuit reversed, holding that American Express operates in a "two-sided" credit card services market in which its customers—merchants and cardholders—stand in an interdependent relationship with one another in which price changes to one group (or on one side of the market) affect the demand of the other group (or on the other side of the market). Because the district court failed to consider—and plaintiffs had not presented—evidence of the competitive effects of the challenged rules on the credit cardholder side of the market, the Second Circuit directed entry of judgment for American Express.

Eleven states filed a petition for certiorari on whether the government's showing of anticompetitive effects on the merchant side of the market was sufficient to shift the burden to American Express to establish the rules' procompetitive benefits. The court's decision to grant certiorari, particularly without a circuit split on the issue, is a departure from the types of antitrust cases the court typically reviews. While the court has previously stepped in to clarify *which* mode of antitrust analysis applies to a challenged practice, this review

While the court has previously stepped in to clarify which mode of antitrust analysis applies to a challenged practice, this review suggests that the court may offer guidance on how to apply the rule of reason to two-sided markets.

SHEPARD GOLDFEIN AND KAREN HOFFMAN LENT ARE PARTNERS AT SKADDEN, ARPS, SLATE, MEAGHER & FLOM. MICHELLE HONOR, *a law clerk at the firm, assisted in the preparation of this column.*

suggests that the court may offer guidance on *how* to apply the rule of reason to two-sided markets.

Two-Sided Markets

The court's review highlights the growing use of two-sided market economic analysis and its tendency to complicate traditional antitrust analysis. Two-sided markets are markets in which a single platform sells different products to two separate but interrelated groups of customers and enables interactions between the two groups. These markets are characterized by network or feedback effects, where the value of the network to customers on each side of the platform depends on the number of customers on the other side of the platform. Two-sided markets include social media platforms like Facebook and Instagram, recruiting and dating sites, travel sites and ride-sharing applications. *Ohio v. American Express* concerns a classic two-sided market: credit cards and their payment processing networks. The payment processing networks connect and enable purchasing between cardholders on one side and merchants on the other.

The district court and Second Circuit both applied the rule of reason to analyze the competitive effects of American Express' anti-steering rules. A traditional application of the rule of reason typically proceeds as follows: First, the court isolates a relevant product and geographic market in which the defendant conducts business. Second, the court determines whether the plaintiff has shown that the conduct at issue is prima facie anticompetitive. Plaintiffs can make that showing directly by proving that the defendant's actions had an "actual, adverse effect on competition" or indirectly by demonstrating that the defendant has market power in the relevant market. Third, if the plaintiff has shown that the challenged conduct is prima facie anticompetitive, the burden shifts to the defendant to establish procompetitive justifications for the conduct. If the defendant successfully makes that showing, then the court balances the conduct's anticompetitive effects with the conduct's procompetitive benefits. In balancing, the court considers whether the benefits could have been achieved through less restrictive means. Despite their agreement on the relevant standard to apply, however, the district court and Second Circuit took vastly different approaches in their analysis.

> The potential magnitude of the ruling and its impact on markets and individuals warrant keeping an eye on oral arguments later this month.

Application of the Rule Of Reason

The differences in the Second Circuit and district court's approaches to the *American Express* case boil down to whether or not the rule of reason requires accounting for the impact of the challenged conduct on both sides of a two-sided market. Grounded by this difference in application, the Second Circuit took issue with everything from the district court's definition of the relevant market and determination of market power to the district court's analysis of anticompetitive effects.

Market Definition. The district court had defined the relevant market as the "general purpose card network services" offered to merchants. That market did not include credit card services provided to cardholders because, the district court reasoned, merchant card services and cardholder card services are not reasonably interchangeable or substitutable. On appeal, the Second Circuit rejected the district court's definition and defined the market to include card network services offered to both merchants and cardholders. The Second Circuit's determination thereby accounted for both sides of the two-sided market and for any impact that merchant attrition from the network due to high merchant fees might have on cardholder demand. It reasoned that the appropriate way to define the relevant market when assessing a restraint in a two-sided market is to account for the multi-sided network feedback effects, and not to simply analyze whether the services offered on each side are interchangeable.

Market Power. The differing approaches to defining the relevant market in a two-sided market necessarily influence the determination of market power. The district court focused its analysis of market power over merchants, determining that American Express' ability to increase merchant fees without significant merchant attrition reflected its market power. The Second Circuit's analysis, in contrast, accounted for the impact of increasing merchant fees on both merchants and cardholders. The Second Circuit held that American Express' ability to increase fees without significant merchant attrition was not sufficient evidence of market power because the increased fees that American Express collects may be dissipated by the payment of rewards or discounts to cardholders. Thus, under the Second Circuit's opinion, a finding of market power in a multi-sided market requires that the aggregate or net price charged on both sides of the market increase without causing customer attrition.

Anticompetitive Effects and Burden Shifting. The disagreement over market definition resulted in similar discord regarding how plaintiffs directly prove that a restraint is prima facie anticompetitive under the rule of reason. The district court's relevant market analysis required that the plaintiffs show only that the restraint harmed merchants before the burden shifts to the defendant to present procompetitive justifications. In contrast, the Second Circuit's market definition analysis requires that the plaintiffs show that the restraint causes net harm to both sides of the platform before the burden shifts to the defendant.

Conclusion

Ohio v. American Express is an opportunity for the court to clarify how to assess two-sided markets under the rule of reason. Such guidance would be particularly significant given the increasing prevalence of multi-sided markets across industries. The potential magnitude of the ruling and its impact on markets and individuals warrant keeping an eye on oral arguments later this month.

1. In 2010, plaintiffs sued American Express, MasterCard Inc. and Visa Inc. MasterCard and Visa settled in 2011. The DOJ's case was *U.S. v. American Express Co.* et al. The U.S. Department of Justice did not join the states in their petition for cert.