

Supreme Court Holds American Express Rule Is Not an Antitrust Violation

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On June 25, 2018, in *Ohio v. American Express Co.*, the U.S. Supreme Court affirmed the decision of the U.S. Court of Appeals for the Second Circuit and held that American Express' "anti-steering rules" — which prohibit merchants from discouraging customers from using their American Express cards in favor of other payment cards — do not violate Section 1 of the Sherman Act. The decision is notable because, for the first time, the Supreme Court has acknowledged the economic concept of two-sided transaction markets.

The case began in the U.S. District Court for the Eastern District of New York, which had ruled against American Express. After a seven-week trial, the court concluded that American Express operates in two separate markets — one for services to merchants that accept credit cards and one for services to cardholders that use credit cards — and that the competitive effects of the challenged anti-steering rules had to be determined in the market for services to merchants. The district court further held that the challenged rules were unlawful under the rule of reason, in part because they restrain competition in the market for services to merchants. The Second Circuit reversed, holding that American Express operates in a single, two-sided product market that consists of services to both cardholders and merchants, and the determination of whether American Express' rules on merchants restrained trade must consider the effect of those rules on both merchants and cardholders.

In a 5-4 decision written by Justice Clarence Thomas, the Supreme Court affirmed the Second Circuit's decision. The Court held that the plaintiffs had not demonstrated anti-competitive effects resulting from American Express' anti-steering rules and thus failed the first step of the rule of reason's three-step burden-shifting framework. That framework, the Court confirmed, requires an antitrust plaintiff first to show that the challenged rules have an anti-competitive effect in a relevant market. The Court noted that the anti-competitive effects of a horizontal agreement among competitors have sometimes been determined without precise definition of the relevant market, but that the competitive effects of vertical agreements like the challenged anti-steering rules could not be evaluated unless the Court first defined the relevant market. If the plaintiff succeeds in making a showing of anti-competitive effects in a relevant market, then the burden of proof shifts to the defendants to show that the challenged rules serve a pro-competitive purpose. If the defendants can make that showing, then the burden of proof shifts back to the plaintiff to show that the pro-competitive purpose could be achieved by a less restrictive means.

The Court recognized that a traditional relevant market for antitrust purposes generally includes all products or services that are reasonably substitutable for one another and that, in holding that American Express operates in a two-sided transaction market, it was departing from that traditional analysis. Unlike traditional relevant markets, two-sided transaction markets include products or services that are not substitutable for one another but that are sufficiently interrelated that they exhibit what economists refer to as "indirect network effects," meaning that the value of services provided on one side of the market increases as the number of users on the other side of the market increases. In the credit card services market, for instance, the Court found that the value of American Express' services to merchants increases as more cardholders use American Express cards, and the value of American Express' services to cardholders increases as more merchants accept American Express cards. Indeed, American Express can sell its services to merchants and cardholders only in a one-to-one proportion, with each transaction including the provision of services to both a merchant and a cardholder. Accordingly, the Court held that American Express operates in a single, two-sided relevant market.

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The Court further held that to prove that American Express' anti-steering rules have an anti-competitive effect on the two-sided credit card services market, the plaintiffs could not rest on proof that the challenged rules increased merchants' costs to accept American Express cards. They must also examine the effect of those rules on the cardholder side of the market, where American Express had reduced the cost to cardholders of credit card usage by providing rewards and other cardholder benefits. The Court concluded that it is not always necessary to consider both sides of a two-sided market, and that a market should be treated as one-sided when the impacts of indirect network effects and relative pricing in that market are minor. But that analysis is necessary in credit card markets, the Court held, where networks facilitate a single, simultaneous transaction between participants.

Taking account of both sides of the credit card services market, the Court held that the plaintiffs had not met their burden of proving that the challenged anti-steering rules had the requisite anti-competitive effect. Relying on precedent holding that an increase in costs above a competitive level cannot be achieved without a reduction in output, and observing the explosive output of credit card transactions during the relevant period, the majority rejected the plaintiffs' argument that the challenged rules' anti-competitive effect could be inferred from an increase in merchant costs between 2005 and 2010. Moreover, the Court held that the plaintiffs had failed to prove that American Express' anti-steering rules stifled interbrand competition among credit card companies. Indeed, the Court observed that the challenged anti-steering rules actually promote interbrand competition by ensuring that merchants do not undermine American Express' efforts to provide cardholders with frictionless credit card transactions. The Court also agreed with American Express that the rules prevented one merchant's efforts at steering cardholders away from American Express from causing American Express cardholders to be less likely to use an American Express card with all other merchants, a negative externality that the Court concluded could endanger the viability of the entire American Express network. On these grounds, the Court held, the plaintiffs' Sherman Act claim failed at the first part of the three-part rule of reason framework.

In his dissenting opinion, Justice Stephen G. Breyer, joined by Justices Ruth Bader Ginsburg, Sonia Sotomayor and Elena Kagan, maintained that the majority's analysis was flawed in many respects. First, the dissenting justices argued that direct evidence of anti-competitive effects — such as evidence that the anti-steering rules impeded Discover's efforts to gain a share of merchant acceptance by lowering its acceptance cost — was sufficient for the first step of the rule of reason analysis even without a definition of the relevant market. Second, the dissenting justices disagreed with the majority's market definition because the services American Express provides to merchants and cardholders are not substitutes for one another — meaning that customers cannot respond to a price increase for merchant services by switching to cardholder services — and thus should not be included in the same market. Finally, the dissenting justices contended that the plaintiffs had made the requisite showing of anti-competitive effects because the evidence below showed that the increase in merchants' costs of accepting American Express cards was not entirely offset by the reduction in cardholder usage costs through rewards and other cardholder benefits, and thus the net cost of American Express credit card services to merchants and cardholders had indeed increased. The dissent disagreed with the majority's assertion that output had not been reduced by the challenged rules, explaining that the proper test of output reduction is not a comparison of actual output over time, but rather a comparison of actual output with a hypothetical output that would likely have occurred absent the challenged rules.

Importantly, while the dissent would have defined the relevant markets here under traditional analysis as two separate markets for (i) services to merchants and (ii) services to cardholders, it did not exclude the possibility that, in the second part of the rule of reason's three-part framework, the defendant could justify any anti-competitive effects of a challenged restraint in one market by showing that the restraint serves a pro-competitive purpose in the other market.

The *American Express* decision represents an important clarification in antitrust relevant market analysis. It will now be up to the lower courts to apply two-sided market analysis in other commercial contexts.