

CLIENT ALERT

Supreme Court Takes Sides on the Two-Sided Market

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In a 5-4 decision, the U.S. Supreme Court on Monday upheld contracts between American Express and merchants that prohibit merchants from "steering" customers to cheaper credit cards. The case was closely watched because it required the Court to determine how Section 1 of the Sherman Act, which bans unreasonable restraints of trade, applies to so-called "two-sided" platforms—where businesses (in this case, credit-card networks) bring together in one transaction two consumer groups (in this case, cardholders and merchants).

The case arose when the United States and several States sued Visa, Mastercard, and American Express, alleging that their contracts with merchants were anticompetitive because (among other things) they barred merchants from offering discounts to steer customers to cards that charged the merchants lower fees. Visa and Mastercard settled. After a seven-week bench trial, the district court held that American Express's antisteering provisions unreasonably restrained trade in the U.S. general purpose credit-card market—in which American Express competes with other card companies to provide cardholders and merchants a payment network. The district court found that American Express's antisteering provisions were anticompetitive because they raised merchant fees.

The Second Circuit reversed, holding that the government must address anticompetitive effects not just to the merchant side of the credit-card platform, but also to the cardholder side. As the court noted, a credit-card transaction involves two sales: a sale to the merchant, and a sale to the cardholder. According to the court, the American Express antisteering rules were not anticompetitive when this two-sided platform was viewed *as one market*.

In a decision by Justice Clarence Thomas, the Supreme Court affirmed. Applying the burden-shifting framework of the rule of reason, the majority held that the government plaintiffs did not carry their initial burden of proving anticompetitive effects in the relevant market because they showed only that the American Express antisteering provisions raised fees to merchants without addressing offsetting benefits to cardholders.

The Court concluded that the credit-card market was two-sided, and it was appropriate to consider both sides. As the Court stated, a credit card "is more valuable to cardholders when more merchants accept it, and is more valuable to merchants when more cardholders use it." Thus, raising the price on one side of the market risks losing customers on that side, and, consequently, lowering the value to the other side of the market. These "indirect

network effects" meant that "courts must include both sides of the platform—merchants and cardholders—when defining the credit-card market."

Having thus defined the market, the Court found that plaintiffs failed to carry their rule-of-reason burden at step one merely by showing that the antisteering provisions raised merchant fees. The Court cautioned that "[e]vidence of a price increase on one side of a two-sided transaction platform cannot by itself demonstrate an anticompetitive exercise of market power." Rather, plaintiffs would have to prove that American Express's antisteering provisions raised credit-card transaction costs to anticompetitive levels, reduced the number of credit-card transactions, or otherwise stifled competition in the relevant two-sided market. According to the Court, plaintiffs offered no evidence that the prices of credit-card transactions were anticompetitive, and the evidence as to whether American Express's charged more than its competitors was "ultimately inconclusive." Further, the Court concluded, American Express's business model "has spurred robust interbrand competition"—which is the primary purpose of the antitrust laws.

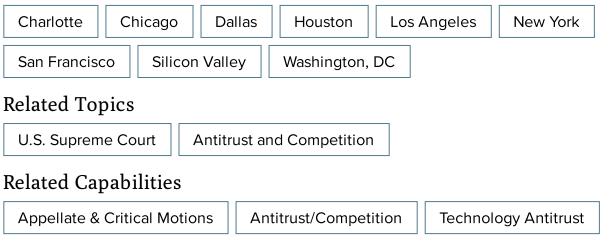
Although it determined that the two-sided credit-card platform must be considered as a whole, the Court made clear that finding a two-sided *platform* does not equate to finding a two-sided *market*: "To be sure, it is not always necessary to consider both sides of the platform. A market should be treated as one sided when the impacts of indirect network effects and relative pricing in that market are minor." Here, the Court distinguished between platforms with only weak, indirect network effects (where considering both sides of the platform was unnecessary), and those in which the platform facilitates a single, simultaneous transaction (where considering both sides was necessary). The credit-card platform, the Court held, fell into the latter category.

In a lengthy dissenting opinion, Justice Breyer (joined by Justices Ginsburg, Sotomayor, and Kagan) disagreed that the relevant market included services to both merchants and cardholders. Only services to merchants counted, Justice Breyer wrote, because those were the services directly affected by the antisteering provisions *and* because they were no substitute for services to cardholders. Further, Justice Breyer stated, the majority did not even need to define the market in the first place given the district court's extensive findings of strong, direct evidence of anticompetitive harm—including preventing interbrand competition.

In light of these unchallenged findings, Justice Breyer continued, it was American Express's burden to show, at steps two and three of the rule-of-reason inquiry, that procompetitive effects of the antisteering provisions outweighed any anticompetitive effects. In Justice Breyer's view, the majority instead addressed procompetitive justifications at the outset of its rule-of-reason inquiry—effectively placing the burden on the government plaintiffs to discount procompetitive effects.

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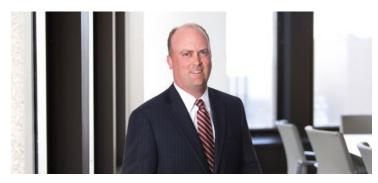
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