15-1672

IN THE
United States Court of Appeals
for the
SECOND CIRCUIT

UNITED STATES OF AMERICA, *et al.*,

Plaintiffs-Appellees

– v. –

AMERICAN EXPRESS COMPANY, *et al.*,

Defendants-Appellants

(Full caption on inside cover)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

BRIEF FOR *AMICI CURIAE* J. GREGORY SIDAK, ROBERT D. WILLIG, DAVID J. TEECE, AND KEITH N. HYLTON SCHOLARS AND EXPERTS IN ANTITRUST ECONOMICS IN SUPPORT OF DEFENDANTS-APPELLANTS AND SUPPORTING REVERSAL

ELAI KATZ
DAVID N. KELLEY
JULIA K. WOOD
BENJAMIN H. ALBERT
CAHILL GORDON & REINDEL LLP
80 Pine Street
New York, New York 10005
(212) 701-3000
Counsel for Amici Curiae

UNITED STATES OF AMERICA, STATE OF MARYLAND, STATE OF MISSOURI, STATE OF VERMONT, STATE OF UTAH, STATE OF ARIZONA, STATE OF NEW HAMPSHIRE, STATE OF CONNECTICUT, STATE OF IOWA, STATE OF MICHIGAN, STATE OF OHIO, STATE OF TEXAS, STATE OF ILLINOIS, STATE OF TENNESSEE, STATE OF MONTANA, STATE OF NEBRASKA, STATE OF IDAHO, STATE OF RHODE ISLAND, *et al.*,

Plaintiffs-Appellees,

STATE OF HAWAII,

Plaintiff,

v.

AMERICAN EXPRESS COMPANY, AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC.,

Defendants-Appellants,

MASTERCARD INTERNATIONAL INCORPORATED, VISA INC.,

Defendants,

CVS HEALTH, INC., MEIJER, INC., PUBLIX SUPER MARKETS, INC., RALEY'S, SUPERVALU, INC., AHOLD U.S.A., INC., ALBERTSONS LLC, THE GREAT ATLANTIC & PACIFIC TEA COMPANY, INC., H.E. BUTT GROCERY CO., HYVEE, INC., THE KROGER CO., SAFEWAY INC. WALGREEN CO., RITE-AID CORP., BI-LO LLC, HOME DEPOT USA, INC., 7-ELEVEN, INC., ACADEMY, LTD., DBA ACADEMY SPORTS + OUTDOORS, ALIMENTATION COUCHE-TARD INC., AMAZON.COM, INC., AMERICAN EAGLE OUTFITTERS, INC., ASHLEY FURNITURE INDUSTRIES INC., BARNES & NOBLE, INC., BARNES & NOBLE COLLEGE BOOKSELLERS, LLC, BEALL'S, INC., BEST BUY CO., INC., BOSCOVS, INC., BROOKSHIRE GROCERY COMPANY, BUC-EE'S LTD, THE BUCKLE, INC., THE CHILDRENS PLACE RETAIL STORES, INC., COBORNS INCORPORATED, CRACKER BARREL OLD COUNTRY STORE, INC., D'AGOSTINO SUPERMARKETS, INC., DAVIDS BRIDAL, INC., DBD, INC., DAVIDS BRIDAL CANADA INC., DILLARD'S, INC., DRURY HOTELS COMPANY, LLC, EXPRESS LLC, FLEET AND FARM OF GREEN BAY,

FLEET WHOLESALE SUPPLY CO. INC., FOOT LOCKER, INC. THE GAP, INC., HMSHOST CORPORATION, IKEA NORTH AMERICA SERVICES, LLC, KWIK TRIP, INC., LOWE'S COMPANIES, INC., MARATHON PETROLEUM COMPANY LP, MARTIN'S SUPER MARKETS, INC., MICHAELS STORES, INC., MILLS E-COMMERCE ENTERPRISES, INC., MILLS FLEET FARM, INC., MILLS MOTOR, INC., MILLS AUTO ENTERPRISES, INC., WILLMAR MOTORS, LLC, MILLS AUTO ENTERPRISES, INC., MILLS AUTO CENTER, INC., BRAINERD LIVELY AUTO, LLC, FLEET AND FARM OF MENOMONIE, INC., FLEET AND FARM OF MANITOWOC, INC., FLEET AND FARM OF PLYMOUTH, INC., FLEET AND FARM SUPPLY CO. OF WEST BEND, INC., FLEET AND FARM OF WAUPACA, INC., FLEET WHOLESALE SUPPLY OF FERGUS FALLS, INC., FLEET AND FARM OF ALEXANDRIA, INC., NATIONAL ASSOCIATION OF CONVENIENCE STORES, NATIONAL GROCERS ASSOCIATION, NATIONAL RESTAURANT ASSOCIATION, OFFICIAL PAYMENTS CORPORATION, PACIFIC SUNWEAR OF CALIFORNIA, INC., P.C. RICHARD & SON, INC., PANDA RESTAURANT GROUP, INC., PETSMART, INC., RACETRAC PETROLEUM, INC., RECREATIONAL EQUIPMENT, INC., REPUBLIC SERVICES, INC., RETAIL INDUSTRY LEADERS ASSOCIATION, SEARS HOLDINGS CORPORATION, SPEEDWAY LLC, STEIN MART, INC., SWAROVSKI U.S. HOLDING LIMITED, WAL-MART STORES INC., WHOLE FOODS MARKET GROUP, INC., WHOLE FOODS MARKET CALIFORNIA, INC., MRS. GOOCH'S NATURAL FOOD MARKETS, INC., WHOLE FOOD COMPANY, WHOLE FOODS MARKET PACIFIC NORTHWEST, INC., WFM-WO, INC., WFM NORTHERN NEVADA, INC., WFM HAWAII, INC., WFM SOUTHERN NEVADA, INC., WHOLE FOODS MARKET, ROCKY MOUNTAIN/SOUTHWEST, L.P., THE WILLIAM CARTER COMPANY, YUM! BRANDS, INC., SOUTHWEST AIRLINES CO.

Movants.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

IDENTITY AND INTEREST OF *AMICI CURIAE* 1

INTRODUCTION AND SUMMARY OF ARGUMENT 3

ARGUMENT 6

I. THE DISTRICT COURT'S ANALYSIS OF MARKET POWER WAS ERRONEOUS 6

II. THE DISTRICT COURT'S ANALYSIS OF COMPETITIVE EFFECTS WAS ERRONEOUS 10

III. THE DISTRICT COURT'S MARKET DEFINITION WAS ERRONEOUS 14

IV. CONCLUSION 19

TABLE OF AUTHORITIES

CASES **PAGE(S)**

Geneva Pharm. Tech. Corp. v. Barr Labs. Inc., 386 F.3d 485 (2d Cir. 2004) 10, 14

United States v. Am. Express. Co., No. 10-CV-4496 (NGG)(RER), 2015 WL 728563 (E.D.N.Y. Feb. 19, 2015) .... *passim*

United States v. Visa U.S.A., Inc., 344 F.3d 229 (2d Cir. 2003) 17

PUBLICATIONS

Alexei Alexandrov, George Deltas & Daniel F. Spulber, *Antitrust and Competition in Two-Sided Markets*, 7 J. Competition L. & Econ. 775 (2011) 18

Mark Armstrong, *Competition in Two-Sided Markets*, 37 RAND J. Econ. 668 (2006) 3

William J. Baumol, John C. Panzar & Robert D. Willig, *Contestable Markets and the Theory of Industry Structure* (rev. ed. 1988) 8

Robert H. Bork & J. Gregory Sidak, *What Does the Chicago School Teach About Internet Search and the Antitrust Treatment of Google?*, 8 J. Competition L. & Econ. 663 (2012) 4

Sujit Chakravorti & Roberto Roson, *Platform Competition in Two-Sided Markets: The Case of Payment Networks*, 5 Rev. Network Econ. 118 (2006) 4

Robert W. Crandall & J. Gregory Sidak, *Competition and Regulatory Policies for Interactive Broadband Networks*, 68 S. Cal. L. Rev. 1203 (1995) 5

David S. Evans, *The Antitrust Economics of Multi-Sided Platform Markets*, 20 Yale J. on Reg. 325 (2003) 3, 15

Lapo Filistrucchi, Tobias J. Klein & Thomas O. Michielsen, *Assessing Unilateral Merger Effects in a Two-Sided Market: An Application to the Dutch Daily Newspaper Market*, 8 J. Competition L. & Econ. 297 (2012)....................15

Andrei Hagiu, *Two-Sided Platforms: Product Variety and Pricing Structures*, 18 J. Econ. & Mgmt. Strategy 1011 (2009) 3, 4

Richard A. Posner, *Vertical Restraints and Antitrust Policy*, 72 U. Chi. L. Rev. 229 (2005) 8

Jean-Charles Rochet & Jean Tirole, *Platform Competition in Two-Sided Markets*, 1 J. Eur. Econ. Ass'n 990 (2003) 4

Jean-Charles Rochet & Jean Tirole, *Two-Sided Markets: A Progress Report*, 37 RAND J. Econ. 645 (2006) 3, 4, 5, 15

Roberto Roson, *Two-Sided Markets: A Tentative Survey*, 4 Rev. Network Econ. 142 (2005)....................3, 15

Marc Rysman, *The Economics of Two-Sided Markets*, 23 J. Econ. Persp., no. 3, 125 (Summer 2009) 4

J. Gregory Sidak, *A Consumer-Welfare Approach to Network Neutrality Regulation of the Internet*, 2 J. Competition L. & Econ. 349 (2006)....................4

J. Gregory Sidak & David J. Teece, *Innovation Spillovers and the "Dirt Road" Fallacy: The Intellectual Bankruptcy of Banning Optional Transactions for Enhanced Delivery Over the Internet*, 6 J. Competition L. & Econ. 521 (2010)....................4

IDENTITY AND INTEREST OF *AMICI CURIAE*

The *amici* are scholars and experts on the economic analysis of antitrust law whose scholarly writings have been cited approvingly on multiple occasions by the federal courts:[1]

- **J. Gregory Sidak**, Chairman, Criterion Economics, L.L.C. He has held the Ronald Coase Professorship of Law and Economics at Tilburg University in The Netherlands, the F.K. Weyerhaeuser Chair in Law and Economics at the American Enterprise Institute for Public Policy Research, and academic positions at Yale University and Georgetown University. He is co-editor of the *Journal of Competition Law & Economics*, published by the Oxford University Press.
- **Robert D. Willig**, Professor of Economics and Public Affairs at the Woodrow Wilson School and at the economics department of Princeton University. He served in the Antitrust Division of

[1] Pursuant to Fed. R. App. P. 29(c)(5), *amici* certify that no party's counsel authored this brief in whole or in part; no party or party's counsel contributed money intended to fund the preparation or submission of the brief; and no person other than *amici* or their counsel contributed money intended to fund the preparation or submission of the brief. Pursuant to Rule 29(a), all parties have consented to the filing of this brief.

the U.S. Department of Justice as Deputy Assistant Attorney General for economics. He is a co-editor of the *Handbook of Industrial Organization* and has served on the editorial boards of the *American Economic Review*, the *Journal of Industrial Economics*, and the MIT Press series on regulation.

- **David J. Teece**, Thomas W. Tusher Professor in Global Business at the Haas School of Business at the University of California, Berkeley. He was formerly on the faculty of the Stanford Graduate School of Business. He is a co-editor of the journal *Industrial and Corporate Change*, published by the Oxford University Press.
- **Keith N. Hylton**, William Fairfield Warren Professor of Boston University and Professor of Law at Boston University School of Law. He is the author of *Antitrust Law: Economic Theory and Common Law Evolution*, a contributing editor of *Antitrust Law Journal*, co-editor of *Competition Policy International*, and a former chair of the Section on Antitrust and Economic Regulation of the American Association of Law Schools.

The *amici* sign this brief in their individual capacities.

The *amici* have an interest because they believe that errors in the district court's opinion threaten to undermine proper economic analysis of antitrust questions in two-sided markets.

INTRODUCTION AND SUMMARY OF ARGUMENT

Credit card networks—like shopping malls, executive recruiting firms, dating services, social and professional networking websites, and video games—exemplify multi-sided platforms. A consumer accessing a smartphone application like AirBnB or Uber uses a two-sided platform. Similarly, Amazon and eBay connect online vendors with online shoppers, and Google Search, Android, and Facebook connect advertisers, consumers, application developers, and social media users to one another. Such two-sided markets (or two-sided platforms) have features that differ in significant ways from traditional markets, and a proper analysis should acknowledge those differences.

Since the early 2000s, economists (including Nobel laureate Jean Tirole) have produced an extensive literature on two-sided markets.[2] Economists now

---

[2] *See, e.g.*, David S. Evans, *The Antitrust Economics of Multi-Sided Platform Markets*, 20 Yale J. on Reg. 325 (2003); Jean-Charles Rochet & Jean Tirole, *Two-Sided Markets: A Progress Report*, 37 RAND J. Econ. 645 (2006); Roberto Roson, *Two-Sided Markets: A Tentative Survey*, 4 Rev. Network Econ. 142 (2005); Mark Armstrong, *Competition in Two-Sided Markets*, 37 RAND J. Econ. 668 (2006); Andrei Hagiu, *Two-Sided Platforms: Product Variety and Pricing Structures*, 18 J.

widely accept the definition of Tirole and Jean-Charles Rochet that, in a multi-sided market, "one or several platforms enable interactions between end-users and try to get the two (or multiple) sides 'on board' by appropriately charging each side."[3] Antitrust scholars have applied the economic principles of two-sided markets to a range of cases and regulatory policies.[4]

Typically, platforms in two-sided markets charge a low, sometimes negative, price to attract customers on one side of the market and a higher price to the other side of the market.[5] A credit card network might charge the cardholder a negative

---

Econ. & Mgmt. Strategy 1011 (2009); Sujit Chakravorti & Roberto Roson, *Platform Competition in Two-Sided Markets: The Case of Payment Networks*, 5 Rev. Network Econ. 118 (2006); Jean-Charles Rochet & Jean Tirole, *Platform Competition in Two-Sided Markets*, 1 J. Eur. Econ. Ass'n 990, 990–91 (2003); Marc Rysman, *The Economics of Two-Sided Markets*, 23 J. Econ. Persp., no. 3, 125, 125–27 (Summer 2009).

[3] Rochet & Tirole, *Two-Sided Markets: A Progress Report*, *supra* note 2, at 645. Rochet and Tirole clarify that a market is two-sided only if the volume of transactions between the end users on each side of the platform depends on the allocation of the aggregate price—the sum of the price that the platform charges each side. *Id.* at 648. In a one-sided market, the volume of transactions would depend only on the aggregate price. That is, the allocation or division of the aggregate price between the two sides will not affect the number of transactions.

[4] *See, e.g.*, Robert H. Bork & J. Gregory Sidak, *What Does the Chicago School Teach About Internet Search and the Antitrust Treatment of Google?*, 8 J. Competition L. & Econ. 663 (2012); J. Gregory Sidak, *A Consumer-Welfare Approach to Network Neutrality Regulation of the Internet*, 2 J. Competition L. & Econ. 349 (2006); Hagiu, *supra* note 2.

[5] *See, e.g.*, Rochet & Tirole, *Platform Competition in Two-Sided Markets*, *supra* note 2, at 992, 1013–14; J. Gregory Sidak & David J. Teece, *Innovation Spillovers and the "Dirt Road" Fallacy: The Intellectual Bankruptcy of Banning*

price by offering rewards or discounts to entice consumers to use the network's card. By allocating a relatively small, or even negative, portion of the aggregate price to the cardholder and allocating a relatively large portion to the merchant, a card network encourages cardholders to use credit cards belonging to that network, which in turn increases a merchant's incentive to accept that network's credit cards. If the card network instead allocated a relatively large portion of the aggregate price to the cardholder and a relatively small portion to the merchant, fewer consumers would adopt that network's credit cards, and fewer merchants would accept those credit cards, all other things being equal. Thus, network effects magnify the effect of a price change on one side of the two-sided market.[6]

In other words, a card network's allocation of the aggregate price between the cardholders and the merchants affects the total volume of transactions on that card network and therefore the success of that network. Consequently, if a court in an antitrust case considers only the discount fee that the card network charges merchants, it disregards the salient fact that the proper allocation of the aggregate price between the two sides of the market is essential to optimizing the number of

---

Optional Transactions for Enhanced Delivery Over the Internet, 6 J. Competition L. & Econ. 521, 541–42 (2010).

[6] *See* Rochet & Tirole, *Two-Sided Markets: A Progress Report*, *supra* note 2, at 648. Economists have recognized the relevance of this insight to telecommunications regulation since at least the mid-1990s. *See, e.g.,* Robert W. Crandall & J. Gregory Sidak, *Competition and Regulatory Policies for Interactive Broadband Networks*, 68 S. Cal. L. Rev. 1203, 1219–20 (1995).

transactions on both sides of the platform and thereby promoting consumer welfare. Although the district court did recognize that American Express operates in a two-sided market, it did not properly apply this perspective and widely accepted two-sided market principles in its analysis.

We *amici* do not purport to be experts on the facts of this case, and we do not address every disputed economic issue. Instead, we focus on three reversible errors committed by the district court concerning (1) whether American Express possessed market power, (2) the competitive effects of the challenged conduct, and (3) market definition in this two-sided market. We first address the district court's analysis of market power, which we consider the most significant error.

ARGUMENT

I. THE DISTRICT COURT'S ANALYSIS OF MARKET POWER WAS ERRONEOUS

The district court emphasized the customer loyalty or cardholder insistence of American Express's cardholders in its finding that American Express possessed market power. The district court said that "Amex's market share alone likely would not suffice to prove market power by a preponderance of the evidence were it not

for the amplifying effect of cardholder insistence."[7] The district court said that American Express cardholders insist on using their American Express payment cards, which "effectively prevents merchants from dropping American Express."[8] This ignores the fact that, as the district court noted, some three million merchants accept Visa, MasterCard and Discover but do not accept American Express.[9] A merchant chooses whether or not to accept a card based on its assessment of the costs and benefits of doing so. Different merchants face different costs and benefits, and can (and do) reach different conclusions about whether or not to accept a particular card. There is no meaningful economic difference between "dropping American Express" – which the district court said would not happen and which it says indicates market power – and a decision not to accept American Express in the first place – which the district court recognizes that millions of merchants do. Moreover, the district court recognized that this cardholder insistence arises because of the rewards and other associated services that American Express offers,[10] which does not indicate market power but instead indicates the competitive benefits on the cardholder side of the two-sided market

[7] *United States v. Am. Express Co.*, No. 10-CV-4496 (NGG)(RER), 2015 WL 728563, at *37 (E.D.N.Y. Feb. 19, 2015).
[8] *Id.* at *38.
[9] *Id.* at *9.
[10] *Id.* at *37.

and the concomitant resulting competitive benefits to merchants that accept American Express cards.

Moreover, the district court erroneously asserted that "American Express cannot avert a finding of market power premised on cardholder insistence merely because that loyalty and [American Express's] current market share would dissipate if the company were to stop investing in those programs that make its product valuable to cardholders."[11] That assertion reveals the district court's confusion between market power and consumer benefit resulting from successful innovation and product differentiation under competition. Cardholder insistence on using American Express's cards is a part of what makes accepting American Express's cards (and paying the merchant discount) a worthwhile business for the merchants that accept them.[12] In addition, the district court's recognition that American Express's market share would dissipate if it were to cease investing in its

---

[11] *Id.* at *40. That American Express's market share would dissipate, either due to ease of entry or ease of expansion by competing firms, implies that American Express could not possess market power. *See* William J. Baumol, John C. Panzar & Robert D. Willig, *Contestable Markets and the Theory of Industry Structure* 351 (rev. ed. 1988).

[12] Customer loyalty, of which the cardholder insistence on using American Express cards is an example, can have procompetitive effects. *See* Richard A. Posner, *Vertical Restraints and Antitrust Policy*, 72 U. Chi. L. Rev. 229, 240 (2005) ("Another name for [loyalty] might be low transaction costs and customer inertia, which might be another name for economizing on transaction costs.").

cardholder rewards and services undermines—rather than supports—the court's finding of market power.

The district court's analysis of American Express's "Value Recapture" initiatives from 2005 to 2010 and the associated increases in merchant discounts is incomplete, incorrect, and does not indicate market power. Price increases alone are not evidence of market power if there are no concurrent adoptions or expansions of anticompetitive conduct. The district court recognized that American Express's costs were increasing concurrently with the Value Recapture program.[13] Raising prices when costs increase is not evidence of market power. Moreover, the district court recognized that American Express invested substantially in new co-branding programs that had marketing and promotional purposes and effects.[14] Competitive firms raise prices when expensive marketing and promotional efforts succeed in elevating demand for their products. When demand for American Express's product expands on the cardholder side, value also expands on the merchant side, which indicates that increases in merchant discounts are a concomitant of a successful investment in creating output and value.

In sum, although we certainly do not purport to have assessed all the evidence on market power, we believe that the district court's evidentiary findings

---

[13] *Am. Express Co.*, 2015 WL 728563, at *42.

[14] *See, e.g.*, *id.* at *47 & n.37.

(particularly the finding that American Express's market share would dissipate without its continued investment in consumer benefits), properly interpreted, indicate the *absence* of market power. While the district court's analysis of the Value Recapture program does not indicate to us the absence of market power, it suggests that the district court's inference of the existence of market power was unwarranted.

II. THE DISTRICT COURT'S ANALYSIS OF COMPETITIVE EFFECTS WAS ERRONEOUS

For Sherman Act claims analyzed under the rule of reason, "plaintiffs bear an initial burden to demonstrate the defendants' challenged behavior had an actual adverse effect on competition as a whole in the relevant market."[15] Because the district court failed to evaluate American Express's market power correctly in a two-sided market, the court necessarily failed to determine correctly the net competitive effect of the challenged conduct by summing the conduct's competitive effect on the merchant side of the market and its competitive effect on the cardholder side of the market. The United States argued that the former reduced consumer surplus, and American Express argued that the latter increased consumer surplus. To determine the *net* effect on consumer surplus, the district court needed

[15] *Geneva Pharm. Tech. Corp. v. Barr Labs. Inc.*, 386 F.3d 485, 506–07 (2d Cir. 2004) (emphasis and internal quotation marks omitted).

to make factual findings of the magnitude of both the former and the latter—which the court did not do.

American Express presented evidence of the competitive effects of its Non-Discrimination Provisions (NDPs) on the cardholder side of the market. For example, American Express argued that the NDPs were necessary "to preserve American Express's differentiated business model and thus the company's ability to drive competition in the network services market[.]"[16] That is, American Express could not pursue its business model if merchants could discriminate by steering the cardholder at the point of sale to a different form of payment. This "discrimination" by merchants would make the cardholder less likely to use American Express as a form of payment in subsequent transactions.[17] Consequently, a negative feedback effect in merchant steering would cause American Express to lose discount revenue from merchants. The loss of discount revenue from merchants would increase the cost to American Express of providing enhanced benefits to its cardholders, a practice which differentiates American Express from its competitors and benefits cardholders and merchants.[18]

Given a reduction in merchant revenue, American Express's optimal level of cardholder benefits would decrease, which in turn would reduce the intensity of

---

[16] *Am. Express Co.*, 2015 WL 728563, at *66.
[17] *Id.*
[18] *Id.* at *67.

competition among credit card networks on the cardholder side of the market. American Express argued that, because its NDPs prevent this negative feedback effect, they help American Express "drive innovation and compete effectively with the dominant firms in the [cardholder market]"—namely, Visa and MasterCard.[19] As the NDPs increase the level of cardholder benefits that American Express will offer, they intensify competition among credit card networks on the cardholder side of the market, which benefits both cardholders and merchants.

The district court mischaracterized this argument as a proffered procompetitive benefit, which it then found not to be legally cognizable because American Express's "procompetitive benefits" on the cardholder side of the market came (in the district court's assessment) at the expense of suppressing competition on the merchant side of the market for network services.[20] The district court said that "a restraint that causes anticompetitive harm in one market may not be justified by greater competition in a *different* market."[21] However, as we explain in greater detail in Part III, the district court erroneously defined the relevant product market to exclude one side of the two-sided market (namely, the cardholder side), which the court then inaccurately called a "different" market.

---

[19] *Id.*

[20] *Id.* at *69.

[21] *Id.* (emphasis added).

A correct analysis of competitive effects would have been two-sided, considering *both* the effects on network services to merchants *and* the effects on credit card services to cardholders. The correct analysis would not have enabled the district court to reason that the NDPs caused a procompetitive benefit "in one market" at the expense of an anticompetitive cost "in a different market." Only one market exists, but it has two sides. Consequently, to determine the competitive effect of the challenged conduct, the district court would have needed to balance the welfare gains on the cardholder side of the market against the possible welfare losses on the network services market, so as to determine the net competitive effect of the NDPs. It is the total price charged on both sides of the market that drives output in the general purpose credit and charge (GPCC) card industry. That the total volume of GPCC transactions increased during the period in which the NDPs were in place[22] is prima facie evidence of a net *positive* effect on competition.[23] Merchant decisions not to accept American Express do not relate to the market output and are not indicative of a net negative effect on competition. Instead, the ability of merchants to substitute away from American Express, just as cardholders

---

[22] *See* PX2702.41; DX7828.10.

[23] Total output could have increased for reasons other than the existence of NDPs. However, the United States had the burden to show that other factors drove that increase and to isolate any negative effect of the NDPs.

can do as well, is plain evidence of competition facing American Express in the two-sided market.

The two-sided competitive-effects analysis that the district court failed to perform differs from asking whether efficiency justifications (such as economies of scale or prevention of free riding) offset adverse competitive effects and thus excuse them from liability. One gets to that question only after the United States has carried its burden of proving that, on balance, American Express's NDPs had an adverse competitive effect in the properly defined two-sided market. By mischaracterizing a countervailing effect of the NDPs on the cardholder side of the market as a procompetitive justification, the district court introduced a legal theory that violates economic theory and would endanger consumer welfare if applied to any two-sided market.

III. THE DISTRICT COURT'S MARKET DEFINITION WAS ERRONEOUS

The purpose of the market definition inquiry is "to identify the market participants and competitive pressures that restrain an individual firm's ability to raise prices or restrict output."[24] The overall demand for a credit card transaction is the vertical summation of the respective demand curves of the merchant and the

---

[24] *Geneva Pharm. Tech. Corp. v. Barr Labs. Inc.*, 386 F.3d 485, 496 (2d Cir. 2004).

cardholder. Demand is two-sided. The consumer surplus created by a transaction conducted on the two-sided platform of the credit card network is the sum of the cardholder's surplus and the merchant's surplus. Because antitrust law aims to maximize consumer surplus, it necessarily must consider the effect that the disputed business practice has on consumer surplus on *both* sides of a two-sided market.

The district court recognized that American Express operates in a two-sided market.[25] In a multi-sided market, "[a]ny change in demand or cost on one side of the market will necessarily affect the level and relationship of prices on all sides."[26] That a firm has a high price-cost margin on one side of the market does not reliably indicate market power, because a two-sided platform needs to attract both sides to its services.[27] One must consider both sides of a two-sided platform when applying the hypothetical monopolist test (HMT) to define the relevant market. Asking whether a hypothetical profit-maximizing monopolist can profitably implement a small but significant and nontransitory increase in price (SSNIP) on one side of a

---

[25] *Am. Express Co.*, 2015 WL 728563, at *6.

[26] David S. Evans, *The Antitrust Economics of Multi-Sided Platform Markets*, 20 Yale J. on Reg. 325, 355 (2003); *see also* Rochet & Tirole, *Two-Sided Markets: A Progress Report*, *supra* note 2, at 648, 664–65; Lapo Filistrucchi, Tobias J. Klein & Thomas O. Michielsen, *Assessing Unilateral Merger Effects in a Two-Sided Market: An Application to the Dutch Daily Newspaper Market*, 8 J. Competition L. & Econ. 297, 301–02 (2012).

[27] Roson, *Two-Sided Markets: A Tentative Survey*, *supra* note 2, at 155–56.

two-sided market must account for the SSNIP's impact on the other side of the market, with its own consequences for profit and for feedback on the first side of the two-sided market. A one-sided HMT in a two-sided market ignores the hypothetical monopolist's *net* price and therefore distorts the analysis of the effect that a SSNIP would have on a hypothetical monopolist's aggregate profits, which is the relevant indicator.

The district court never made a rigorous, fact-based inquiry into the propriety of including the cardholder side of the market in its definition of the relevant product market. Its market definition is therefore unreliable, as are the district court's conclusions on market power and competitive effects.

The district court did not perform the HMT when defining a market for network services instead of a market for transactions. The court considered only (on a largely impressionistic level) the effect of a SSNIP when determining whether to include debit-card network services in the (supposedly) relevant product market consisting of network services.[28] Even then, the district court did not appear to apply the HMT correctly.

Without formally applying the HMT in any context, let alone in a manner that accounted for the two-sidedness of the market for credit or payment card transactions, the district court defined the relevant product market as the market for

---

[28] *See Am. Express Co.*, 2015 WL 728563, at *24–27.

network services in a conclusory and mistaken fashion. Although the district court purported to consider both sides of the market,[29] as a proper reading of *United States* v. *Visa U.S.A., Inc. (Visa II)* requires,[30] it did not attempt to quantify the change in cardholder behavior resulting from the decreased demand of merchants to use the hypothetical monopolist's network for credit card transactions.[31] The district court considered cardholder behavior only with respect to a merchant's decision to *join* a card network. However, the relevant economic question is the extent to which cardholder behavior affects the profitability of a SSNIP by the hypothetical monopolist.

The district court analyzed whether the relevant product market should be based around transactions (a definition that would implicitly also incorporate cardholders into the relevant market) without ever considering the effects of a SSNIP on the cardholder side of the market.[32] The district court did not apply the HMT to determine whether network services constitute the relevant product market. The court *presumed* that the decrease in the quantity of network services

---

[29] *Id.* at *23–24.

[30] *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 237–39 (2d Cir. 2003).

[31] *See Am. Express Co.*, 2015 WL 728563, at *21–24. Puzzlingly, the district court acknowledged "American Express is correct that the court *must account for the two-sided features* of the credit card industry *in its market definition inquiry*, as well as elsewhere in its antitrust analysis", but nevertheless concluded that the relevant market was the market for network services. *Id.* at *23–24 (emphasis added).

[32] *See id.* at *21–24.

demanded by merchants facing a SSNIP would be too small to render the price increase unprofitable, but it did not quantify or even realistically consider the change in cardholder behavior resulting from the decreased merchant demand.[33]

A proper HMT would consider the extent to which, because of feedback effects in a two-sided market, even a low level of merchant attrition would cause some cardholders to switch to alternative forms of payment. At some empirical threshold, merchant attrition would cause a SSNIP to be unprofitable for the hypothetical monopolist.[34] A proper HMT would consider the feedback effect in the assessment of a SSNIP's profitability by accounting for the reduction in cardholders' demand for cards or card transactions that would accompany any degree of merchant attrition.

To retain cardholders, a card network might need to increase the rewards to cardholders (a price cut by any other name), which would diminish the network's profitability from the SSNIP.[35] If the network chooses not to increase rewards to cardholders, then merchant attrition very likely would increase further as a result of

---

[33] *See id.* at *25–27.

[34] *See id.* at *27.

[35] *See* Alexei Alexandrov, George Deltas & Daniel F. Spulber, *Antitrust and Competition in Two-Sided Markets*, 7 J. Competition L. & Econ. 775, 777 (2011) (explaining that it might be "appropriate to treat the sum of prices in a two-sided market as one would treat the price offered to buyers in a one-sided market").

the reduction in the number of cardholders, such that the reduction in transactions over time could make the SSNIP unprofitable.

In sum, the district court applied the HMT incorrectly. By ignoring the response of cardholders to the SSNIP, the district court defined a relevant product market that was improperly narrow.

IV. CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed.

Dated: August 10, 2015

Respectfully submitted,

/s/ Elai Katz
ELAI KATZ
DAVID N. KELLEY
JULIA K. WOOD
BENJAMIN H. ALBERT
CAHILL GORDON & REINDEL LLP
80 Pine Street
New York, New York 10005
(212) 701-3000

Counsel for Amici Curiae

CERTIFICATE OF COMPLIANCE WITH F.R.A.P. 32

Pursuant to Rule 32(a)(7)(C)(i) of the Federal Rules of Appellate Procedure, the foregoing brief is in 14-Point Times New Roman proportional font and contains 4,210 words, excluding the parts of the brief exempted by Rule 32(a)(7)(B)(iii), and thus is in compliance with the 7,000 word limit for *amicus* briefs in the Federal Rules of Appellate Procedure for the Second Circuit.

Dated: August 10, 2015

/s/ Elai Katz
ELAI KATZ