No. 16-1454

In the Supreme Court of the United States

STATE OF OHIO, ET AL.
Petitioners,
v.
AMERICAN EXPRESS CO., ET AL.
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF OPEN MARKETS INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICUS CURIAE*[1]

The Open Markets Institute is a non-profit research organization dedicated to promoting fair and competitive markets. Its mission is to safeguard our political economy from excessive concentrations of private power that undermine competition and threaten liberty, democracy, and prosperity. OMI regularly provides expertise on antitrust law and competition policy to Congress, journalists, and other members of the public. It does not accept any funding or donations from for-profit corporations.

[1] All parties consent to this brief, and no party's counsel authored it in whole or part. Apart from *amicus curiae*, no person contributed money to fund its preparation or submission.

INTRODUCTION AND SUMMARY OF ARGUMENT

By introducing a special rule for "two-sided" markets, the Second Circuit needlessly departed from a longstanding approach to antitrust law. Its new rule greatly raises the burden that a plaintiff in the "two-sided" market context must carry at the very earliest stage of litigation. Not only is the new rule unjustified, it is pegged to a concept that is contested and ill-defined. Defendant companies ranging from airlines to chicken processors could reasonably claim that they meet the definition of "two-sided," winning themselves more favorable judicial review.

Basing a fundamental and often decisive inquiry on a slippery definition is a mistake. Troublingly, the Second Circuit's approach also risks exempting from effective antitrust scrutiny the dominant tech platforms, including Amazon, Google, and Facebook. These firms enjoy dominant positions in key markets that provide ample opportunity for anticompetitive conduct, underscoring the need for robust antitrust enforcement. Yet if the Second Circuit's rule is upheld, a wide range of anticompetitive activity would become virtually beyond reach, given the far higher burden that plaintiffs would have to meet to establish even a *prima facie* case. In practice, this approach would risk immunizing dominant platforms from effective antitrust review.

Because this result is intolerable, and because it rests on shaky and malleable economic reasoning, this Court should reverse the Second Circuit's decision.

ARGUMENT

I. A special rule for "two-sided" markets is unnecessary and risks enabling legal arbitrage.

A. The Second Circuit departed from longstanding tradition.

Markets that could be characterized as "two sided" under the Second Circuit's newly-minted framework have been around for centuries. They include grain futures markets (connecting farmers and buyers of farm products), banking (connecting depositors and borrowers), and health maintenance organizations (linking patients and health care providers). The Internet has facilitated a new crop of technologies that essentially play this same role, connecting, for instance, job seekers and employers (LinkedIn) and fliers and airlines (Kayak).

For decades, courts have analyzed potential anticompetitive conduct in such scenarios by considering the specific market defined by the subset of customers allegedly harmed. *See Times Picayune Publ'g Co. v. United States*, 345 U.S. 594 (1953) (holding that a newspaper's restraint affecting advertisers, but not readers, had anticompetitive effect); *Lorain Journal Co. v. United States*, 342 U.S. 143, 152–53 (1951) (same); *Telecor Commc'ns, Inc. v. S.W. Bell Tel. Co.*, 305 F.3d 1124, 1134 (10th Cir. 2002) (holding that a telephone company's restraint affecting pay-phone operators, but not telephone users, had anticompetitive effect); *United States v. Microsoft Corp.*, 253 F.3d 34, 60–62, 65–72 (D.C. Cir. 2001) (focusing an analysis of Microsoft's monopolization of the operating-system market on the anticompetitive effects with respect to software developers, not users).

The Second Circuit unnecessarily eschewed this longstanding form of analysis. It held that the plaintiff bears the initial burden to show not just that the conduct at issue has anticompetitive effects in the market where customers were allegedly harmed, but also that those effects outweigh any benefits in a *separate* market. App. 53a. By adopting this wrong approach, the Second Circuit reached the extraordinary conclusion that a firm can eliminate horizontal price competition for millions of its customers without violating antitrust laws. Its reasoning was premised on the idea that conduct in "two-sided" markets requires a novel rule. App. 35a, 39a. But the only thing new about "two-sided" markets is the terminology.

While antitrust scrutiny of these markets traces back a century, the concept of a "two-sided" market was developed only in the 2000s, following antitrust litigation against Visa and MasterCard.[2] In one of those cases, economists paid by Visa and MasterCard unsuccessfully floated the same basic argument that American Express advances here: that customers alleging anticompetitive harm in the payment-card market must show injury to cardholders as well as to merchants.[3] The Second Circuit instead correctly followed the traditional approach: it

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[2] Richard A. Epstein & Victor P. Goldberg, *Introductory Remarks: Some Reflections on Two-Sided Markets and Pricing*, 2005 Colum. Bus. L. Rev. 509, 509 (2005).

[3] Lloyd Constantine et. al., *In re Visa/MasterMoney Antitrust Litigation: A Study of Market Failure in a Two-Sided Market*, 2005 Colum. Bus. L. Rev. 599, 600 (2005) (noting that "Visa and MasterCard argued that to assert a damage claim in a two-sided market, buyers must show an overcharge impacting both sides of the market, regardless of which side they are on"). Notably, while the argument was advanced by their paid experts, Visa and MasterCard did not heavily push the theory in their pleadings.

construed credit-card companies as operating in "two interrelated, but separate, product markets," found that exclusionary rules injured competition in one of those markets, and held that this showing was sufficient to establish a violation of the Sherman Act. *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 238 (2d Cir. 2003).

In the years since, a group of scholars and consultants has built up a body of work reconceiving these "two interrelated, but separate, product markets," *id.*, as a single "two-sided" market. The Second Circuit's decision relies on this work. But in key instances, the panel relied on a small number of industry-funded studies[4] that are fundamentally at odds with scholarship by leading antitrust thinkers. *See, e.g.*, P. Areeda & H. Hovenkamp, *Antitrust Law*, 2017 Supp ¶565, p.104 (stating that the Second Circuit "incorrectly conclud[ed] that the relevant market in which to consider American Express's anti-steering rules was not limited to the market for network

[4] The six studies cited in the decision's analysis of "two-sided" markets were all written by at least one author with clear financial connections to the credit-card industry: David S. Evans, Richard Schmalensee, Benjamin Klein, and Andrew Lerner. Mr. Evans has repeatedly served as a paid expert for Visa and has testified on behalf of payment-card clients for over 30 years. *See* David Evans (biography), https://goo.gl/14FccP. Mr. Schmalensee has also repeatedly served as a paid expert for Visa. *See, e.g.*, *United States v. Visa U.S.A*, 163 F. Supp. 2d 322, 331 (S.D.N.Y. 2001); *In re Visa Check/MasterMoney Antitrust Litig.*, 192 F.R.D. 68, 74 (E.D.N.Y. 2000); *In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124, 131 (2d Cir. 2001); *SCFC ILC, Inc. v. Visa U.S.A., Inc.*, 819 F. Supp. 956, 984 (D. Utah 1993); *SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 968 n.13 (10th Cir. 1994); *United States v. Visa U.S.A., Inc.*, 183 F. Supp. 2d 613, 616 (S.D.N.Y. 2001). Finally, Mr. Klein and Mr. Lerner have likewise served as paid consulting and testifying experts for Visa and other credit-card companies. *See* c.v. of Benjamin Klein, https://goo.gl/StVuUa; c.v. of Andrew V. Lerner, https://goo.gl/5S3ZES.

[merchant] services but also included consumers"); *id.* at ¶1505, pp. 170–71 (describing as "troubling" the Second Circuit's "conclusion that when a restraint is alleged in a two-sided market, a *prima facie* case requires the plaintiff to allege net harm aggregated across both sides"); *see generally* Brief of 25 Professors of Antitrust Law as *Amici Curiae* Supporting Petitioners (July 6, 2017) (petition stage).

Even some of the scholarship that the Second Circuit cites in support of its decision—such as work by Jean-Charles Rochet and Nobel Prize recipient Jean Tirole—fails to support the court's position. App. 8a. Credited with pioneering work on platforms that link two or more distinct groups, Rochet and Tirole analyze the various pricing decisions and incentives that face actors in these markets. But neither of their articles cited by the court states that the injury suffered by one set of customers due to anticompetitive restraints should be weighed against potential benefits enjoyed by another set of customers.[5] Insofar as their work *does* examine any balancing or tradeoffs between the two groups, the focus is on levels of *pricing*. Since the conduct at issue is a form of restraint rather than a decision about pricing levels, the work the court cites does not justify the rule it adopted.

Disregarding credible arguments firmly rooted in this Court's antitrust guidance, the Second Circuit adopted an analysis that obfuscates market realities.

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[5] Jean–Charles Rochet & Jean Tirole, *Two–Sided Markets: A Progress Report*, 37 Rand J. Econ. 645, 646, 648 (2006); Jean–Charles Rochet & Jean Tirole, *An Economic Analysis of the Determination of Interchange Fees in Payment Card Systems*, 2 Rev. Network Econ. 69 (2003).

B. Definitions of "two-sided" platforms are too vague and contested to sustain a critical legal distinction.

The Second Circuit introduced an approach to market definition that hinges on whether a firm serves as a platform in a "two-sided" market. But there is no consensus on what constitutes a "two-sided" market,[6] and the parameters of leading definitions can be read broadly. Drawing sharp lines on the basis of a vague and contested definition is a mistake, as it will confuse courts and enable legal arbitrage.

Under one definition of "two-sided" markets, the key feature is that the total volume of transactions is sensitive to the allocation of the prices charged in each market.[7] Say, for example, that a business raises the price it charges Group A (in one market) by three dollars and simultaneously lowers the price it charges Group B (in a second market) also by three dollars. If this change in the *structure* of the relative prices changes the total number of transactions that occur, then the market is considered "two-sided." If, instead, the change does not affect the total volume, then the firm does not operate in a "two-sided" market.

Under this conception, however, even a non-platform firm could self-define as a platform, by treating the prices it pays for inputs as negative prices charged for using the company as a platform to reach buyers. For example, an airline that hiked airfares and increased wages for pilots by the same amount would likely see a

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[6] *See* E. Glen Weyl, *A Price Theory of Multi-Sided Platforms*, 100 Am. Econ. Rev. 1642, 1644 (2010) ("The definition of two-sided markets is controversial.").

[7] Rochet & Tirole, *Two–Sided Markets*, *supra* note 5 at 646, 648.

reduction in the total transaction volume, even as the net price between the two sides remained the same. In this way, even an airline could self-define as a "two-sided" platform.

This lack of clarity is shared by other proposed definitions of "two-sided" markets. Another description, for instance, conceives of them as platforms that (i) can charge different prices to different customer groups, (ii) have market power with respect to those groups, and (iii) generate cross-platform network effects (such that greater usage by group A on one side of the platform makes the platform more attractive to group B on the other side).[8] Again, this definition risks being overly broad. For example, any chicken processor with regional market power could claim status as a platform, since an increase in the number of food retailers it supplies would theoretically also benefit chicken farmers. Upending market definition for sectors ranging from airlines to chicken processing cannot be justified.

Whether a firm gets characterized as a "two-sided" platform may also come to depend on its chosen business model. For example, Netflix charges consumers for content without also seeking advertising revenue, and so would likely be considered "one-sided" under Rochet & Tirole's definition.[9] But a service like Hulu that charges both consumers and advertisers would be "two-sided." The distinction here would be based not on the market in which these firms operate, but on the specific business strategy they adopt. Anti-competitive restrictions imposed by Netflix would effectively be analyzed more harshly than identical restrictions imposed by Hulu—

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[8] Weyl, *supra* note 6.

[9] Rochet & Tirole, *Two–Sided Markets*, *supra* note 5 at 646.

even though both firms compete in the same consumer market. Applying different burden-shifting regimes to companies that operate in the same market and engage in the same anti-competitive conduct makes no sense.

Pegging a fundamental inquiry in antitrust analysis to a concept that has no clear parameters is dangerous. It will encourage a wide swath of firms to seek shelter under this more permissive approach. Lacking a coherent and precise definition of "two-sided" markets, courts will be left to base their analysis on irrelevant aspects of companies' self-definition and business models, rather than on features distinguishing actual industry realities. This Court should reassert its traditional analysis of market definition and reject the Second Circuit's slippery approach.

II. The Second Circuit's approach risks immunizing some of the most dominant companies in America's political economy from antitrust scrutiny.

A. A small number of tech platforms mediate a growing share of our commerce and communications.

While it is not new for one intermediary firm to engage in two distinct but related markets, Internet technologies have enabled the rapid rise of platform companies that fit this description. These firms exercise power over a large and growing share of our nation's commerce and communications. Apple, Alphabet (Google's parent company), Microsoft, Amazon, and Facebook are the world's largest companies by market valuation.[10] All are

[10] Martin Wolf, *Taming the masters of the tech universe*, Fin. Times (Nov. 14, 2017), http://on.ft.com/2AnuHX0.

major platforms that operate in markets that could easily be characterized as "two-sided."

Due to the nature of digital markets, these firms can wield great leverage over both sellers and buyers of goods and services. This has two effects on our political economy. First, it enables platforms to leverage their existing dominance to further entrench their positions and keep out new rivals—conditions susceptible to anticompetitive behavior. Second, it provides them an opportunity to manipulate the interactions between buyers and sellers in ways that may harm both.[11]

Amazon, for example, already captures one of every two dollars spent online, and around half of all online shopping searches begin on its platform.[12] The company accounts for more than 80 percent of e-book sales and is now the second-biggest seller of apparel and footwear in the U.S.[13] In addition to being a dominant retailer, Amazon is also a manufacturer, a massive logistics network, a book publisher, a producer of TV and film, a lender of credit, and the biggest provider of cloud-computing services. News of the company's decisions (or even just speculation around them) regularly causes valuations to plummet and spurs companies to merge.[14]

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[11] Barry C. Lynn, *Killing the Competition*, Harper's (Feb. 2012) http://bit.ly/2BnkRIk.

[12] Olivia LaVecchia & Stacy Mitchell, *Amazon's Stranglehold: How the Company's Tightening Grip Is Stifling Competition, Eroding Jobs, and Threatening Communities*, Inst. For Loc. Self-Reliance 10 (Nov. 2016), http://perma.cc/A4ND-2NDJ.

[13] Brian Heater & Anthony Ha, *A decade of Amazon Kindle*, Tech Crunch (Nov. 19, 2017), http://bit.ly/2AoT6eC; Matthew Boyle, *The Retail Apocalypse Is Fueled by No-Name Clothes*, Bloomberg (Dec. 11, 2017), http://bit.ly/2jRJlPY.

[14] Evelyn Cheng, *Amazon's new Whole Foods discounts wipe out nearly $12 billion in market value from grocery sellers*, CNBC

The firm's history of capturing markets means that investors today effectively allocate capital in many sectors of the U.S. economy based on actions Amazon takes or might take.

Google, meanwhile, enjoys 78 percent of the online search advertising market and captures 55 percent of the global web browser market.[15] Sixty-six percent of smartphone users rely on its Android operating system.[16] Facebook controls 77 percent of mobile social-networking traffic in the United States, and 53 percent of Americans use Facebook every day.[17] Together Google and Facebook are set to command 84 percent of the digital ad market globally, and are capturing 99 percent of the growth.[18] With their dominant positions, these two firms wield outsized control over the flow of information

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(Aug. 24, 2017), http://bit.ly/2BjB1mb; Thomas Franck, *Shares of dental suppliers drop on potential new threat from Amazon*, CNBC (Dec. 6, 2017), http://bit.ly/2ktriiB; Sarah Todd, *The CVS-Aetna deal is actually all about Amazon*, Quartz (Dec. 3, 2017), http://bit.ly/2zOboph.

[15] Shannon Bond, *Google and Facebook build digital ad duopoly*, Fin. Times (Mar. 14, 2017), http://on.ft.com/2npS0cv; Mark Bergen & Scott Moritz, *Google Pays to Put Search Back on Firefox Browser in U.S.*, Bloomberg (Nov. 14, 2017), https://bloom.bg/2jShAGY.

[16] *iPhone market share slips in October-quarter*, Reuters (Dec. 5, 2017), http://reut.rs/2ChtLVr.

[17] Robert Verbruggen, *Google Facebook, Amazon: Our Digital Overlords*, Nat'l Rev. (Dec. 12, 2017), http://bit.ly/2Aoi5Pt; Robinson Meyer, *Facebook Is America's Favorite Media Product*, The Atlantic (Nov. 11, 2016), http://theatln.tc/2ePLZU4.

[18] Matthew Garrahan, *Google and Facebook dominance forecast to rise*, Fin. Times (Dec. 3, 2017), http://on.ft.com/2jKl913; Matthew Spector, *Facebook's Russia Problem Proves Feds Are Missing the Point*, WIRED (Nov. 16, 2017), http://bit.ly/2zbFxB4.

in society.[19] And as Americans have learned over the last year, this control appears to give them even the power to censor viewpoints and sway elections.[20]

Given the increasingly dominant role a small number of tech platforms play in our political economy today, the implications of the Second Circuit's new rule are especially troubling.

B. By dramatically raising the plaintiffs' initial burden, the Second Circuit's rule will exempt platforms from effective antitrust review.

The nature of digital markets, along with the slowness of antitrust officials to grasp the reality of how these markets work, suggests that the platform giants of today will continue to dominate numerous realms of our economy and society for years to come. Key features of these markets—such as the fact that established players dominate without facing any real threat of entry—raise the likelihood of anticompetitive conduct, and thereby raise the importance of antitrust enforcement. But the Second Circuit's new rule risks exempting platforms from real scrutiny.

Effective antitrust enforcement in these markets is paramount because (1) rivals are not likely to dislodge Amazon, Google, and other platforms from their dominant roles and (2) the increasingly essential nature of the services they provide gives them immense leverage over sellers and buyers across markets. Several factors account for entry barriers. First is the fact of network

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[19] Robert Verbruggen, *Google Facebook, Amazon: Our Digital Overlords*, Nat'l Rev. (Dec. 12, 2017), http://bit.ly/2Aoi5Pt; Wolf, *supra* note 10.

[20] Emily Bell, *Silicon Valley helped Russia sway the election*, The Guardian (Oct. 29, 2017), http://bit.ly/2ifTRia.

effects, whereby each additional user of the network enhances the value of the entire network, yielding a massive edge to players that acquire an early lead.[21] Second, a platform's control over data tends to entrench its position.[22] Access to user data enables platforms to better customize services and gauge demand, and also positions firms to leverage insights collected in one market to benefit another business line.[23] Network effects combined with the self-reinforcing advantages of data means that tech platform markets are winner-take-all: a company looking to compete in these markets must seek to capture them.

The winner-take-all nature of platform markets, in turn, incentivizes potentially anti-competitive conduct. Amazon, for example, established dominance as an online platform partly through sustaining losses and engaging in predatory pricing; indeed, it consistently listed negative returns for the first seven years it was in business.[24] Yet Amazon's stock price has soared despite the fact that it has invested most profits into infrastructure investments or pricing below cost. In essence, investors have given Amazon a free pass to grow without any pressure to show profits—enabling the firm to sink money to capture market share and acquire rivals. A similar situation is at play with Uber: it lost $708 million in the first quarter of 2017 alone, yet investors "applauded."[25] By rationalizing the pursuit of growth at the

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[21] Maurice Stucke & Allen Grunes, BIG DATA AND COMPETITION 163 (2016).

[22] Frank Pasquale, BLACK BOX SOCIETY 83 (2015).

[23] Lina M. Khan, *Amazon's Antitrust Paradox*, 126 Yale L. J. 710, 780–83 (2017).

[24] *Id.*

[25] Seth Fiegerman, *Uber is losing billions: Here's why investors*

expense of returns, platform markets incentivize predation. In other words, not only do these markets suffer from a lack of competition, but—given the dynamics of digital markets—they are also more conducive to anticompetitive conduct, underscoring the need for effective antitrust.

Critically, the informational advantages that dominant tech platforms enjoy enable them to quash nascent rivals in the bud. Facebook, for example, uses a privacy application it acquired to track closely which rival products divert users from Facebook. This "unusually detailed look at what users collectively do on their phones" serves as an "early bird" warning system to flag potential competitors.[26] By seeing which other products and features are doing well, Facebook can target fast-growing rivals by rolling out replicas, or can seek to purchase the companies themselves. And because Facebook can spot product success before anyone else, it can acquire firms for far cheaper than what it would pay absent its informational advantage—and can do so without triggering antitrust review. In this way, platform markets have created new pathways for dominant actors to choke off start-ups and undermine innovation.[27] This Court's ruling has the potential to add an artificial legal advantage to the structural market advantages these companies already enjoy.

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don't care, CNN (June 1, 2017) http://cnnmon.ie/2rqNi0o.

[26] Betsy Morris & Deepa Seetharaman, *The New Copycats: How Facebook Squashes Competition from Startups*, Wall St. J. (Aug. 9, 2017), http://on.wsj.com/2vmw4TT.

[27] Elizabeth Dwoskin, *Facebook's willingness to copy rivals' apps seen as hurting innovation*, Wash. P. (Aug. 10, 2017), http://wapo.st/2kt3E5B.

Affirming the Second Circuit will likely stymie one of the main avenues for antitrust enforcement. While antitrust agencies have shown some interest in policing abuses by dominant platforms, there is growing evidence that their enforcement efforts have lagged behind the evolving realities of market power in digital markets. Despite finding that Google violated antitrust laws on three counts, for instance, the Federal Trade Commission failed to bring an action, settling for voluntary concessions from Google instead.[28] The agency missed an important opportunity for halting anticompetitive conduct and, by doing so, closed off the market to new entrants at a critical moment.[29] By dramatically expanding what a plaintiff must allege in establishing a *prima facie* case, the Second Circuit's rule will pose a major obstacle to much-needed enforcement.

Given that tech platform markets are ripe for anticompetitive conduct, an approach that risks immunizing dominant platforms from antitrust scrutiny is deeply problematic. If the Second Circuit's novel rule is allowed to persist, these firms will further centralize control over commerce and communications, undermining open markets, free enterprise, and core liberties.

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[28] Brody Mullins et al., *Inside the U.S. Antitrust Probe of Google*, Wall St. J. (Mar. 19, 2015), http://perma.cc/H4PZ-JZ9K.

[29] Frank Pasquale, *Paradoxes of Digital Antitrust: Why the FTC Failed to Explain Its Inaction on Search Bias*, Harv. J. L. & Tech. Occasional Paper Series, July 2013, http://bit.ly/2AF0Tcq.

CONCLUSION

The Court should reverse the decision below.

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