No. 16-1454

IN THE
Supreme Court of the United States

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

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

BRIEF FOR RESPONDENTS AMERICAN EXPRESS COMPANY AND AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC.

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QUESTION PRESENTED

Whether Section 1 of the Sherman Act condemns a vertical restraint in a case where the defendant lacks market power and the plaintiff fails to offer evidence of reduced output or supracompetitive prices in the affected market.

CORPORATE DISCLOSURE STATEMENT

Pursuant to this Court's Rule 29.6, respondents American Express Company and American Express Travel Related Services Company, Inc. state the following:

American Express Company is the parent company of American Express Travel Related Services Company, Inc., and American Express Company is a publicly held company. Berkshire Hathaway Inc., a publicly held corporation, owns more than 10% of the outstanding shares of American Express Company.

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INTRODUCTION

Amex offers consumers a premium credit card with generous benefits. Those benefits are funded by transaction fees paid by merchants. Merchants do not have to accept the Amex card, and many merchants that process billions of dollars of transactions annually do not. Those that do, however, benefit from the investments Amex has made to promote use of its card by consumers who spend more, on average, than other cardholders. In exchange, Amex obligates accepting merchants not to discriminate against Amex cards by discouraging cardholders from using Amex at the point of purchase.

For decades, these nondiscrimination provisions have enabled Amex to innovate and compete effectively against the dominant payment networks. The result has been intense competition among credit cards, leading to an explosion of output fueled by increased consumer benefits.

Plaintiffs ask the Court to disrupt this thriving market by holding that Amex's nondiscrimination provisions are unlawful under Section 1 of the Sherman Act. But this Court has not affirmed the imposition of liability under Section 1 based on a vertical restraint in decades, and for good reason. Unlike horizontal agreements among competitors, vertical agreements between firms at different levels of the chain of distribution or production are not only essential to commerce but also presumptively procompetitive. Absent horizontal collusion – which is not alleged here – an actor without market power imposes a vertical restraint for only one reason: to compete more effectively.

Plaintiffs failed to meet their burden of proving that Amex's nondiscrimination provisions harmed competition. In a ruling that they do not challenge, the Second Circuit held that they failed to prove that Amex has market power. If a firm lacks market power – the power to reduce market-wide output by curtailing its own supply – it cannot harm competition through a vertical restraint. If the firm tries to reduce output, other firms will pick up any slack. As the Second Circuit properly concluded, that is the case with Amex, which has only one quarter of U.S. credit card transaction volume, less than 10% of credit cards in circulation, and one-third fewer merchants accepting its cards compared to competing networks. Amex's lack of market power is a sufficient basis to affirm.

Plaintiffs contend that they can skip any showing of market power by proving "directly" that a vertical restraint has anticompetitive effects. This case illustrates why Plaintiffs' argument is a throwback to an era when vertical restraints were routinely (and wrongly) condemned. In the absence of market power, vertical restraints do not restrain output because they leave rivals free to compete. Yet subjecting such restraints to further scrutiny risks erroneous decisions that will deter procompetitive conduct and harm consumers.

Plaintiffs' attempt to bypass Amex's lack of market power is even more troubling given that they also advocate a standard for direct effects that imposes no meaningful limits on potential liability. It would allow a plaintiff to prevail simply by showing that a vertical restraint interferes with the "competitive process." Plaintiffs have little choice but to urge this

diminished standard because their direct proof of competitive harm was fundamentally deficient, as the Second Circuit correctly recognized.

To demonstrate anticompetitive effects from the nondiscrimination provisions, Plaintiffs had to show reduced output or quality and/or supracompetitive pricing. Plaintiffs made no effort to show that Amex had reduced the quality or quantity of credit card transactions. Indeed, they conceded that output had exploded and that quality has been increasing.

Instead, Plaintiffs relied exclusively on supposed evidence of price increases. But that evidence does not show competitive harm; it is perfectly consistent with vibrant competition. First, Plaintiffs' evidence related solely to prices *to merchants*, when Plaintiffs acknowledge that a credit card transaction – the relevant measure of output – involves simultaneous consumption by merchants *and cardholders*. Merchant prices in isolation thus are not an accurate proxy for output and the competitive health of the market. Second, even if merchant prices in isolation were relevant, the pricing evidence that formed the basis of the district court's decision did not correspond to the market definition the district court adopted. Third, even setting all that aside, evidence of increased prices is not equivalent to proof of supracompetitive prices – pricing above marginal cost – which Plaintiffs concededly lack. Price increases are consistent with increasing costs to Amex from serving cardholders and merchants. A rule that ignores the costs of doing business would punish firms like Amex for providing superior products.

None of these deficiencies can be overcome by Plaintiffs' complaints about alleged distortion of the "competitive process." Those arguments rely on this

Court's cases involving "quick look" analysis applicable only to *horizontal* restraints – a red flag that Plaintiffs are trying to cut evidentiary corners. And allowing Plaintiffs to satisfy their burden by substituting economic generalities for actual proof of market harm will open the door wide to meritless litigation and mistaken condemnation of vertical restraints that enhance competition – all to the detriment of consumers and the U.S. economy.

In short, Plaintiffs have failed to show market power; they have failed to prove anticompetitive effects; and they ask this Court to elide the settled distinction between horizontal and vertical restraints. To interfere with the nondiscrimination provisions under Plaintiffs' amorphous legal standard would risk draining the market of vibrancy and innovation that has brought enormous benefit to consumers. This Court should decline that invitation and affirm.

STATEMENT

A. Factual Background

1. The Credit Card Industry Is Characterized by Intense Competition

The market for general-use credit and charge cards – for simplicity, "credit cards" – is characterized by vigorous competition among four major competitors. Measured by transaction volume, which all parties agree is the proper measure of output, as of 2013 (the year Amex's market share peaked), Visa accounted for 45% of all credit card volume, followed by Amex (26.4%), MasterCard (23.3%), and Discover (5.3%). *See* App. 13a. In that same timeframe, Visa and MasterCard together accounted for more than 432 million cards in circulation in the United States as compared to the 53 million Amex cards in circulation. *See* E.D.N.Y. Dkt. 447-1, ¶ 18.

Industry output has increased dramatically while Amex's nondiscrimination provisions have been in place. *See* App. 52a-53a. That output explosion has been driven by intense competition for both acceptance by merchants and spending by cardholders. *See generally* Tr. 6393:22-6395:4 (describing the various "channels of competition that exist today," including competition to attract consumers to use particular cards, competition for "corporate accounts," "competition for co-brand partnerships," and "competition for merchant acceptance"). Both merchants and cardholders have benefited from the superior value created by that intense competition. *See*, *e.g.*, App. 52a (describing cardholder benefits); Tr. 417:16-418:17, 1312:5-1313:4 (describing merchant benefits such as "building business" and signing bonuses).

Amex has led the industry in providing innovative cardholder and merchant services. On the cardholder side, Amex's signature Membership Rewards program provides cardholders with economic rewards for using the card (for example, airline miles or points redeemable for goods and services), as well as other valuable benefits (such as cash back, fraud protection, extended warranties, and purchase and return protection). *See* App. 16a, 18a, 89a. Amex's innovation also has resulted in greater "financial inclusion" in the credit card market. Tr. 4318:20-4320:23. For example, Amex's Blue Bird co-branded Walmart card is a "completely free product" that provides banking and card-payment services to those without a bank – in particular, people "in poor communities where traditional banks don't want to serve them." Tr. 3722:10-3723:14; *see also* Tr. 4318:16-25 ("70 million Americans . . . are unbanked").

On the merchant side, Amex has developed innovative data-analysis tools "to deliver marketing and data analytics services to merchants that its competitors cannot match." App. 88a. Merchants value those analytics for targeted advertising, geographic expansion, and other business strategies. *See id.*; *see also*, *e.g.*, Tr. 5530:10-5540:24 (describing merchant's use of Amex's data analytics to determine "the viability of . . . new [store] location[s]"). Amex also provides unique marketing opportunities for merchants. For example, Amex's "Small Business Saturday" and "Shop Small" programs have successfully provided financial incentives for cardholders to spend at small businesses. Tr. 5279:22-5280:10, 5704:13-5708:14.

2. Credit Card Networks Are Two-Sided Platforms with "Multihoming" on Both Sides

a. Credit card networks are referred to as "two-sided" platforms because their core service is bringing together merchants and cardholders to engage in a single transaction. *See* App. 77a (card networks compete for "two separate yet interrelated groups of customers who . . . rely on [their chosen] platform to intermediate some type of interaction between them"); Tr. 6056:12-15 ("It's extremely important to understand that there are two sides of the coin that [card-payment companies] serve every day. The first one is the customer, the Cardmember; and the second one is the merchant."). Without a merchant that accepts the card and a customer willing to use the card at the point of sale, no transaction will be consummated. *See* App. 118a, 185a (calling cardholder and merchant demand "inextricably linked" and "intertwined").

Credit card platforms are often referred to as "simultaneous" two-sided platforms because they exhibit a special quality not found in many other two-sided

platforms. *See* App. 78a. A credit card transaction cannot occur unless a merchant and a cardholder jointly and simultaneously decide to use the network's services. With respect to the consummation of a transaction, the card networks' provision of service to the merchant is inseparable from the provision of service to the cardholder. *See id.* ("for every unit of payment services sold to the cardholder at the moment of purchase, a matching service is sold to the merchant in order to execute the transaction, and vice versa").

Likewise, the price charged by card networks for completing a transaction is "two-sided," consisting of a positive price to merchants – known as the merchant discount or fee (and usually calculated as a percentage of the cardholder's purchase amount) – and a "negative" price to cardholders, who receive rewards and other valuable benefits for using their cards. *See* App. 9a, 14a-15a; App. 16a (describing the "numerous" benefits Amex provides to cardholders). The fees paid by merchants fund the incentives paid to cardholders to encourage card use. *See* App. 50a.

b. "[C]ardholders benefit from holding a card only if that card is accepted by a wide range of merchants, and merchants benefit from accepting a card only if a sufficient number of cardholders use it" to make a purchase – a phenomenon known as "network effects." App. 8a. "[N]etwork effects exist when the number of agents or the quantity of services bought on one side of a two-sided platform affects the value that an agent on the other side of the platform can realize." App. 79a (citing, *inter alia*, David S. Evans & Richard Schmalensee, *The Industrial Organization of Markets with Two-Sided Platforms*, 3 Competition Pol'y Int'l 151, 151-52 (2007)).

Because "merchants' demand for payment card acceptance is largely derived from consumers' demand for payment card usage," providing incentives for cardholder usage of a network's card enhances the network's value to merchants. App. 81a; *see also*, *e.g.*, Tr. 2630:21-25 (benefits that give cardmembers incentives to use a particular card "turn into benefits for the merchants" accepting that card "because these cardmembers are now more incentivized to go and spend at the merchants on the network"). The merchant fee thus funds the rewards and other benefits that give cardholders incentives to carry and use their cards, which in turn creates greater value to merchants. *See* App. 39a (discussing the "feedback effect" between merchant and cardholder sides of the platform).

c. Both the merchant and cardholder sides of the credit card platform are characterized by "multi-homing": virtually all merchants accept more than one network's cards, and most cardholders carry more than one type of credit card. *See* App. 16a. Acceptance of a network – by a merchant or a cardholder – does not by itself result in any transactions. Rather, a transaction requires a further decision by a cardholder at the "point of sale" to use one network's card – and not a rival's card – to consummate the transaction. For example, if a cardholder carries Visa, MasterCard, and Amex cards, and the merchant accepts all three, the cardholder's choice of which card to use will determine which network has successfully competed for that transaction. *See* App. 16a-17a.

3. The Nondiscrimination Provisions Are Vertical Restraints That the Credit Card Networks Independently Implemented To Enhance Interbrand Competition

Because of the network effects between the cardholder and merchant sides of the platform, a credit card network must balance prices and other terms of dealing on both sides of the market. Finding an optimal balance maximizes the value of the network's services to both cardholders and merchants, and thus enhances the network's ability to compete effectively against its rivals. *See* App. 9a; *see also* Tr. 2886:5-10 ("[W]e invest an awful lot in our card . . . products, we invest a lot in our merchant business, we're constantly trying to strike the right balance and ensure that both constituents are seeing the value in doing business with American Express.").

Yet "[t]his can be a difficult task since cardholders' and merchants' respective interests are often in tension: merchants prefer lower network fees, but cardholders desire better services, benefits, and rewards that are ultimately funded by those fees." App. 9a. Although merchants benefit from networks' investment in cardholder rewards and other benefits, *see supra* p. 8, merchants would (obviously) prefer to pay lower discount rates. One way merchants historically sought to do so was to dissuade cardholders from using their chosen card at the point of sale – a practice known as "steering." *See* App. 18a-19a.

Merchant steering has several harmful effects. *See* App. 21a. First, merchant steering directly undermines Amex's efforts to promote "welcome acceptance" – "a frictionless and consistent point-of-sale experience" – which is critical to the relationship of trust between Amex and its cardholders. *Id.*; *see* Tr.

4633:16-24 (Amex CEO's testimony that "[w]elcome acceptance" was and is the "cornerstone of trust"). Such an effect is particularly corrosive, because a negative experience using Amex makes the cardholder less likely to use the card for subsequent transactions. Second, merchant steering undermines the investment that Amex makes – through Membership Rewards and other benefits – to encourage its cardholders to use Amex rather than one of the other cards that almost all Amex cardholders also carry. Merchant steering thus "interferes with a network's ability to balance its two-sided net price." App. 21a.

To prevent the harmful effects of merchant steering, Amex implemented "anti-steering" policies, or "nondiscrimination provisions," in its agreements with merchants. App. 19a-21a. Amex has had nondiscrimination provisions in its merchant agreements since the 1950s. *See* App. 19a. Under those provisions, if a merchant chooses to accept Amex, it agrees not to engage in specified conduct that attempts to dissuade cardholders from using their card of choice. *See* App. 19a-20a (describing Amex's current nondiscrimination provisions). Amex strengthened these nondiscrimination provisions in the 1990s following successful campaigns by Visa to encourage merchant steering with the goal of undermining "welcome acceptance." App. 19a, 21a. Those campaigns were designed not to improve Visa's competitive offering but rather to weaken Amex by destroying its ability to attract cardholders by providing rewards and services those cardholders valued. *See* C.A. App. 1257 (PX0132, at 0003930) (describing campaign as designed to undermine Amex's strategy of investing merchant fees in "advertising, systems and services," thereby "breaking [Amex's] success cycle").

By the time this suit was filed, Visa, MasterCard, and Discover had independently implemented their own nondiscrimination provisions. *See* App. 22a; Tr. 926:6-15.

4. Amex's Differentiated Business Model Provides a Vital Competitive Check on Visa and MasterCard

Amex's nondiscrimination provisions – and the "welcome acceptance" they ensure its cardholders – are critical to Amex's ability to provide cardholder benefits, differentiate its business model, and compete effectively with Visa and MasterCard, which have entrenched structural advantages.

a. Visa's and MasterCard's market dominance is rooted in their historical structure. Both emerged in the mid-1960s as "open-loop," joint-venture bank associations whose member banks issued Visa- or MasterCard-branded cards to their retail banking customers, contracted with merchants to accept payment cards, or both. App. 12a-13a, 85a n.5. "Issuing banks" have relationships with cardholders, issuing them cards and billing them for their purchases. "Acquiring banks" have relationships with merchants, paying for cardholder purchases (less the merchant fee or discount) and obtaining payment from the issuing bank (less the applicable "interchange" fee). *See* App. 5a-6a, 13a. The acquiring bank also pays a "network fee" to Visa or MasterCard. *See* App. 56a. Although similar cooperative bank associations came into existence during the same period, Visa and MasterCard soon became "the two national associations that '[j]ust about every bank in the card field' became 'convinced' they must join." App. 12a (quoting David S. Evans & Rich-

ard Schmalensee, *More than Money*, *in Platform Economics: Essays on Multi-Sided Businesses* 282, 290 (David S. Evans ed., 2011)) (alteration in original).

Visa and MasterCard maintained their joint-venture status until 2006 and 2008, when first Visa and then MasterCard "converted . . . into single-entity, publicly traded companies with no bank governance." App. 85a n.5. But, even following this change, Visa and MasterCard continued to operate as "cooperative," "open-loop," or "umbrella" networks of "issuing" and "acquiring" banks. App. 5a-6a, 13a.

Amex, in contrast, operates a different business model – one that is "unique in the industry." App. 87a. It relies on a "closed-loop" network, meaning that the company has direct relationships with nearly all Amex cardholders and Amex-accepting merchants. App. 14a-15a. Amex did not start out as a bank association and, to this day, few Amex cards are issued by third-party banks.[1] Rather, Amex itself typically provides card-issuing services to cardholders and acquiring and processing services to merchants, as well as the network services necessary to facilitate transactions between the two. *See* App. 15a.

Visa and MasterCard continue to have significant structural advantages over Amex – most important, ubiquity among both cardholders and merchants. If a retail customer of a bank wants a credit card, the fact that "[j]ust about every bank in the card field" is in the

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[1] For many years, Visa and MasterCard unlawfully barred member banks from issuing Amex (or Discover) cards. *See United States v. Visa U.S.A., Inc.*, 344 F.3d 229 (2d Cir. 2003) (affirming the invalidation of these "exclusionary rules" as anti-competitive horizontal restraints). In recent years, Amex has contracted with a very limited number of third-party U.S. banks to act as issuers. *See* App. 85a.

Visa and MasterCard networks makes issuance of a Visa or MasterCard nearly inevitable. App. 12a (alteration in original); *see* Tr. 4329:21-25 ("The reality is that Visa and MasterCard . . . ha[ve] access to all the banks, channels and capabilities. So you open up a checking account, you got a card.").

The ubiquity of Visa and MasterCard cardholders also means that Visa and MasterCard are accepted by virtually every card-accepting merchant in the United States. *See* App. 17a. In contrast, the district court found that "[a]pproximately three million of the total nine million U.S. merchant locations that accept credit cards – that is, roughly one out of every three – do not accept Amex cards." App. 17a, 85a; *see* Tr. 3398:18-3399:20 (describing Visa and MasterCard commercials highlighting merchants that "don't take American Express").

In addition, the vast majority of Amex cardholders carry a Visa or MasterCard, while only a relatively small number of Visa and MasterCard cardholders also carry an Amex card. *See* Tr. 3686:6-20. Thus, "when compared to the ubiquity enjoyed by Visa and MasterCard," Amex "may be fairly characterized as a discretionary card." App. 159a.

Given Visa's and MasterCard's dominant positions in the market, Amex must compete fiercely for both merchant acceptance and cardholder loyalty – a loyalty that would rapidly "dissipate" if Amex were to offer lower value to cardholders than its rivals do. App. 46a; *see also* Tr. 6373:4-7 ("[c]ustomers can be stolen away from Amex, and any loyalty has to be re-earned constantly by delivering value to customers"); Tr. 4162:6-18.

b. Amex's business model is also differentiated in another critical way. "Unlike Visa and MasterCard,

which run 'lend-centric' models deriving more than half their revenues from interest charged to cardholders for unpaid balances on the cardholder's charges for a given billing period, Amex runs a 'spend-centric' model whose revenues are primarily dependent on merchant-discount fees." App. 16a. "This model is critical to Amex's merchant value proposition, which is that merchants who accept Amex gain access to 'marquee' cardholders who tend to spend more on both an annual and per-transaction basis than customers using alternative payment methods." *Id.*; *see* App. 176a-177a (finding that Amex "does, in fact, deliver on its differentiated value proposition to merchants in many respects"). "Amex's model is also critical to its cardholder value proposition," because the merchant fees fund the rewards Amex provides to cardholders to use their Amex cards. App. 16a.

Amex's spend-centric business model has spurred greater innovation and product choice in the market. "Beginning around 2006, for example, both Visa and MasterCard introduced new premium card categories . . . to enable issuers to more effectively compete with Amex's high-reward products." App. 179a. As a result of this competition, "industry-wide transaction volume has substantially *increased* and card services have significantly *improved* in quality." App. 52a.

B. Proceedings Below

1. On October 4, 2010, the United States, eventually joined by petitioners (collectively, "Plaintiffs"), sued Amex, Visa, and MasterCard, alleging that the nondiscrimination provisions in each network's merchant agreements unreasonably restrained trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. Visa and MasterCard (which face little risk of having their cardholders steered to Amex, which most

of those cardholders do not carry) entered into a consent judgment in 2011 and rescinded their nondiscrimination provisions, while Amex proceeded to trial.

Following a bench trial, the district court held that Amex's nondiscrimination provisions violate Section 1. The court recognized that the nondiscrimination provisions are vertical non-price restraints subject to rule-of-reason scrutiny. App. 105a-106a. Under the three-part burden-shifting framework used by the Second Circuit, Plaintiffs bore "an initial burden of demonstrating that the challenged restraints have had an 'adverse effect on competition as a whole in the relevant market.'" App. 108a. The district court reasoned that Plaintiffs could discharge that burden either: (1) by proving that Amex has market power in a properly defined market and showing that there are "other grounds" to believe that the nondiscrimination provisions will cause competitive harm, or (2) by showing "directly" that the nondiscrimination provisions cause an "actual adverse effect" or harm to market-wide competition. App. 108a-109a.

The district court acknowledged that credit card networks are simultaneous two-sided platforms. App. 78a. Indeed, those findings were compelled by the trial testimony of Plaintiffs' own economic expert, Professor Katz, who agreed that "an assessment of market definition, market power and competitive effects should account for the two-sided nature of the market" and that "[i]t is critical not to draw unwarranted and misleading conclusions by focusing solely on one side of a two-sided market." JA249-50.

Nonetheless, the district court focused on the impact of the nondiscrimination provisions on merchants alone to find that Plaintiffs had satisfied their initial burden of showing an adverse effect on competition.

First, the district court defined the relevant market as "network services," the half of the two-sided platform where Amex, Visa, MasterCard, and Discover compete for merchant acceptance. App. 114a-118a. It excluded cardholders from the relevant market because doing so would go "too far" and "frustrate" the analysis of anticompetitive effects. App. 116a-118a, 122a.

Second, the district court concluded that Amex had market power by analyzing the effects of Amex cardholder loyalty and Amex pricing changes on merchants only. While the court recognized that "Amex's market share alone likely would not suffice to prove market power," it nonetheless found that Amex enjoyed a more significant position in the market than its share would suggest due to "cardholder insistence" – meaning consumer loyalty that could cause some Amex cardholders not to shop, or to spend less, at a merchant that chose not to accept Amex. App. 156a. While it recognized that such insistence would "dissipate" the moment Amex stopped offering robust cardholder benefits, the court rejected the notion that cardholder loyalty was not "durable," citing "high barriers to entry in the network services market." App. 164a-165a.

The district court next pointed to evidence that Amex had increased merchant fees to certain merchants without significant merchant defection. App. 165a-169a. In determining that Amex's prices had increased, the court declined to take into consideration the cost to Amex of cardholder rewards or other cardholder investments, which the government failed to prove. App. 182a-184a.

Third, the district court held that Plaintiffs had directly demonstrated anticompetitive effects, confining

its analysis again to the nondiscrimination provisions' effects on merchants. App. 194a-203a. The court conceded there was no "empirical evidence that the [nondiscrimination provisions] have resulted in a higher two-sided price – i.e., that the price charged across Amex's entire platform, accounting for both [merchant] discount revenue and the expense of providing cardholder rewards, increased as a result of the network's anti-steering rules." App. 209a. The court nonetheless concluded that, because "these restraints have resulted in higher all-in *merchant* prices across the network services market," Plaintiffs had shown "proof of their actual anticompetitive effect." App. 207a (emphasis added).

The district court acknowledged both that there was no reliable evidence of Amex's profit margins, App. 172a-173a, and that there was an "absence of clarity with respect to whether Amex maintains a premium in today's market and whether such premium is or has been justified by the network's differentiated value propositions," App. 180a. The court nevertheless determined that Amex's prices are "supracompetitive." App. 207a-212a. The court placed no weight on the fact that Amex's (and other networks') purported price increases occurred during a time when transaction output surged and costs increased due to "ever more robust suites of rewards and other ancillary [cardholder] benefits." App. 238a.

2. The Second Circuit unanimously reversed. It held that, accepting the district court's factual findings, Amex was entitled to judgment as a matter of law because Plaintiffs failed to carry their burden to show harm to competition. As the court of appeals explained, the district court's fundamental error was excluding cardholders from its analysis.

The court reasoned that limiting the relevant market *to merchants* failed to "consider the feedback effects inherent on the platform by accounting for the reduction in cardholders' demand for cards (or card transactions) that would accompany any degree of merchant attrition" in response to a price increase. App. 39a. The district court's market definition also failed to take into account the "commercial realities" of the market, including the joint and simultaneous nature of cardholder and merchant demand. App. 32a-35a. "Separating the two markets here – analyzing the effect of Amex's vertical restraints on the market for network services while ignoring their effect on the market for general purpose cards – ignores the two markets' interdependence" and "allows legitimate competitive activities in the market for general purposes to be penalized no matter how output-expanding such activities may be." App. 34a-35a.

The Second Circuit also disagreed with the district court's conclusions that Amex possessed sufficient market power to affect competition adversely in the relevant market and that the nondiscrimination provisions had an actual adverse effect on competition. As to market power, the Second Circuit held that, in relying on evidence of increases in merchant fees as a basis for its finding of market power, the district court had ignored the costs Amex incurred to build the value of its network. "The District Court erred . . . by failing to recognize that increased demand on the cardholder side of the platform expands value on the merchant side. In other words, the District Court did not acknowledge that increases in merchant fees are a concomitant of a successful investment in creating output and value." App. 43a.

The Second Circuit also held that cardholder insistence fails to form a source of market power because, as the district court's findings made clear, Amex cardholder loyalty simply reflects "competitive benefits on the cardholder side of the platform and the concomitant competitive benefits to merchants who choose to accept Amex cards." App. 45a. That Amex must constantly compete to offer "robust rewards programs" and other benefits to cardholders – that other networks can and do attempt to replicate – "indicates, if anything, a *lack* of market power." App. 46a. Moreover, concluding that cardholder insistence prevents merchants from dropping Amex ignores the finding that nearly one-third of credit card-accepting merchants do not accept Amex. App. 46a-48a.

As to anticompetitive harm, the Second Circuit held that the district court "erroneously elevated the interests of merchants above those of cardholders" by finding that Plaintiffs had carried their burden to show competitive harm without proving the impact of the nondiscrimination provisions on "the two-sided net price [that] account[s] for the effects of the [nondiscrimination provisions] on both merchants and cardholders." App. 49a. Applying the correct legal standard to the record, Plaintiffs' proof failed as a matter of law to establish that the nondiscrimination provisions adversely affect competition among credit card networks – particularly given the lack of evidence of Amex's two-sided price or profit margins, and the undisputed evidence of increasing output and higher-quality cardholder benefits. App. 49a-53a. The court also noted that, even as to the prices charged to merchants, the government never attempted to prove the price of its proposed relevant product: "network

services" provided to merchants. Instead, the government attempted to show competitive effects through evidence concerning the full merchant discount rate, which covers a broader bundle of services, not simply fees associated with network services. App. 37a-38a n.45.

"One of the ironies of this case," the Second Circuit pointed out, "is that the government, which usually worries about oligopolists engaging in indirect collusion leading to pricing similarities, seeks relief . . . that might drive the three cards to greater similarities," which "could . . . increase market concentration by reducing Amex's share to Visa's and MasterCard's benefit." App. 48a-49a n.51.

The Second Circuit denied Plaintiffs' petition for rehearing en banc without any dissent and without requesting a response.

SUMMARY OF ARGUMENT

At trial, Plaintiffs sought to show anticompetitive harm under the rule of reason both indirectly, by showing market power and grounds for believing the challenged restraint could harm competition, and directly, by showing actual adverse effects on competition. Petitioners do not challenge the Second Circuit's holding that Plaintiffs' proof of market power was inadequate; they contend only that they directly proved actual adverse effects on competition. Plaintiffs further argue that they can meet that burden simply by showing that a vertical restraint disrupts the "competitive process."

This Court should affirm on either of two grounds. First, this Court should hold that a vertical restraint cannot be condemned as an unlawful restraint of trade under the rule of reason if the defendant lacks market power, as Amex does. Second, alternatively, it should

affirm the Second Circuit's correct conclusion that Plaintiffs failed to demonstrate direct anticompetitive harm under the proper standard, which requires actual proof of reduced output, reduced quality, and/or supracompetitive prices.

I.A. This Court's precedents draw a basic distinction between horizontal and vertical restraints. Agreements between competitors reduce the intensity of rivalry that is critical to competition. Vertical restraints – though sometimes disliked by distributors whose freedom is constrained – promote the interests of consumers by allowing a producer to compete more effectively against its rivals, thus intensifying interbrand competition. Accordingly, restraints that were once condemned as *per se* unlawful now are recognized as benign, at least in the absence of market power.

B. The nondiscrimination provisions at issue here are a classic vertical restraint that intensifies interbrand competition. It is perfectly reasonable for Amex to insist, as a condition of dealing, that a merchant stand behind Amex's cards at the very moment a customer chooses which card to use, rather than advocate for rival networks in service of the merchant's own short-term self-interest. The challenged restraints enhance Amex's efforts to promote a superior product that can compete against its powerful and ubiquitous rivals. Conversely, merchant steering thwarts those competitive efforts by undermining card networks' investment in the rewards and other benefits that make cards attractive to consumers.

C. This Court should hold that, when a defendant lacks market power, as Amex does here, a vertical restraint such as the nondiscrimination provisions cannot be condemned under the rule of reason. A firm with market power – the power to reduce market-wide

output by curtailing its own supply – can harm consumers because it can deprive some of them of desired supply and increase prices for the rest. But, if a firm lacks such power, curtailing supply unilaterally will simply result in a loss of market share, because other suppliers will fill the gap.

A firm that lacks market power cannot harm competition through a vertical restraint because such restraints leave rivals free to meet market demand. In cases challenging vertical restraints, permitting a plaintiff to dispense with a showing of market power will erroneously subject firms to treble damages and the high costs of litigation, deterring innovation that benefits consumers.

D. As the Second Circuit correctly determined, Amex – which accounts for only 26% of credit card transaction volume and only 10% of cards in circulation – lacks market power. Plaintiffs have not challenged that holding, and the district court's reasons for reaching a contrary conclusion were incorrect. Neither the fact that Amex is broadly accepted nor the fact that certain cardholders prefer to use Amex over other cards suggests that Amex has any ability to constrain market-wide output. And there was no evidence that Amex had any ability to impose price increases not justified by the cost and quality of the service provided.

II.A. The Second Circuit's holding that Plaintiffs failed to demonstrate harm to competition is also correct.

The quantity and quality of output in the market for credit card services have increased sharply while the nondiscrimination provisions have been in effect – sure signs of the market's competitive health. Petitioners' effort to rely instead on alleged increases in

prices charged to merchants as evidence of anticompetitive effects failed for several reasons. Most fundamentally, given the unusual, two-sided nature of the market – each credit card transaction is jointly and simultaneously consumed by a merchant and a cardholder – merchant prices in isolation do not provide an accurate proxy for output. Moreover, the all-in merchant discount is not a measure of the price of "network services" – the "product" in the market that Plaintiffs say was affected. And, just as important, evidence about prices alone – in the absence of evidence of costs and margins – cannot show anticompetitive effects.

B. Plaintiffs suggest that the rule-of-reason standard should be relaxed in this case because the challenged restraints purportedly restrict "the competitive process." But that argument – premised entirely on cases involving abbreviated "quick look" analysis of *horizontal* restraints – ignores the fundamental difference between a competition-limiting agreement between competitors and a competition-intensifying vertical agreement. Moreover, Plaintiffs' standard offers no guidance to courts – or to businesses – for determining when vertical restraints offend the antitrust laws. Many vertical restraints restrict some facet of interbrand competition, but, in the absence of market power, the antitrust laws rely on competition – not court-imposed regulation – to promote consumer welfare.

ARGUMENT

I. AMEX'S LACK OF MARKET POWER IN THE CREDIT CARD MARKET PRECLUDES LIABILITY

This Court should affirm the Second Circuit's judgment on the ground that Plaintiffs failed to prove that Amex has market power, a finding that precludes the possibility that a vertical agreement unlawfully restrains trade under the rule of reason.

A. Vertical Restraints, Unlike Horizontal Agreements, Intensify Competition When Used by Firms Without Market Power

This Court's cases draw a sharp distinction between horizontal restraints – agreements among competitors – and vertical restraints – agreements among actors at different levels of a supply or distribution chain. *See Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 888 (2007). Agreement among horizontal competitors blunts the rivalry that brings innovation and lower prices. *Cf. Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768-69 (1984) (noting that "competition assumes and demands" "independent centers of decisionmaking"). Horizontal collusion is the "supreme evil of antitrust" because competitors share an interest in higher prices, which they can achieve by jointly restricting output. *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 408 (2004).

By contrast, vertical agreements – at least when imposed by firms that lack market power – raise no comparable suspicions. First, vertical agreements – unlike horizontal agreements – do not by themselves aggregate market shares or risk creating the power that market concentration may confer. *See* Herbert Hovenkamp, *The Rule of Reason*, Inst. for Law &

Econ. Research Paper No. 17-28, at 56 (July 2017) ("[A] purely vertical agreement does nothing to increase market shares."). Second, vertical agreements are ubiquitous in the economy; commerce is literally impossible without them. *See id.* at 57-58 ("[O]rdinary buy-sell and licensing agreements are an essential part of ordinary business, right down to the consumer level.").

Most fundamentally, the incentive of a manufacturer in a competitive market is to use vertical agreements to improve efficiency, so as to compete more effectively against rivals. Distributors of the firm's products or services, however, face a different incentive: to increase their own profits at the expense of both producers and consumers. *See Leegin*, 551 U.S. at 896 ("[I]n general, the interests of manufacturers and consumers are aligned with respect to retailer profit margins."). Vertical restraints, unlike horizontal ones, do not impede interbrand rivalry; instead, they channel distributor behavior toward more effective interbrand competition. *See Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 55 (1977) (noting, as an example, that "[e]stablished manufacturers can use" vertical restraints "to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products").

Recognizing the force of the distinction between horizontal and vertical agreements, this Court has "rejected the approach of reliance on rules governing horizontal restraints when defining rules applicable to vertical ones." *Leegin*, 551 U.S. at 888. Until the 1970s, antitrust law embodied rules that subjected restrictions that manufacturers placed on their dealers to searching scrutiny and even *per se* condemnation.

See, *e.g.*, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), *overruled by Continental T.V.*, 433 U.S. at 58. But, in recent decades, this Court has swept away virtually all of the *per se* rules of illegality that had once applied to vertical restraints. *See Leegin*, 551 U.S. 877 (minimum resale price maintenance); *State Oil Co. v. Khan*, 522 U.S. 3 (1997) (maximum resale price maintenance); *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988) (all non-price vertical restraints); *Continental T.V.*, 433 U.S. 36 (territorial restrictions). This Court's recent decisions now recognize that vertical restraints – far from being subject to *per se* condemnation – are presumptively lawful. Unless a firm has market power – *i.e.*, "so long as interbrand competition exist[s]" – its vertical restraints enhance consumer welfare rather than unreasonably restrain trade. *Business Elecs.*, 485 U.S. at 725 (explaining *Continental T.V.*'s rationale).

B. Amex's Nondiscrimination Provisions Share the Procompetitive Attributes of Other Vertical Restraints

The nondiscrimination rules, like vertical restraints generally, foster more effective interbrand competition. As the district court recognized, when a retailer, after having agreed to accept Amex, discourages consumers from using it, that does not merely lead to the loss of a single transaction, but it also undermines cardholders' trust that, where Amex is accepted, it is welcomed. A negative experience using Amex discourages the cardholder from using the card in the future. *See* App. 80a. The retailer is unlikely to perceive any negative consequences from that in the short term. But the consequences for Amex, spread across millions of merchants and billions of transactions, is

to undermine the network investments that distinguish Amex from its larger and more ubiquitous rivals. By requiring Amex-accepting merchants to stand behind its brand, Amex enhances its ability to compete with rival networks, including the dominant network, Visa. And Amex's continuing ability to offer unique and differentiated value has long-term benefits for card-members and merchants alike.

The trial record establishes that the nondiscrimination rules foster intense competition for cardholder spending, fueled by consumer rewards and benefits. *See* App. 238a. Those benefits include cash back, low or zero interest on balances, travel rewards, free rental car insurance, zero transaction fees on foreign purchases – the list is limited only by the creativity and marketing savvy of competing companies. And many of those methods involve merchants – for example, a network may offer special discounts for purchases at designated merchants, including on co-branded cards. The nondiscrimination rules help to ensure that merchants do not stand in the way of Amex's efforts to provide enhanced value for credit card consumers through diverse and differentiated services, benefits, and rewards that give cardholders incentives to use their cards. *See Leegin*, 551 U.S. at 890. This increases, rather than decreases, output and demonstrates how the nondiscrimination rules intensify the card networks' "dominant incentive" to make products attractive to consumers. *Business Elecs.*, 485 U.S. at 725.

Plaintiffs – and the merchants that support them – have never taken serious issue with the conclusion that the impact of the nondiscrimination provisions on credit card users has been increased benefits, services, rewards, and competition for cardholders. Instead,

they argue that the rules are anticompetitive because *merchants* are subject to higher fees than they would be if they were able to discourage use of a particular card at the point of purchase. As an initial matter, the record contradicts the premise that the nondiscrimination provisions cause merchants to pay higher fees. Plaintiffs' expert witness acknowledged that, in the three years after Visa and MasterCard agreed not to enforce their nondiscrimination provisions, there was no evidence that merchant fees decreased for merchants that did not accept Amex cards (and thus were not subject to Amex's nondiscrimination provisions). *See* Tr. 4239:1-18, 4240:5-13. Furthermore, the same expert stated that he could not confidently predict whether, in the absence of nondiscrimination provisions, merchant fees would increase or decrease. *See* JA257-59.

Even assuming that merchant fees would be lower absent the nondiscrimination provisions, that would not distinguish the nondiscrimination provisions from other vertical restraints. As discussed above, such restrictions frequently limit distributors' freedom to maximize their own profits in the short run, in the interest of promoting the most efficient distribution of a manufacturer's product. If a credit card company determines that it can compete most effectively by giving cardholders incentives – funded by higher merchant fees – and if merchant steering would make those investments less effective, then restricting steering enhances competition. As in the case of other vertical restraints, the interests of upstream producer and consumer are aligned.

The United States asserts (at 25-26) – without analysis – that merchants are not distributors "at least in any traditional sense." But, while merchants

are (jointly with cardholders) consumers of an Amex transaction, *see* App. 74a n.4, they are also distributors in the relevant sense: the merchant stands between Amex and the cardholder making the ultimate decision whether to consume services from Amex or from a rival network. *See* App. 21a. When a merchant agrees to accept a network's cards, that acceptance alone does not generate a transaction; it merely makes Amex's credit card services available to cardholders at the point of sale – much like a retailer's agreement to carry a brand of product makes those products available for purchase by the consumer. The cardholder, not the merchant, ultimately decides which network to use. *See* U.S. Br. 26. For these reasons, Amex has a critical interest in ensuring merchants do not undermine Amex's competitive strategy.

Just as retailers seek higher profits at the expense of manufacturers and consumers, *see Leegin*, 551 U.S. at 896; *Continental T.V.*, 433 U.S. at 56, steering reflects merchants' preference for lower fees even though lower fees reduce the benefits of competition for cardholders. *See* App. 9a ("[C]ardholders' and merchants' respective interests are often in tension: merchants prefer lower network fees, but cardholders desire better services, benefits, and rewards that are ultimately funded by those fees."); *cf. Leegin*, 551 U.S. at 890 (noting retailers' motive to increase profits by free-riding). It is reasonable for a manufacturer lacking market power to insist that a distributor not discriminate against the manufacturer's products. In turn, by reducing merchant behavior that harms the value proposition of Amex's differentiated offering, the nondiscrimination provisions enhance Amex's efforts to compete against its rivals.

C. Given the Vertical Nature of the Nondiscrimination Provisions, Plaintiffs Could Not Establish Liability Absent a Showing of Market Power

The logic of this Court's cases – and the holdings of numerous lower courts – is that, when an actor without market power enters into a vertical restraint, it is for the purpose of competing more effectively, and not for the purpose of suppressing competition. Accordingly, a plaintiff challenging a vertical restraint under the rule of reason – in the absence of any claim of collusion – cannot prevail if the restraining firm lacks market power.

1. This Court has defined market power as "the ability of a single seller to raise price and restrict output," giving that seller "the power to force a purchaser to do something that he would not do in a competitive market." *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 464 (1992). Every firm in a competitive market produces up to the point where the revenue from its last unit of output is equal to the marginal cost of producing it. In such a market, the marginal revenue from each additional sale is the market price, and every firm produces up to the point where its marginal cost is equal to the market price. This maximizes consumer welfare. *See* Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697, 702 (1975); *see also* Pet. Br. 21 (citing *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 459 (1986)).

But a firm with market power, unconstrained by interbrand competition, can raise prices by reducing output because no existing or new competitors are able to take up the slack. Such a firm tends to produce

less, earning higher profits but making consumers worse off. In a competitive market, a firm thrives by giving consumers what they want. *See*, *e.g.*, *NCAA v. Board of Regents*, 468 U.S. 85, 103 (1984) (restraints are "procompetitive" if they "increase sellers' aggregate output"). By contrast, a firm with market power can maximize profits by *depriving* (some) consumers of what they want. *See United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 176 (1964) ("The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more.").

2. Because a firm without market power must compete to win – and keep – customers, vertical restraints imposed in a competitive market do not threaten consumer harm. Such restraints are likely to enhance a firm's profits only if they make that firm better able to stimulate and satisfy – not frustrate – market demand.

This Court's decision in *Leegin* reflects this logic. In that case, the Court reconsidered the century-old rule barring a manufacturer from requiring retailers to charge a minimum price for the manufacturer's products. *See* 551 U.S. at 887-89 (discussing *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911)). The Court noted that the "justifications for vertical price restraints are similar to those for other vertical restraints," in that they help to preserve the diversity of competitive options. *Id.* at 890. At the same time, this Court found that resale price maintenance could threaten anticompetitive harm in two ways. First, such resale price maintenance could facilitate horizontal collusion among manufacturers or retailers. *See id.* at 892-93. Second, resale price

maintenance could be abused by a "powerful manufacturer or retailer" to preserve its ability to charge monopoly prices. *Id.* at 893-94.

But because a manufacturer in a competitive market has no incentive to make its product less attractive by artificially propping up retail prices, *see id.* at 896, vertical price restrictions "may not be a serious concern unless the relevant entity has market power." *Id.* at 898. Without market power, "there is less likelihood" that a manufacturer could "use the practice to keep competitors away from distribution outlets." *Id.*

3. Because a vertical restraint imposed by a single firm lacking market power cannot produce market-wide harm, a plaintiff's inability to show market power "is a good way of short-circuiting a Rule of Reason case" that otherwise would consume substantial resources and risk condemning harmless (and potentially procompetitive) activities. Richard A. Posner, *Antitrust Law* 195 n.5 (2d ed. 2001) (cited at Pet. Br. 23, 47, 48); *accord* Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 160 (1984) ("All three of the possibly anticompetitive manifestations of vertical arrangements can occur only if there is market power.") (cited at Pet. Br. 24, 26, 33).

The majority of the courts of appeals have stated that a market-power showing is required when applying the rule of reason. *See Eastern Food Servs., Inc. v. Pontifical Catholic Univ. Servs. Ass'n, Inc.*, 357 F.3d 1, 5 (1st Cir. 2004) (Boudin, J.) ("Virtually always, anti-competitive effects under the rule of reason require that the arrangement or action in question create or enhance market power – meaning the power to control prices or exclude competition."); *Oksanen v. Page Mem'l Hosp.*, 945 F.2d 696, 709 (4th Cir. 1991)

(en banc) (Wilkinson, J.) ("Absent this market power, any restraint on trade created by the defendants' actions is unlikely to implicate section one."); *General Leaseways, Inc. v. National Truck Leasing Ass'n*, 744 F.2d 588, 596 (7th Cir. 1984) (Posner, J.) ("Rule of Reason . . . requir[es] that the plaintiff first prove that the defendant has sufficient market power to restrain competition substantially. If not, the inquiry is at an end; the practice is lawful.") (citations omitted); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 221 (D.C. Cir. 1986) (Bork, J.) (stating that the court could "rest . . . upon the absence of market power," because, if the defendant lacked market power, its "agreement must be designed to make the conduct of their business more effective").[2]

This Court's decisions in *Indiana Federation of Dentists* and *NCAA* do not support dispensing with a showing of market power in a case challenging a vertical restraint. Both cases involved horizontal agreements closely analogous to *per se* unlawful restraints of trade: in one case, an agreement to limit the number of college football games that could be televised (a restraint on output); in the other, an agree-

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[2] *See also PSKS, Inc. v. Leegin Creative Leather Prods., Inc.*, 615 F.3d 412, 418-19 (5th Cir. 2010) ("To allege a vertical restraint claim sufficiently, a plaintiff must plausibly allege the defendant's market power"); *Hand v. Central Transp., Inc.*, 779 F.2d 8, 11 (6th Cir. 1985) (per curiam) (stating that, under the rule of reason, "[a] defendant must have market power"); *Assam Drug Co. v. Miller Brewing Co.*, 798 F.2d 311, 316-17 (8th Cir. 1986) ("a finding of no market power precludes any need to further balance . . . competitive effects"); *Graphic Prods. Distribs., Inc. v. ITEK Corp.*, 717 F.2d 1560, 1568 (11th Cir. 1983) (noting that "a plaintiff attacking vertical restrictions [must] establish the market power of the defendant").

ment to refuse to provide insurers dental x-rays (a collective refusal to deal). In each case, this Court found that the restrictions at issue were "naked restraint[s] on price and output" and the plaintiff had documented their market-wide impact on output. *NCAA*, 468 U.S. at 110; *see Indiana Fed'n of Dentists*, 476 U.S. at 460. In the case of a vertical restraint, there is no such justification for dispensing with the market-power inquiry.

Furthermore, in each case, this Court found that the evidence established market power because the defendants effectively controlled nearly all supply in the market. *See NCAA*, 468 U.S. at 112 ("[T]he NCAA's complete control over [college football] broadcasts provides a solid basis for the District Court's conclusion that the NCAA possesses market power with respect to those broadcasts."); *Indiana Fed'n of Dentists*, 476 U.S. at 460 ("Federation dentists constituted heavy majorities of the practicing dentists and . . . as a result of the efforts of the Federation[] insurers . . . were . . . actually unable to obtain compliance with their requests for submission of x rays."). Amex has no such power.

4. Requiring a firm to have market power before a vertical restraint can be found unlawful also protects against the risk that mistaken condemnation – or burdensome litigation – will deter procompetitive agreements.

This Court has emphasized "the importance of clear rules in antitrust law." *Pacific Bell Tel. Co. v. linkLine Commc'ns, Inc.*, 555 U.S. 438, 452 (2009). Petitioners themselves embrace that principle. *See* Pet. Br. 24-26. The structure of those rules should

> take account of the institutional fact that antitrust rules are court-administered rules. They

> must be clear enough for lawyers to explain them to clients. They must be administratively workable and therefore cannot always take account of every complex circumstance or qualification.

Town of Concord v. Boston Edison Co., 915 F.2d 17, 22 (1st Cir. 1990) (Breyer, C.J.). Firms engaged in vigorous competition need assurance that they can use vertical restraints that facilitate competition against rivals without running the risk of costly antitrust litigation, treble damages, and attorney's fees. The market-power requirement broadly adopted by the lower courts "largely has succeeded in providing guidance" not only "for tribunals in applying the rule of reason," but also "for industry in predicting the consequences of their practices." M. Laurence Popofsky & Mark S. Popofsky, *Vertical Restraints in the 1990s: Is There a "Thermidorian Reaction" to the Post-*Sylvania *Orthodoxy?*, 62 Antitrust L.J. 729, 737-38 (1994).

This clarity is important because, as previously noted, vertical restraints frequently promote the interests of manufacturers and ultimate consumers over those of distributors and retailers. As a result, there will be potential plaintiffs with a strong motivation to challenge such restraints – or to lobby the government to do so – despite their procompetitive character. Thus, there would be an unacceptable risk of error if a plaintiff could prevail on a Section 1 challenge to a vertical agreement absent clear proof of the defendant's ability to exercise substantial market power by reducing output and thereby diminishing quality or increasing price. *See Trinko*, 540 U.S. at 414 ("The cost of false positives counsels against an undue expansion of [antitrust] liability."); *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993) ("mistaken inferences" "chill the very conduct

the antitrust laws are designed to protect"); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986) ("[W]e must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition.") (alteration in original); *accord* Thomas C. Arthur, *The Costly Quest for Perfect Competition:* Kodak *and Nonstructural Market Power*, 69 N.Y.U. L. Rev. 1, 21 (1994) (calling a market-power requirement "essential to a sensible antitrust law" because it "minimizes false positive errors"); Frank H. Easterbrook, *Limits of Antitrust*, 63 Tex. L. Rev. 1, 12-13, 20-21 (1984).

D. The Second Circuit's Unchallenged Holding That Amex Lacks Market Power Is Correct

The Second Circuit held that Plaintiffs failed to adduce adequate evidence that Amex has market power. App. 40a-48a. Petitioners have not challenged that holding, *see* Pet. i, 18-25; U.S. Br. 23 n.4, and it is correct.

1. The record evidence cannot sustain a finding that Amex has market power. "The existence of such power ordinarily is inferred from the seller's possession of a predominant share of the market." *Eastman Kodak*, 504 U.S. at 464. At the time of trial, Amex accounted for only 26.4% of all credit card transaction volume. As the district court recognized, such a small share of the market "would not suffice" on its own to show that Amex has market power. App. 156a.

With such a modest market share, Amex cannot reduce market-wide output, especially because Amex's competitors are in virtually every wallet and at every register: if Amex tried to curtail supply, Visa, MasterCard, and Discover would rush to fill the gap. *See*

Penn-Olin, 378 U.S. at 176 (noting that, when markets are competitive, "rival sellers, whether existing competitors or new or potential entrants into the field, would keep [market] power in check"). No case of this Court has ever held that a firm with such a small market share has market power. And lower courts routinely agree that market shares like Amex's are insufficient to show market power.[3]

2. The district court's reasons for believing Amex possesses market power were legally inadequate. Most fundamentally, none reflects Amex's ability to control market-wide output of credit card transactions.

a. The fact that Amex has achieved acceptance by a large percentage of merchants does not prove that Amex has the power to restrict market-wide supply. Merchant acceptance, by itself, entails no guarantee that cardholders will actually use an Amex card. Discover has even greater merchant coverage than Amex, *see* App. 184a-185a, yet it cannot plausibly restrict market-wide output with its modest 5.3% share

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[3] "[S]ince *Jefferson Parish* [*Hospital District No. 2 v. Hyde*, 466 U.S. 2 (1984),] no court has inferred substantial market power from a market share below 30 percent." *Brokerage Concepts, Inc. v. U.S. Healthcare, Inc.*, 140 F.3d 494, 516-17 (3d Cir. 1998) (finding lack of "sufficient market power" to support *per se* tying claim). *See also*, *e.g.*, *Valley Prods. Co. v. Landmark, a Div. of Hospitality Franchise Sys., Inc.*, 128 F.3d 398, 402 n.3 (6th Cir. 1997) ("courts hav[e] repeatedly held that a 30 percent market share is insufficient to confer . . . market power"); *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1403 (7th Cir. 1989) ("Cases frequently say that as a matter of law single-firm shares of 30% or less cannot establish market power."); *Northwest Power Prods., Inc. v. Omark Indus., Inc.*, 576 F.2d 83, 90-91 (5th Cir. 1978) (firm "conspicuously lack[ed]" market power with only "a 25 percent share" of the market).

of transaction volume, *see* App. 13a. Merchant acceptance still requires card networks to compete vigorously for each card swipe by "investing in those programs that make its product valuable to cardholders." App. 165a. That is why all parties have agreed throughout this litigation that the relevant unit of output is a transaction, not the number of retailers that are prepared to engage in a transaction if a cardholder desires to use a card issued on a particular network. Pet. Br. 3.

b. The Second Circuit also correctly rejected the argument that Amex cardholders' preference to use Amex's cards – labeled "cardholder insistence" – could establish market power. "Insistence" does not reflect power to restrict market-wide supply, but rather Amex's "successful investment in creating output and value," App. 43a, by fulfilling market demand.

As Plaintiffs' economist acknowledged, Amex's cardholder rewards operate as a price discount for transactions. *See* App. 45a-46a; *see also* App. 157a n.25 (Amex's "very attractive rewards program" is "the big source of insistence" for most Amex cardholders). The fact that Amex's cardholders prefer to use Amex's cards because they offer superior value compared to alternative credit cards cannot show that Amex can profitably reduce output. "A firm that can attract customer loyalty only by *reducing* its prices does not have the power to *increase* prices unilaterally." App. 45a-46a; *accord* IIB Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 501, at 111 (4th ed. 2014) ("*Antitrust Law*") ("[A] firm that can exclude rivals only by charging [a] competitive price does not have significant market power.").

Any "insistence" by Amex cardholders would evaporate if Amex eliminated the rewards and other benefits it provides to cardholders, as the district court recognized. App. 165a. Market power built on continuous investment in superior value does not create the kind of "substantial . . . and durable" market power that warrants judicial intervention. IIB *Antitrust Law* ¶ 501, at 111; *see Fortner Enters., Inc. v. U.S. Steel Corp.*, 394 U.S. 495, 505 (1969) (a firm that takes "unique and unusual" investment risks lacks market power unless those investments result from its "unique economic advantages").

Accepting petitioners' contention that demand for a firm's products equates to power over market supply would condemn successful competition. That would disserve antitrust law's fundamental purpose of promoting robust competition and, in turn, increased output. *See Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 26 (1984) ("[Plaintiff] reli[es] on the preference of persons residing in Jefferson Parish to go to East Jefferson, the closest hospital. A preference of this kind, however, is not necessarily probative of significant market power.").

c. Evidence that Amex increased its merchant discount rates to some merchants in the late-2000s as part of its "Value Recapture" program likewise fails to demonstrate market power. This Court has warned against drawing an incorrect inference of power from mere evidence of higher prices, precisely because a firm's decision to charge higher prices does not mean the firm has restricted market-wide output. *See Brooke Grp.*, 509 U.S. at 237 ("Even in a concentrated market, the occurrence of a price increase does not in itself permit a rational inference of . . . supracompeti-

tive pricing."). Indeed, "[w]here, as here, output is expanding at the same time prices are increasing, rising prices are equally consistent with growing product demand." *Id.*

Plaintiffs' expert testified that prices were already at competitive levels before they were increased. *See* App. 167a. But evidence of a price increase – even if a firm raises its prices above the prices charged by other firms – is perfectly consistent with the possibility that the firm is offering superior value that merits a comparatively higher price. The district court itself recognized that the fact that Amex "may charge a higher price to merchants than Visa and MasterCard . . . is not necessarily proof that such prices are supracompetitive; merchants may be receiving commensurate value for the higher price." App. 173a. The producer of a superior mousetrap can charge more for it.

Moreover, for reasons discussed further below, evidence that Amex's merchant discount increased is particularly uninformative absent evidence about Amex's costs – including the cost of cardholder benefits. *See* IIB *Antitrust Law* ¶ 502, at 112 (defendant's "market power is commonly defined by the excess of its profit-maximizing price above its marginal cost"); 28 Law Professors' Br. 6 (market power is "the power to profitably raise price above marginal cost"). Although the district court found that not all of the increases were offset by identical adjustments on the cardholder side, App. 166a-167a, the court admittedly had no evidence about Amex's costs, including how Amex's costs or margins changed over the relevant period, App. 42a-44a. Without evidence of excess margins and in the face of increasing quality and

sharply higher output, Plaintiffs failed to prove Amex's market power.

II. PLAINTIFFS FAILED TO MEET THEIR BURDEN OF PROVING HARM TO MARKET-WIDE COMPETITION

If the Court does not affirm on the basis of Amex's lack of market power, it should affirm on the ground that Plaintiffs failed to demonstrate actual harm to competition. To meet their burden, Plaintiffs had to show that the nondiscrimination provisions actually harmed competition, either through evidence of diminished quantity or quality of output, or through evidence of supracompetitive prices indicative of constrained output. *See Brooke Grp.*, 509 U.S. at 237 (requiring proof "that output was restricted or prices were above a competitive level"). The Second Circuit properly determined that Plaintiffs failed to make any such showing.

A. Plaintiffs Failed To Demonstrate That the Nondiscrimination Provisions Produced Anticompetitive Effects

Antitrust law's fundamental purpose is to ensure that competition generates the optimal level of output to meet demand. *See supra* p. 30; *see also* I *Antitrust Law* ¶ 100, at 3 (4th ed. 2013) ("For the economist, if all other things are equal, the best measure of competition is equilibrium output."). Thus, the purpose of Section 1 is to prohibit agreements that "restrict competition and decrease output." *Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19-20 (1979); *see California Dental Ass'n v. FTC*, 526 U.S. 756, 776 (1999) (antitrust question was "whether the [challenged restraint] obviously tends to limit the total delivery of dental services").

Plaintiffs' effort to establish harm to competition through proof of increased merchant fees – either across the industry or for Amex in particular – fails because, in this industry, such increases provide no evidence of reduced output. *See* Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution* 13 (2008) ("While we often think of antitrust as troubled by high prices, it is better to think of antitrust's main concern in terms of restrictions on output. Competition is injured when a firm . . . is able to reduce output in some market, and 'output' can be measured by either quantity or innovation.").

1. Plaintiffs Introduced No Evidence of Reduced Output or Quality

The only trial evidence directly related to output demonstrated a substantial *increase* in output, consistent with robust competition.

As the district court found, and as petitioners agree, the relevant measure of output in this case is credit card transactions, measured by charge volume. *See* App. 151a-152a ("charge volume is the most direct measure of output"); Pet. Br. 3. Both sides used credit card transaction volume in calculating Amex's 26% market share. *See* App. 13a.

Plaintiffs provided no direct evidence of reduced transaction volume by any measure or against any benchmark. On the contrary, as the court of appeals noted, "industry-wide transaction volume has substantially *increased*." App. 52a. The record evidence showed "a dramatic increase in transaction volume across the entire credit-card industry" of 30% from 2008 to 2013 – including an 8% increase from 2012 to 2013 alone, indicating "a thriving market for credit-card services." *Id.*

Plaintiffs also conceded on appeal that quality has been increasing; "credit-card networks are offering more and better cardholder benefits than ever before." *Id.* Increased quality of services is the logical result of the fact that Amex (as well as competitors Visa and MasterCard) have invested billions of dollars in improving services and increasing cardholder rewards. *See id.*; Tr. 4379:1-6.

2. Plaintiffs Introduced No Evidence of Supracompetitive Prices

Plaintiffs' argument (Pet. Br. 37-40; U.S. Br. 30-31) that evidence of higher merchant fees overcomes this evidence of expanding output fails because merchant prices alone are not a proxy for market-wide output, however one defines the relevant market.

a. As the Second Circuit correctly concluded, merchant discount rates are not the appropriate measure of market price because they do not correspond to the relevant unit of output, credit card transactions. *See* App. 44a ("merchant pricing is only one half of the pertinent equation"), 49a (district court's "anticompetitive effects finding" came up short because it "failed to consider the two-sided net price").

Merchants and cardholders jointly consume – and share the costs and benefits of – that unit of output. The price paid for that unit of output is the net price they pay together. Any other measure of price leads to incorrect conclusions about output effects. As Plaintiffs' expert testified, "[i]t is critical not to draw unwarranted and misleading conclusions by focusing solely on one side of a two-sided market." JA249-50. For example, as the expert further acknowledged, a reduction in the price to the merchant – which might seem procompetitive when viewed in isolation – "can

harm consumers" by causing the network to reduce benefits to cardholders, which *reduces* output. JA256.

The district court concededly had no evidence about this net price, let alone whether the nondiscrimination provisions caused sustained net prices above the competitive level. As the court put it, "neither party has presented a reliable measure of American Express's two-sided price that appropriately accounts for the value or cost of the rewards paid to cardholders." App. 209a; *see* App. 174a n.30 ("[T]he evidentiary record does not include a reliable measure of the two-sided price charged by American Express that correctly or appropriately accounts for the network's expenses on the cardholder side of the platform."). The court thus lacked any ability to determine the price *indicative of output* – let alone whether it was supracompetitive.

As the United States acknowledges, this Court "need not resolve the market-definition question," Br. 41, to evaluate Plaintiffs' case. Even so, the Second Circuit's holding that the district court's market definition erroneously failed to account for cardholders was entirely consistent with this Court's precedents. Defining markets is not an end in itself but rather a means "to recognize competition where, in fact, competition exists." *Brown Shoe Co. v. United States*, 370 U.S. 294, 326 (1962). Given that the best indicator of robust competition is an efficient level of output, it made no sense to ignore the undisputed market reality that credit card transactions jointly consumed by merchants and cardholders are the relevant measure of output.

It likewise makes no sense to complain that the Second Circuit "never explained how the services that Amex provides to merchants are 'reasonably inter-

changeable' with the services it provides to cardholders," U.S. Br. 37. These two "services" cannot be substituted because they are two sides of the same coin; a credit card network cannot supply only the merchant side of a transaction or only the cardholder side. Put another way, Plaintiffs' market definition presupposes a product that does not exist – a credit card transaction consumed by the merchant but not the cardholder. The fact that the service Amex actually provides has merchant-facing and cardholder-facing components that are not interchangeable is irrelevant.[4]

Analyzing the "merchant services" market or the "cardholder services" market in isolation is not just analytically unsound but also likely to lead to unreliable conclusions about the impact of the challenged provisions on competition. *See*, *e.g.*, David S. Evans & Michael Noel, *Defining Antitrust Markets When Firms Operate Two-Sided Platforms*, 2005 Colum. Bus. L. Rev. 667, 695 (2005). As discussed above (at 25), *distributor* welfare is often in conflict with *consumer* welfare. The district court's decision to define a market limited to merchant services undermined the core purpose of the antitrust laws by erroneously focusing on the welfare of merchants to the exclusion of the consumers who are equally indispensable to

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[4] A single market may include non-interchangeable products if they have collective economic significance. *See*, *e.g.*, *United States v. Grinnell Corp.*, 384 U.S. 563, 571-72 (1966) (rejecting argument "that the different central station services offered are so diverse that they cannot . . . be lumped together"); *accord United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 356 (1963) (recognizing that "the cluster of products . . . and services . . . denoted by the term 'commercial banking' composes a distinct line of commerce") (citation omitted).

transactional output. *See* App. 192a ("Proof of anti-competitive harm to merchants . . . is sufficient to discharge Plaintiffs' burden in this case."). So too would petitioners' suggestion (at 50-51) that a plaintiff can shift the burden to a defendant based on evidence of harm to distributors alone.

Petitioners' analogy to *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594 (1953), is inapt. That case held that the defendant newspaper lacked market power in the sale of advertising to advertisers, without considering readers. But, as the district court itself recognized, although newspapers exhibit "two-sidedness" in the sense that they receive revenue from both readers and advertisers, newspapers do not involve any joint consumption decision: readers subscribe to newspapers without purchasing advertised products, and advertisers promote their products only to some readers. App. 77a-78a. Accordingly, defining a market limited to the sale of advertising (or subscriptions) is unlikely to lead to the sorts of errors committed by the district court in this case.[5]

b. Even if a one-sided, merchant-only market definition were proper, Plaintiffs never defined or purported to measure the price for the "network services" that they claimed the merchants were consuming.

In Visa's and MasterCard's "open loop" networks, issuing banks provide cards to consumers, acquiring banks sign merchants up to accept those cards, and

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[5] *NCAA* involved vertical distribution of a product (college football television rights); the possibility that broadcast television is a two-sided platform was irrelevant to the analysis. *See* 468 U.S. at 111. The Court's market analysis simply differentiated various programming that could be televised, holding that college football was distinct enough to constitute a separate market. *Id.* at 111-12.

the Visa or MasterCard network sits in the middle, providing the network services that allow for a transaction to be processed. Amex provides each of these services in its closed-loop network. According to Plaintiffs, the relevant market in this case is limited to the services that the network provides to the merchant (usually through an acquirer in the open-loop systems) to enable the communication necessary for credit card acceptance. *See* App. 113a.

In the case of Visa or MasterCard, the overall merchant discount fee on which Plaintiffs relied here generally has three components: (1) the issuer's fee (called the interchange fee), which the issuer uses to fund cardholder incentives and rewards; (2) an acquirer fee, which is retained by the acquiring bank to cover its services to the merchant; and (3) a (relatively small) network fee that the network retains as the price of facilitating the transaction. *See* App. 83a. If, as Plaintiffs argued, the relevant market is limited to network services, then the relevant price is only this final component, the network services fee.

Plaintiffs never offered any evidence that network services fees are supracompetitive. As to Visa and MasterCard, the only evidence was a single, point-in-time snapshot of the network services fee with no evidence that the fee had changed or resulted in excess margins. Even more starkly, Plaintiffs offered no evidence at all of Amex's network services fee. Because Amex has traditionally acted as the network, the issuer, and the acquirer, the discount rate charged to merchants is not broken out into separate interchange, acquiring, and network fees and instead covers them all.

Thus, while Plaintiffs' case turns on the assertion that "prices" are supracompetitive as a result of the

nondiscrimination provisions, all of Plaintiffs' evidence with respect to price (such as it is) relates to the *wrong price.* Plaintiffs' proof all relates to the full merchant discount rate, which includes prices for distinct aspects of the credit card transaction, most of which fall outside the relevant market that Plaintiffs urged.[6]

c. Even if a one-sided, merchant-only market definition were correct, and even if the full merchant discount rate were the relevant price for assessing anticompetitive effects in that market, Plaintiffs' evidence still was insufficient because they claimed only that those rates are "too high" without providing any evidence of costs or margins.

Showing "sustained supracompetitive pricing," *Brooke Grp.*, 509 U.S. at 226, can provide evidence of competitive harm because "reduced output is the almost inevitable result of higher prices," *Fortner Enters.*, 394 U.S. at 503; *see also Brooke Grp.*, 509 U.S. at 233 ("Supracompetitive pricing entails a restriction in output."). But supracompetitive prices should not be confused with prices that have merely increased over time. "[T]he occurrence of a price increase does not in itself permit a rational inference of . . . supracompetitive pricing. Where, as here, output is expanding at the same time prices are increasing, rising prices are equally consistent with growing product demand." *Id.* at 237.

The district court cited no evidence that Amex (or any other network) charged prices above costs or,

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[6] The Second Circuit recognized this error, *see* App. 37a n.45, but did not need to address its impact. This failure of proof, by itself, should have doomed the government's case and, if this Court were not to affirm outright, would have to be addressed by the court of appeals on remand.

more critically, earned supracompetitive profits. Indeed, the district court found "Plaintiffs have not provided a reliable measure of American Express's per transaction margins across its industry groups," App. 172a-173a, and nothing in the record "correctly or appropriately accounts for the network's expenses on the cardholder side of the platform," App. 174a n.30. Nor was Plaintiffs' evidence about Amex's "Value Recapture" program (*see supra* pp. 39-40) a substitute; as the Second Circuit explained, "[a] finding that not every dime of merchant fees is passed along to *cardholders* says nothing about *other* expenses that Amex faces, let alone whether its profit margin is abnormally high." App. 51a (emphases added). This Court has repeatedly discussed supracompetitive prices and a firm's ability to generate supracompetitive profits as equivalent. *See FTC v. Actavis, Inc.*, 133 S. Ct. 2223, 2234 (2013); *Brooke Grp.*, 509 U.S. at 237; *Eastman Kodak*, 504 U.S. at 475-76; *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 117-19 & n.15 (1986); *Indiana Fed'n of Dentists*, 476 U.S. at 459; *Matsushita*, 475 U.S. at 593. Without such evidence, Plaintiffs could not establish that Amex's prices were supracompetitive.

The record here illustrates the perils of relying on price alone, without reference to cost, margins – and, ultimately, output. The ability of a particular competitor to charge higher prices may reflect the superior value of its product relative to alternatives. *See Leegin*, 551 U.S. at 896-97. Indeed, the district court concluded that any premium over Visa and MasterCard was at least partly "justified by the differentiated value [Amex] delivers to merchants." App. 176a. Assuming Amex charged a premium – and the district court found the evidence inconclusive – condemning

Amex on the basis of that evidence alone risks punishing Amex for successful competition. Erroneous judicial intervention in any market is problematic, but this Court should be particularly reluctant to distort competition in the credit card market, which is "among the largest, most diverse, and most complex markets of any consumer financial product."[7] *Accord* Verizon Br. 12 ("In order to avoid harming the consumer public, the Court should follow a policy of 'nonintervention' when it is unclear whether particular market activity is pro- or anti-competitive.").

3. The Unproven Claim That Credit Cards Raise Prices for Consumers Who Do Not Use Them Cannot Establish Anticompetitive Effects

Petitioners argue that the nondiscrimination provisions raise the overall price of goods, causing consumers who use other payment methods (like cash) effectively to subsidize cardholders' rewards. Pet. Br. 48-49; *see* App. 211a. The district court presumed such a subsidy without proof, but even assuming it exists, this consideration is not a basis for condemnation under the antitrust laws.

Consumers frequently bear some cost for services they do not use – not everyone who buys a book wants free gift-wrapping; free parking at the mall does users of public transportation no good. But this does not justify judicial intervention in the market. Consumers, overall, prefer to have the option of using credit cards; merchants can operate more efficiently if they accept such cards (or else they would not do so). And Amex's

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[7] Consumer Fin. Prot. Bureau, *The Consumer Credit Card Market* 5 (Dec. 2017), http://files.consumerfinance.gov/f/documents/cfpb_consumer-credit-card-market-report_2017.pdf.

nondiscrimination provisions leave merchants free to offer discounts to consumers who pay with cash, checks, or debit cards. *See* 15 U.S.C. § 1693*o*-2(b)(2)(A); Pet. Br. 7. That merchants rarely offer such discounts is a matter of their choice.

More fundamentally, the supposed (though unproven) impact on consumers who do not use credit cards is irrelevant to antitrust law's basic concern, which is fulfilling consumer demand by protecting competition. The possibility that increased credit card use imposes an indirect burden on those who do not use credit cards raises questions of welfare redistribution in the bailiwick of a legislature or a regulator, not an antitrust court. *Cf.* 15 U.S.C. § 1693*o*-2(a) (granting the Federal Reserve authority over interchange rates for debit cards); *linkLine*, 555 U.S. at 452 ("Courts are ill suited 'to act as central planners, identifying the proper price, quantity, and other terms of dealing.'") (quoting *Trinko*, 540 U.S. at 408).

B. Theoretical Claims of "Harm to the Competitive Process" Cannot Substitute for Evidence of Actual Harm to Competition

Lacking direct or indirect proof that Amex's nondiscrimination provisions deprived the market of credit card services, Plaintiffs argue that they nevertheless sustained their burden by asserting that the challenged restraints "harmed the competitive process in the credit-card industry." U.S. Br. 49; *see* Pet. Br. 34. Such arguments seek to reverse the tide of this Court's precedents by subjecting Amex's *vertical* nondiscrimination provisions to the equivalent of a "quick look" standard that has been reserved exclusively for *horizontal* restraints. Furthermore, Plaintiffs propose no workable standard to identify

the sort of "harms to the competitive process" that should be subject to condemnation.

1. Plaintiffs' "competitive process" argument seeks to equate the competition-suppressing effects of horizontal agreements with the competition-intensifying effects of vertical agreements. In particular, they rely exclusively on cases in which this Court has applied "quick look" treatment to horizontal restraints that expressly restrict output. Pet. Br. 31-32; U.S. Br. 25-28, 47-49. For example, *Indiana Federation of Dentists* condemned "a horizontal agreement among the participating dentists to withhold from their customers a particular service that they desire." 476 U.S. at 459. And *NCAA* condemned a "horizontal agreement" imposing "an artificial limit on the quantity of televised football that is available to broadcasters and consumers." 468 U.S. at 99.

This Court has rightly confined "quick look" analysis to this narrow class of horizontal restraints that "an observer with even a rudimentary understanding of economics could conclude . . . would have an anticompetitive effect on customers and markets." *California Dental*, 526 U.S. at 770; *see Texaco Inc. v. Dagher*, 547 U.S. 1, 7 n.3 (2006) (explaining that "quick look" condemnation applies only to "business activities that are so plainly anticompetitive that courts need undertake only a cursory examination before imposing antitrust liability"). Indeed, the Court rejected such abbreviated review (in favor of full examination) in a case alleging that one horizontal competitor gave another a "payment in return for staying out of the market," recognizing that the challenged agreements involved settlements that generally are procompetitive. *Actavis*, 133 S. Ct. at 2234.

And this Court has never applied "quick look" treatment to condemn vertical restraints, which likewise generally have procompetitive virtues.

Plaintiffs claim that the nondiscrimination provisions are "different from the vertical restraints this Court has considered in other recent cases" because their "effect" is to "block *inter*brand" competition. U.S. Br. 23-24. But this Court has previously rejected claims that vertical restraints with supposed horizontal effects cross the vertical-horizontal line: "[A] restraint is horizontal not because it has horizontal effects, but because it is the product of a horizontal agreement." *Business Elecs.*, 485 U.S. at 730 & n.4. Adopting Plaintiffs' position would "introduce[] needless confusion" into the antitrust laws by blurring the fundamental distinction between vertical and horizontal restraints. *Id.* at 730.

2. Furthermore, notwithstanding petitioners' promise "to provide greater clarity over the rule of reason," Pet. 16, Plaintiffs offer no administrable standard to assess when supposed interference with the "competitive process" should give rise to condemnation of a vertical restraint. All restraints, by definition, restrain competition in some fashion. *See Board of Trade of Chicago v. United States*, 246 U.S. 231, 238 (1918) ("Every agreement concerning trade, every regulation of trade, restrains."). To say that the competitive process is restrained is to pose the rule-of-reason question, not to answer it. For example, many other vertical restraints – exclusive dealing, output contracts, requirements contracts – affect horizontal competition by limiting a competitor's access to a valued resource or distribution channel. *See* Hovenkamp, *Rule of Reason* 58-60. Such agreements are ubiquitous and – in the absence of market power

– pre-sumptively benign even though they restrain the "competitive process." *See*, *e.g.*, XI *Antitrust Law* ¶ 1821c, at 196 (3d ed. 2011) (proposing a standard of *per se* legality for distribution restraints unless defendant has "a minimum . . . market share in the range of 30 or 40 percent" and the challenged agreements "are 'robust' in the twin senses that they require absolute exclusion and cannot be evaded in a short period of time").

Plaintiffs' claim that Amex's nondiscrimination provisions "'disrupt the proper functioning of the price-setting mechanism of the market,'" Pet. Br. 34 (quoting *Indiana Fed'n of Dentists*, 476 U.S. at 461-62), likewise fails to differentiate between procompetitive and anticompetitive vertical restraints. As discussed above, restraints on the competitive process *at the distribution level* generally enhance interbrand competition, to the benefit of consumers. Thus, it is perfectly reasonable for a firm that lacks market power to demand dealer loyalty by contract. The "competitive process" that the government seeks to protect may give merchants leverage over the card networks, but that leverage harms networks' competition for consumers, which is antitrust law's proper concern.

Plaintiffs also posit that prohibiting merchant steering makes cardholder demand less responsive to net price. Pet. Br. 34. Even as a theoretical matter, the suggestion that greater merchant freedom will benefit consumers is doubtful. Like most distributor restraints, the procompetitive tendency of the nondiscrimination provisions is to prevent merchants from undermining the billions of dollars that networks and issuers invest in making their cards valuable to cardholders and merchants alike. More fundamentally, the plaintiff's burden of proof in a rule-of-reason case

is to offer not just hypotheses but evidence – here, proof that prohibiting merchant steering actually raises net two-sided prices to supracompetitive levels. And even then Plaintiffs would have to explain how such evidence could be squared with the undisputed evidence of increased market-wide output, which is a clear sign of vibrant competition. Plaintiffs cannot resort to economic generalities when the search for concrete evidence comes up empty, as it did here. Setting the rule-of-reason bar so low will encourage meritless lawsuits and unwarranted condemnation of procompetitive vertical restraints.

Amici economists argue that this Court should disregard increasing output in the credit card market because that increase is the result of a "distortion" that makes credit cards *too* attractive to consumers. Connor et al. Br. 35. The argument that market competition is providing excessive benefits, making other forms of payment less attractive, may interest a regulator, but it has nothing to do with the case Plaintiffs presented. (Indeed, it depends on the assertion that the relevant market is "all payment methods," *id.*, which Plaintiffs vigorously disputed below.) The claim that increased output in response to enhanced cardholder benefits suggests inefficiency is nonsense: any shift to credit cards reflects consumer-benefiting innovation (which is why merchants rarely provide discounts for consumers to use other forms of payment). Authorizing antitrust plaintiffs to challenge output-enhancing agreements on the ground that they "distort" the market would stray far from this Court's precedents and be at least as unadministrable as a rule allowing challenges to above-cost price-cutting. *Cf. Brooke Grp.*, 509 U.S. at 223 (noting that such a standard would "court[] intolerable risks").

One credit card company – Discover – supports Plaintiffs and complains that the restraint on merchant steering impedes its low-cost-to-merchants strategy. *See* Discover Br. 28-30. The trial evidence shows, however, that Discover's business model struggled because of low cardholder benefits, the ubiquity of Visa and MasterCard, and technical limitations. *See* Tr. 955:1-956:17, 957:12-17, 4182:13-4184:12, 4192:23-4193:1. Notably, there is no evidence that Discover attempted any such low-cost strategy in the millions of merchant locations, involving hundreds of billions of dollars of commerce, where Amex was not accepted and where anti-steering rules were not in place. More fundamentally, Discover has no right to pursue a form of competition that depends on conspiring with Amex's own distributors to discriminate against Amex's products. *See supra* pp. 26-27 (explaining the procompetitive benefits of restraints designed to ensure distributor loyalty). Discover remains no less able than other networks to compete for merchant acceptance, cardholders, and cardholder spending. If it has been unsuccessful, it can hardly lay that failure at Amex's feet.

3. It would be problematic enough to judicially restructure a market affecting "an astronomical number of retail transactions in the United States." Pet. 26. But the problems with Plaintiffs' position extend far beyond this case.

"Litigation costs are the product of vague rules combined with high stakes, and nowhere is that combination more deadly than in antitrust litigation under the Rule of Reason." Easterbrook, *Limits of Antitrust*, 63 Tex. L. Rev. at 12-13. Courts cannot realistically and reliably navigate claims about a restraint's effect on the "competitive process" without

using the fixed stars of market power, output, and supracompetitive prices. Yet Plaintiffs propose a standard lacking in nearly everything that has mattered in prior cases. Ruling for Plaintiffs here would:

- Obliterate the "appreciated differences . . . between vertical and horizontal agreements," *Leegin*, 551 U.S. at 888;
- Eliminate market power as a way to distinguish procompetitive from anticompetitive restraints;
- Permit condemnation of vertical restraints even in the face of undisputed evidence of enormously increased output; and
- Relieve plaintiffs challenging a vertical restraint of the burden to adduce basic evidence of supra-competitive prices, costs, and profit margins.

In an area of law where this Court has required "clear rules," *linkLine*, 555 U.S. at 452, Plaintiffs would leave lower courts with no rules at all – just a blank slate for the finder of fact to decide what restraints "harm the competitive process." But, "[w]hen everything is relevant, nothing is dispositive," and antitrust law "offers no help to businesses planning their conduct." Easterbrook, *Limits of Antitrust*, 63 Tex. L. Rev. at 12. Moreover, the danger that antitrust law "could deter or penalize perfectly legitimate conduct," *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763 (1984), is always lurking, especially in challenges to vertical restraints. That is why "antitrust law limits the range of permissible inferences from ambiguous evidence in a § 1 case." *Matsushita*, 475 U.S. at 588. Plaintiffs' "competitive process" standard admits of no such limits, and their resort to asking the Court to render their burden an effective nullity is a sure sign that they failed to sustain it.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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