No. 16-1454

In the Supreme Court of the United States

STATE OF OHIO, ET AL., PETITIONERS

v.

AMERICAN EXPRESS COMPANY, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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Amex does not deny that its anti-steering rules have effectively eliminated competition among credit-card networks on the fees charged to merchants. It could not reasonably do so. In the 1990s, Amex strengthened the rules to "stifle" successful price competition from Visa and MasterCard, Pet. App. 200a, and the district court found based on overwhelming evidence that the rules have worked as intended. Credit-card networks no longer compete on merchant fees, and the rules prevent Discover or a new entrant from gaining market share by offering merchants a low-cost alternative. Eliminating price competition and blocking rivals in this $50 billion market are paradigmatic anticompetitive harms.

Amex principally argues that even if a vertical restraint is proved to have such anticompetitive effects, it cannot be deemed prima facie unreasonable unless the plaintiff separately shows that the defendant has market power. That argument rests on a fundamental error. Market power is simply a proxy for the ability to harm competition. It can be established indirectly, through an analysis of market share, barriers to entry, and other market conditions. But it can also be established directly, with proof that the defendant *actually has* harmed competition. Further inquiry into a defendant's theoretical ability to harm competition is unnecessary where, as here, a plaintiff proves that the defendant has actually caused such harm.

Amex also asserts that because the anti-steering rules are vertical restraints, their distortion of the competitive process does not qualify as a cognizable anticompetitive harm. Vertical restraints will rarely block interbrand price competition across an entire market. But where, as here, such a distortion is proved, the vertical nature of the restraint does not excuse or diminish it. And even if more proof of anticompetitive harm were required, the district court also found that the anti-steering rules have allowed all four networks to raise prices above competitive levels.

Amex repeatedly invokes the premise that the anti-steering rules serve legitimate ends. But the district court found that those ostensible procompetitive justifications are not "supported by the record," Pet. App. 230a—a holding that Amex did not appeal. And while Amex accuses the United States and the States of elevating merchants' interests over those of consumers, the anti-steering rules have led to higher retail prices and reduced consumer choice. In any event, Amex's asserted procompetitive justifications are relevant only at the second step of the rule-of-reason inquiry, where the burden lies with Amex. They have no bearing on whether the district court's undisturbed factual findings establish a prima facie case that the anti-steering rules unreasonably restrain trade.

A. Amex's Market-Power Argument Lacks Merit

The court of appeals applied the established rule-of-reason framework, which allows a plaintiff to carry its initial burden in either of two ways: directly, by showing that the challenged restraint has actual anticompetitive effects; or indirectly, by showing that the defendant has market power and that the restraint would tend to harm competition. Pet. App. 27a-28a; see Antitrust Law Professors' Amicus Br. 5-10. Amex asserts (Br. 24-41) that the direct method of proof is inapplicable to vertical restraints. That argument is contrary to this Court's precedents and to common sense. And even if separate proof of Amex's market power were required, the district court correctly found it present here.

1. Separate evidence of market power is unnecessary when a plaintiff proves actual adverse effects on competition

Amex correctly observes (Br. 30) that a vertical restraint imposed by a defendant that lacks market power cannot unreasonably restrain trade. Market power is 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) (*Kodak*) (citation omitted), including "the ability to raise prices above those that would be charged in a competitive market," *NCAA* v. *Board of Regents*, 468 U.S. 85, 109 n.38 (1984). By definition, a defendant that lacks such power cannot raise prices, reduce output, exclude competitors, or otherwise harm competition in the market as a whole unless it engages in horizontal collusion.

Although Amex's premise is sound, it does not support a rule requiring indirect evidence of market power. Even absent evidence of market share, "[i]t is clearly reasonable to infer that [a defendant] has market power to raise prices and drive out competition" where, as here, plaintiffs "offer direct evidence that [the defendant] did so." *Kodak*, 504 U.S. at 477; see Antitrust Law Professors' Amicus Br. 6. "[T]he purpose of the inquir[y] into * * * market power is to determine whether an arrangement has the potential for genuine adverse effects on competition." *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 460 (1986) (*Indiana Dentists*). It logically follows that "'proof of actual detrimental effects' * * * can obviate the need for an inquiry into market power, which is but a 'surrogate for detrimental effects.'" *Id.* at 460-461 (citation omitted).

Although *Indiana Dentists* involved a horizontal agreement (Amex Br. 33), this Court's logic applies equally here. Whether the challenged restraint is horizontal or vertical, market power is a "'surrogate'" that serves to identify "the potential for genuine adverse effects on competition." *Indiana Dentists*, 476 U.S. at 460-461 (citation omitted). Thus, whether the restraint is horizontal or vertical, proof of *actual* adverse effects on competition "obviate[s] the need for an inquiry into market power." *Id.* at 461.

Amex cites (Br. 32-33 & n.2) circuit-court decisions stating that vertical restraints adopted by defendants without market power cannot unreasonably restrain trade. But none of those decisions prohibits the use of actual detrimental effects to establish market power. And numerous decisions—including decisions by the same courts—confirm that market power may be shown through "direct proof" of anticompetitive effects. *E.g.*, *United States* v. *Microsoft Corp.*, 253 F.3d 34, 51 (D.C. Cir.), cert. denied, 534 U.S. 952 (2001).[1] Indeed, the Seventh Circuit has rejected as "backwards" the assertion "that anticompetitive effects in a market cannot be shown unless the plaintiff * * * first proves that [the defendant] has a large market share." *Toys "R" Us, Inc.* v. *FTC*, 221 F.3d 928, 937 (2000) (Wood, J.).

2. The district court correctly held that separate evidence showed Amex's market power

Amex contends (Br. 36-41) that the United States and the States failed to offer sufficient separate evidence of its market power. This Court need not address that question in light of the ample proof that the anti-steering rules adversely affect competition. See Part B, *infra*. In any event, Amex's argument is mistaken.

a. The district court correctly found (Pet. App. 148a-191a) that Amex has "the power 'to force [merchants] to do something that [they] would not do in a competitive market,'" *Kodak*, 504 U.S. at 464 (citation omitted), and "to raise prices," *NCAA*, 468 U.S. 85 at 109 n.38. Amex has that power because, "[f]or all but some of the smallest merchants, accepting Amex cards is a requirement of doing business." Wal-Mart Amicus Br. 4.

Many Amex cardholders are "insistent" on using their Amex cards and will take their business elsewhere if a merchant stops accepting Amex. Pet. App. 156a-157a. That insistence "effectively prevents merchants

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[1] See, *e.g.*, *Conwood Co.* v. *United States Tobacco Co.*, 290 F.3d 768, 783 n.2 (6th Cir. 2002), cert. denied, 537 U.S. 1148 (2003); *Todd* v. *Exxon Corp.*, 275 F.3d 191, 206 (2d Cir. 2001) (Sotomayor, J.); *United States* v. *Brown Univ.*, 5 F.3d 658, 668 (3d Cir. 1993); *Flegel* v. *Christian Hosp.*, 4 F.3d 682, 688 (8th Cir. 1993).

from dropping American Express"—as numerous merchants confirmed at trial. *Id.* at 158a; see *id.* at 158a-159a & nn. 26-27. For example, Walgreens tried to stop accepting Amex cards because of Amex's higher fees, but "was forced to retreat" after an "outcry from its customers." *Id.* at 163a. Walgreens' President testified that, although Walgreens is the Nation's ninth-largest retailer, it quickly discovered that "Amex was the 800-pound gorilla" in their negotiations. Tr. 1391-1392.

The district court also found that Amex's power over merchants has allowed it to raise its fees substantially without losing business. Between 2005 and 2010, Amex's Value Recapture initiative "repeatedly and profitably" raised prices that were "already at or above the competitive level," and did so "without losing a single large merchant and losing relatively few small merchants." Pet. App. 165a, 167a; see U.S. Br. 30-31.

b. Amex provides no sound reason to question the district court's conclusion that its leverage over merchants constitutes market power.

Amex asserts (Br. 36) that it "cannot reduce market-wide output" by "curtail[ing] supply." But even if that were true, market power can also be proved through evidence that the defendant can "raise prices" free from competitive pressure. *NCAA*, 468 U.S. at 109 n.38. Amex does not need to curtail supply (whatever that would mean in this context) to raise prices above competitive levels. Instead, it can simply raise its fees. In a competitive market, merchants would respond by shifting volume to lower-priced competitors. Here, however, the combination of Amex's insistent cardholders and the anti-steering rules makes that impossible. Cardholder insistence means that merchants must continue to accept Amex, and the anti-steering rules prohibit Amex-accepting merchants from shifting transactions to lower-fee networks.

Amex argues (Br. 36-37) that its 26.4% market share implies a lack of market power. But Amex has the second-largest share of a "highly concentrated" market with just four participants. Pet. App. 153a; see *id.* at 151a. That market is "constrained by high barriers to entry" and has been "remarkably static," with no new entrants in 30 years. *Id.* at 153a-154a. Although a 26.4% market share without more would not support an inference of market power, it does not preclude a finding to that effect where, as here, such a finding is supported by other evidence.[2]

Amex contends (Br. 38-39) that cardholder insistence cannot contribute to market power because it is based on Amex's continuing investments in cardholder rewards. But *every* firm with market power would quickly lose that power if it stopped providing the features that make its products attractive to customers. Cf. *Microsoft*, 253 F.3d at 57 ("even monopolists have reason to invest in R&D"). The question thus is not whether a firm must continue to invest to maintain its market power; it is whether that market power is "durable" in the sense that it can be expected to persist "for a significant period without erosion by new entry or expansion." 2B Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 501, at 111 (4th ed. 2014)

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[2] At Amex's urging, the Second Circuit previously held that MasterCard had market power when it had a 26% market share. *United States* v. *Visa U.S.A., Inc.*, 344 F.3d 229, 239-240 (2003) (Leval, J.), cert. denied, 543 U.S. 811 (2004); see Amex Amicus Br. at 16, *Visa U.S.A.*, *supra* (No. 02-6074).

(Areeda & Hovenkamp). The district court correctly found that Amex's market power is durable because it has persisted for decades and because it is protected by stable market conditions including "sustained high barriers to entry." Pet. App. 165a.

B. The Facts Found By The District Court Establish That The Anti-Steering Rules Adversely Affect Competition

Amex emphasizes (Br. 24-26) that the anti-steering rules are vertical restraints that must be judged under the rule of reason. The United States and the States have never argued otherwise, and the district court conducted an exhaustive rule-of-reason inquiry. Pet. App. 105a-106a & n.7; see *id.* at 111a-258a. That inquiry showed that the rules impose "actual, sustained adverse effects on competition," *Indiana Dentists*, 476 U.S. at 461, by stifling price competition, blocking rivals, raising merchant fees, and ultimately inflating the retail prices paid by all Americans. U.S. Br. 23-34.

1. Amex does not deny that the anti-steering rules stifle price competition, block rivals, and stunt innovation

a. The anti-steering rules prevent merchants from altering their consumption of a network's services in response to changes in the network's price. Pet. App. 196a. The rules bind merchants that account for 90% of total market volume, and they apply to *all* of the merchants' transactions—even those that do not involve Amex cards. *Id.* at 101a-102a; see U.S. Br. 4. The district court found that the rules have "frustrated" competition on merchant fees "to the point of near irrelevance," Pet. App. 195a, reflecting "a decision made by [Amex] on behalf of all participants in the network services market that networks will not compete * * * by lowering their merchant pricing," *id.* at 240a.

The district court further found that the anti-steering rules make it "nearly impossible" for a new firm to enter the market "by offering merchants a low-cost alternative to the existing networks" or an innovative alternative payment system. Pet. App. 203a; see U.S. Br. 32-34. That harm is not "[t]heoretical" (Amex Br. 51). Discover pursued a low-fee strategy in the 1990s but was thwarted by anti-steering rules. Pet. App. 203a-206a. And by blocking Discover and other potential entrants from pursuing a low-fee strategy, the anti-steering rules reduce competition and artificially constrain the range of options available to merchants and cardholders alike. Connor Amicus Br. 16-21.

b. Amex does not seriously dispute that the anti-steering rules stifle price competition and block low-fee rivals.[3] Instead, it asserts (Br. 51-53) that such harms to the competitive process cannot establish a prima facie case without proof of price or output effects. That is not so. Under the rule of reason, "the criterion to be used in judging the validity of a restraint on trade is its impact on competition." *NCAA*, 468 U.S. at 104. The plaintiff's burden is to "allege and prove harm * * * to the competitive process, *i.e.*, to competition itself." *NYNEX Corp.* v. *Discon, Inc.*, 525 U.S. 128, 135 (1998). A plaintiff can carry that burden by proving that a restraint has rendered price and output "unresponsive to

[3] Amex asserts in a single sentence (Br. 56) that Discover's low-fee strategy failed for other reasons. But the district court found that "the failure of Discover's low-price value proposition is emblematic of the harm done to the competitive process by Amex's rules." Pet. App. 207a. The court also noted that Amex "d[id] not strenuously dispute the evidence regarding the effect of anti-steering rules on Discover's low-price model, or that such restrictions effectively raise a barrier to entry * * * for firms pursuing a low-price strategy." *Id.* at 205a-206a.

consumer preference," *NCAA*, 468 U.S. at 107, or otherwise "disrupt[ed] the proper functioning of the price-setting mechanism of the market," *Indiana Dentists*, 476 U.S. at 461-462.

Amex asserts (Br. 52) that *NCAA* and *Indiana Dentists* are irrelevant because they involved horizontal agreements and the Court therefore applied the "quick look" method rather than the full rule of reason. But whether a court applies the per se rule, the quick look, or the full rule of reason, "the essential inquiry remains the same—whether or not the challenged restraint enhances competition." *NCAA*, 468 U.S. at 104. Vertical restraints require more careful analysis because they are less likely to harm interbrand competition. *Leegin Creative Leather Prods., Inc.* v. *PSKS, Inc.*, 551 U.S. 877, 890 (2007). The Court has cautioned, however, that in applying the rule of reason, "the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated." *Id.* at 894. Where, as here, a full rule-of-reason analysis reveals that a vertical restraint has effectively eliminated price competition across an entire market, the vertical nature of the restraint does not diminish the anticompetitive harm or excuse the defendant from the burden of procompetitive justification.

c. Amex also objects (Br. 53-55) that there is no "administrable standard" for identifying harms to the "competitive process." But as Amex acknowledges (Br. 53-54), courts routinely identify such harms in assessing exclusive-dealing contracts. Courts considering challenges to such restraints do not require proof of price or output effects to establish a prima facie case. Instead, "the proper focus is on the structure of the market." *Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S. 2, 45 (1984) (O'Connor, J., concurring in the judgment). When sellers are "numerous and mobile, and the number of buyers is large, exclusive-dealing arrangements of narrow scope pose no threat" because they do not affect competition in the market as a whole. *Ibid.* But an arrangement may be unreasonable if "a significant fraction of buyers or sellers are frozen out of a market by the exclusive deal." *Ibid.* Such a foreclosure requires some procompetitive justification because it is "an impairment of the competitive structure of the market." *Stop & Shop Supermarket Co.* v. *Blue Cross & Blue Shield*, 373 F.3d 57, 66 (1st Cir. 2004) (Boudin, C.J.) (*Stop & Shop*); see, *e.g.*, *Interface Grp., Inc.* v. *Massachusetts Port Auth.*, 816 F.2d 9, 11 (1st Cir. 1987) (Breyer, J.).

The anti-steering rules are not exclusive-dealing contracts, but their "impairment of the competitive structure of the market," *Stop & Shop*, 373 F.3d at 66, is even clearer. The rules do not prohibit merchants from accepting rival cards, but they have effectively prevented price competition by eliminating any meaningful economic incentive for other networks to lower their merchant fees. That stifling of interbrand price competition is the sort of harm usually associated with horizontal collusion, and it constitutes a serious injury "to the competitive process, *i.e.*, to competition itself." *NYNEX*, 525 U.S. at 135.

Contrary to Amex's assertion (Br. 53-54), deeming such a severe distortion of the competitive process sufficient to establish a prima facie case will not lead to condemnation of benign or procompetitive arrangements that benefit consumers. Vertical restraints that manufacturers impose on their own distributors generally do not restrain interbrand competition. *Leegin*, 551 U.S. at 889-894. Exclusive-dealing arrangements and similar restraints likewise pose no antitrust concern when, as is typical, they cover only a small portion of the market and thus do not affect competition in the market as a whole. See *Stop & Shop*, 373 F.3d at 68 ("For exclusive dealing, foreclosure levels are unlikely to be of concern where they are less than 30 or 40 percent."). The anti-steering rules, by contrast, effectively constrain the entire market because they bind merchants that account for more than 90% of credit-card transactions by dollar value. U.S. Br. 4. Only in unusual cases like this one will plaintiffs be able to prove that a vertical restraint has harmed interbrand competition across a market.

2. The anti-steering rules have allowed all four networks to raise their fees above competitive levels

Even if proof of harm to the competitive process were insufficient, the United States and the States also showed that the anti-steering rules have allowed all four networks to raise their merchant prices. U.S. Br. 30-32. Amex's challenges to the sufficiency of that proof reflect a persistent failure to acknowledge the district court's findings.

a. Amex asserts (Br. 28) that "the record contradicts the premise that the [anti-steering rules] cause merchants to pay higher fees." That statement ignores the finding that the rules "have allowed all four networks to raise their swipe fees more easily and more profitably," resulting in "higher all-in merchant prices across the network services market." Pet. App. 207a; see *id.* at 207a-212a. It also contradicts economic logic and a wealth of evidence from market participants—including Amex's own executives, who acknowledged that without the anti-steering rules, Amex "would face increased pressure to reduce its rates." *Id.* at 218a.[4]

b. Amex also asserts (Br. 48) that the United States and the States could not rely on proof of higher prices without "evidence of costs or margins." But contrary to Amex's assumption (Br. 49), a plaintiff need not show that a defendant's margin exceeds some (unspecified) level to establish that its prices are "supracompetitive." Supracompetitive prices are prices "above those that would be charged in a competitive market." *NCAA*, 468 U.S. at 109 n.38. The relevant question is thus whether the challenged restraint has raised prices above those that would prevail under competitive conditions.

As Amex observes (Br. 49-50), proof that one firm charges higher prices than its rivals is insufficient to establish supracompetitive pricing, because the difference may reflect superior value. *Leegin*, 551 U.S. at 896-897. Even proof of "rising prices" across the market may simply reflect "growing product demand." *Brooke Grp. Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 237 (1993); cf. Amex Br. 39-40. The critical question is whether the "higher prices are a

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[4] Amex observes (Br. 28) that "there was no evidence that merchant fees decreased for merchants that did not accept Amex cards" after Visa and MasterCard rescinded their anti-steering rules in response to this suit. But the "very small" merchants that do not accept Amex "have not yet begun widespread steering," Pet. App. 224a, and the district court found that large merchants bound by Amex's anti-steering rules *would* steer if they could, *id.* at 221a-222a. Amex can hardly argue otherwise, because the remainder of its brief rests on the premise that the rules are necessary to prevent steering (otherwise, they would have no effect at all).

product of nonmarket forces." *Brooke Grp.*, 509 U.S. at 232.[5]

Here, the district court found that networks' increasing merchant fees are attributable in significant part to "nonmarket forces," *Brooke Grp.*, 509 U.S. at 232—specifically, the competition-suppressing effect of the anti-steering rules. The court found that the rules "were integral to American Express's Value Recapture increases," Pet. App. 208a-209a, which substantially raised fees that "were already at or above the competitive level," *id.* at 167a. The court also found that the rules have "enabled American Express's competitors to charge higher all-in fees." *Id.* at 210a. Most strikingly, anti-steering rules allowed Discover "to radically increase its merchant pricing" with "virtual impunity" after it was forced to abandon its low-fee strategy. *Ibid.*

The networks' increased fees cannot plausibly be attributed to rising demand, increasing costs, or other market forces. A Discover executive stated that Discover had radically increased its fees simply because it had been "leaving money on the table." Pet. App. 206a (citation omitted). And Amex executives acknowledged that Amex's Value Recapture price increases were not based on its "cost structure." Tr. 2832. Instead, Amex's pricing strategy starts "with a baseline rate equal to the Visa/MasterCard * * * rate," and then adds a measure of "value" based on the sales a merchant would lose if it stopped accepting Amex. Pet. App. 160a. Using that

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[5] See, *e.g.*, *Gordon* v. *Lewistown Hosp.*, 423 F.3d 184, 210 (3d Cir. 2005) (a plaintiff may carry its burden by showing that the restraint "raised prices"), cert. denied, 547 U.S. 1092 (2006); *Thurman Indus., Inc.* v. *Pay 'N Pak Stores, Inc.*, 875 F.2d 1369, 1373 (9th Cir. 1989) (a plaintiff may carry its burden by showing "price increases caused by the restraint").

method, Amex "targeted" merchants "with relatively high rates of cardholder insistence" for "multiple rounds of price hikes," and the Value Recapture rate increases ultimately yielded "$1.3 billion in incremental pre-tax income." *Id.* at 167a, 170a.

c. Amex also asserts that the district court focused on "the wrong price." Br. 48 (emphasis omitted). The court addressed the merchant discount rate, which is the price merchants pay to Amex and to acquirers affiliated with Visa, MasterCard, and Discover. Amex asserts (Br. 47) that the court should have focused instead on the "network fee," which is the component of the merchant discount rate kept by the network in the disaggregated systems operated by Visa and MasterCard. See Pet. App. 81a-84a. But the district court correctly focused on the price that merchants actually pay—and the price on which the networks would compete if steering were allowed. The fact that Visa and MasterCard ultimately distribute merchant payments among the network, the acquirer, and the issuer is irrelevant.

d. Amex asserts (Br. 43-46) that the district court erred by relying on increases in merchant prices without considering "net" or "two-sided" prices accounting for cardholder rewards. As Amex acknowledges (Br. 43-44), that argument rests on the court of appeals' holding that the relevant market must be defined to include services to cardholders. That holding was incorrect. See Part C, *infra*. And for two reasons, Amex's argument about its two-sided price would be unpersuasive even under the court of appeals' market definition.

First, Amex is wrong to assert (Br. 44) that "the district court concededly had no evidence about [Amex's] net price." In fact, the court found that Amex's Value

Recapture price increases "were not paired with offsetting adjustments on the cardholder side of the platform" and thus constituted increases to Amex's "net price." Pet. App. 166a; see *id.* at 209a (finding "a higher net price"); U.S. Br. 47-49.

Second, even if the higher merchant fees made possible by Amex's anti-steering rules were wholly offset in the aggregate by increased cardholder rewards, the distortion of the market's price-setting mechanism would still be a matter of antitrust concern. U.S. Br. 40-43. That conclusion does not "focus[] on the welfare of merchants to the exclusion of [cardholders]" (Amex Br. 45). The anti-steering rules distort the market—and harm both merchants and cardholders—by precluding legitimate forms of competition on both sides of the platform. U.S. Br. 42.

The district court found that the higher merchant fees that result from the anti-steering rules are passed along to consumers through higher retail prices. See Pet. App. 210a-212a. Amex's argument that the rules benefit consumers depends on the premise that Amex's cardholder rewards are more valuable than the incentives that merchants might provide to use alternative payment methods. Consumer welfare is ordinarily enhanced, however, by the availability of a broader array of options that a competitive environment can produce. The Court in *Leegin* observed that, as a general matter, vertical price restraints "ha[ve] the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between." 551 U.S. at 890. But the purpose and effect of Amex's anti-steering rules is to *foreclose* the development of an analogous range of consumer choices among payment methods.

Thus, while Amex is free to pursue a strategy of pairing high merchant fees with high cardholder rewards, the anti-steering rules harm competition by effectively forcing the *entire market* to follow Amex's path.

3. Increased volume of credit-card transactions does not undermine the showing of anticompetitive effects

Amex emphasizes (Br. 1, 3, 22, 39-40, 42-43) that the dollar volume of credit-card transactions has been increasing. But "a 'reduction in output is not the *only* measure of anticompetitive effect.'" *O'Bannon* v. *NCAA*, 802 F.3d 1049, 1070 (9th Cir. 2015) (citation omitted), cert. denied, 137 S. Ct. 277 (2016). For two reasons, the growth in transaction volume does not undermine the conclusion that the anti-steering rules harm competition.

First, transaction volume is influenced by many factors, including general economic conditions. See Tr. 3544 (Amex's business "grows roughly at the [rate of] discretionary GDP growth"). The fact that volume has increased despite the anti-steering rules thus sheds no light on what it would be if the rules had not existed. Cf. Australian Retailers Ass'n Amicus Br. 15 (describing rapid growth in transaction volume following Australia's prohibition on anti-steering rules).

Second, a focus on output is unilluminating here precisely because of the distorting effect of the anti-steering rules. U.S. Br. 49 n.11. Ordinarily, supracompetitive prices and reduced output go hand-in-hand because consumers respond to higher prices with lower demand. See *Fortner Enters., Inc.* v. *United States Steel Corp.*, 394 U.S. 495, 503 (1969). But the anti-steering rules "sever[] the typical link between merchants' demand for network services and the price charged for the same." Pet. App. 195a.

C. Amex's Services To Cardholders And Its Services To Merchants Belong In Separate Antitrust Markets

The court of appeals held that the relevant market in this case must be defined to include the services Amex provides to cardholders as well as the services it provides to merchants. Pet. App. 32a-33a. This Court need not resolve that issue because proof of "actual, sustained adverse effects on competition" eliminates the need for "specific findings * * * concerning the definition of the market." *Indiana Dentists*, 476 U.S. at 460-461. If the Court does reach the issue, it should reaffirm the rule that an antitrust market "consists only of goods that are reasonably close *substitutes* for one another." Areeda & Hovenkamp ¶ 565a, at 430.

Amex's own description confirms (Br. 5-6) that it provides very different bundles of services on "the cardholder side" and the "the merchant side" of its platform. Amex also acknowledges (Br. 44-45) that those services are not substitutes. And Amex sells those services separately, to different groups of consumers in very different competitive environments. Amex, Discover, and thousands of issuing banks compete vigorously to attract cardholders, but the four networks do not compete on merchant fees. Pet. App. 81a-84a, 119a.

Amex emphasizes (Br. 45) that each credit-card transaction involves services to both merchants and cardholders. But that does not mean that those two bundles of services belong in the same market. And in proposing a market defined in terms of "transactions," it is Amex that "presupposes a product that does not exist" (Amex Br. 44-45). Amex does not sell "transactions." It sells merchant and cardholder services to different customers, who pay for those services in different ways. Collapsing those two nonsubstitutable services into a single market would only cloud the inquiry. U.S. Br. 35-40; Antitrust Law Professors' Amicus Br. 17-20.[6]

D. Amex's Asserted Justifications For The Anti-Steering Rules Are Irrelevant To The Question Presented And Are Foreclosed By The District Court's Factual Findings

Amex repeatedly asserts that the anti-steering rules serve legitimate procompetitive ends. But the district court considered and rejected those procompetitive justifications as factually unsupported—a holding that Amex did not appeal. And even if Amex's justifications were valid, they would be relevant only at the second step of the burden-shifting inquiry. They have no bearing on the question whether the United States and the States carried their initial burden to show that the rules are prima facie anticompetitive.

1. Amex asserts (Br. 26-29) that its relationship with merchants is akin to a manufacturer's relationship with its retailers, and that the anti-steering rules are like retail price maintenance and other restraints that manufacturers use to control the distribution of their products. That comparison is inapt.

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[6] As Amex observes (Br. 45 n.4), this Court has sometimes defined antitrust markets to include products that are not substitutes. But it has done so only when those products are sold together to the same consumers, see, *e.g.*, *United States* v. *Grinnell Corp.*, 384 U.S. 563, 572 (1966) ("burglar alarm" and "fire alarm" services), or when they exhibit similar competitive conditions and it is convenient to analyze them together, see, *e.g.*, *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321, 356 (1963) ("commercial banking" services). Neither rationale applies here. Am. Antitrust Inst. Amicus Br. 22.

A manufacturer and its ultimate consumers share an interest in minimizing the costs of distribution, including retailer profit margins. *Leegin*, 551 U.S. at 896. Accordingly, a manufacturer generally will not impose minimum retail prices or other restraints that increase retailer margins unless those restraints increase efficiency or allow the manufacturer's products to compete more effectively against rival brands. *Id.* at 890-891; see Connor Amicus Br. 16-17.

Merchants are not traditional "distributors" of Amex's services: An Amex cardholder goes to the grocery store to buy groceries, not credit-card services. Instead, both merchants and cardholders are *consumers* of credit-card services, and they share an interest in choosing the most efficient means of completing their transactions. The anti-steering rules interfere with that choice by preventing merchants (who bear the direct cost) from influencing cardholders (who select the network). In blocking that communication, the rules do not "promot[e] the most efficient distribution of [Amex's] product" (Amex Br. 28) or otherwise enhance interbrand competition. Instead, they *suppress* competition between Amex and its rivals.

Amex is also wrong to assert (Br. 27) that merchant steering impedes its ability to provide rewards and services that "give cardholders incentives to use their cards." A cardholder offered a 1% discount or similar incentive to use a Discover card remains free to pay with Amex, and will be steered away only if "he believes that what the merchant is offering is of greater value than the rewards or other benefits he receives for using his Amex card." Pet. App. 257a. Steering is efficiency-enhancing because it shifts transactions to other networks only when "both the merchant-consumer and cardholder-consumer derive a net benefit" from the switch. *Ibid.* Steering thus does not preclude Amex from pursuing a higher-fee, higher-rewards strategy; it simply ensures that the success or failure of that strategy will reflect the preferences of both cardholders and merchants in a competitive environment. See pp. 16-17, *supra.*[7]

Amex also asserts that steering subverts "the relationship of trust between Amex and its cardholders" by undermining "'welcome acceptance'" of Amex cards. Br. 9 (citation omitted). But the United States and the States have not challenged the contractual provisions that prohibit merchants from mischaracterizing Amex's products, disparaging Amex, or charging special fees to Amex users. Pet. App. 249a. Amex does not explain why incentives such as offering customers a discount for using Discover would undermine its relationship with its cardholders (other than by causing some cardholders to conclude that Discover offers a better value). In fact, Amex witnesses conceded at trial that such steering need not interfere with "welcome acceptance." *Id.* at 237a n.53 (citation omitted). And while Amex describes its anti-steering rules as "nondiscrimination provisions" (*e.g.*, Br. 2), a merchant's decision to offer a discount to consumers that choose a good or service that the merchant itself obtains at a lower cost would not ordinarily be viewed as a form of "discrimination."

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[7] For similar reasons, Amex is wrong in suggesting (Br. 9) that steering allows merchants to free-ride on its "investment in cardholder rewards." Rewards and other "investments tied to card use" are "not subject to free-riding" because Amex "does not incur any cost if the cardholder is successfully steered" to another network. Pet. App. 255a-256a.

2. Amex asserts that the anti-steering rules protect its "differentiated business model" and allow it to "compete effectively with Visa and MasterCard." Br. 11 (capitalization altered). But the district court found that Amex's argument is not "supported by the record." Pet. App. 230a. The court emphasized that Amex had "presented no expert testimony, financial analysis, or other direct evidence" that it would "cease to be an effective competitor" without the anti-steering rules. *Id.* at 242a. To the contrary, the court noted that Amex has adapted—and flourished—in markets where steering is allowed. *Id.* at 243a; see, *e.g.*, Australian Retailers Ass'n Amicus Br. 2-23. And it observed that "American Express itself has identified a range of potential, permissible steps" that would "protect its ability to deliver a differentiated product if steering is permitted." Pet. App. 244a. The court thus correctly held that Amex had not carried its burden to establish that the anti-steering rules are reasonably necessary to achieve any legitimate procompetitive benefit in the market for cardholders. See U.S. Br. 52-55.

3. In any event, Amex's asserted procompetitive justifications are not relevant to the only question before this Court. The Court granted certiorari to review the court of appeals' holding that the United States and the States failed to carry their initial burden to establish that the anti-steering rules are prima facie anticompetitive. Pet. i. Amex does not defend the court of appeals' erroneous suggestion that the United States and the States could carry that burden only by anticipating and refuting potential procompetitive justifications for the rules. U.S. Br. 43-47. If this Court vacates the decision below, the court of appeals on remand can consider any properly preserved challenges Amex may

have to the district court's holdings concerning its pro-competitive justifications.

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For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be vacated, and the case should be remanded to the court of appeals for further proceedings.

Respectfully submitted.

NOEL J. FRANCISCO
Solicitor General

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