

Supreme Court Issues Landmark Decision on Two-Sided Markets

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On Monday June 25, the Supreme Court by a 5-4 decision in *Ohio v. Am. Express Co.* held that American Express's ("AmEx") anti-steering provisions do not violate Section 1 of the Sherman Act. This case has important implications for determining antitrust liability in "two-sided markets" like credit card networks and digital platforms that have at least two types of customers, such as merchants or advertisers and consumers.

The most significant element of the Court's holding is that, for purposes of determining competitive effects of conduct in a two-sided market, the relevant market consists of both sides of the market when the market exhibits significant indirect network effects (i.e., significant competitive effects or interdependency among multiple customer types). Accordingly, to satisfy their initial burden under the rule of reason, plaintiffs must demonstrate that the challenged restraint has a substantial anticompetitive effect across the *entire* platform. "Evidence of a price increase on one side of a two-sided transaction platform cannot by itself demonstrate an anticompetitive exercise of market power." *Id.* at 15. The Court's decision adds new factors to the already fact-intensive, rule-of-reason analysis as applied to critical sectors of the economy.

I. Background

Unlike other credit card companies, AmEx earns most of its revenue from merchant fees, and uses its rewards program to encourage cardholders to pay with AmEx. To offer better rewards, AmEx charges higher merchant fees than competing cards from Visa, MasterCard, and Discover. In other words, AmEx charges higher prices to customers (merchants) on one side of the market in order to provide greater benefits to customers (consumer cardholders) on the other. As this strategy could encourage merchants to steer shoppers away from using AmEx at checkout, AmEx requires merchants who accept its cards to agree to anti-steering provisions that, among other things, prohibit the promotion of other cards over AmEx.

In October 2010, the United States and several States sued AmEx, alleging that its anti-steering provisions were an unreasonable restraint on trade in violation of Section 1 of the Sherman Act. The District Court treated the credit-card market as two separate markets—one for cardholders and one for merchants—and found the anti-steering provisions were anticompetitive because of the harm they inflicted on merchants through higher fees. The Court of Appeals for the Second Circuit reversed. It found that the credit-card market was one market, not two separate (merchant and cardholder) markets, and that the anti-steering provisions were not anticompetitive when one considered the effects on the market as a whole. The Supreme Court affirmed.

II. Analysis

The significance of the opinion lies in the Court's analysis of two-sided platforms. Two-sided platforms bring together two (or more) distinct groups that rely on the platform as an intermediary through which those distinct sets of customers interact. The existence of indirect network effects, by which actions taken toward customers on one side of the market affect the value of services to customers on other sides of

the market, distinguish these types of platforms from traditional, single-sided firms. The interdependency creates a feedback loop that requires the platform operator to consider how its actions towards customers on one side of the market will affect the demand for the platform services from customers on the other side of the market. As the Court majority put it, “due to indirect network effects, two-sided platforms cannot raise prices on one side without risking a feedback loop of declining demand.” *Id.* at 12. A price increase on one side of a platform, therefore, does not suggest an anticompetitive effect without evidence of increasing the overall cost of the platform to all customer groups considered together. *Id.* This is because the increased costs to one side might be offset by increased benefits to the other, an effect that would be missed if plaintiffs only had to show harm to one side of the market. Accordingly, “courts must include both sides of the platform—merchants and cardholders—when defining the credit-card market.” *Id.*

Central to the Court’s decision was that courts must only consider both sides of the platform when a two-sided platform exhibits “pronounced indirect network effects and interconnected pricing and demand.” *See id.* at 12-13. The Court found credit cards to qualify as “two-sided transaction platforms” because the product they sell—credit card transactions—essentially involves a simultaneous sale to merchants on one side of the market and cardholders on the other. Without the merchant’s willingness to receive payment with a particular credit card and a customer’s willingness to use that particular card to make payments, no transaction can occur. *See id.* at 2, 13. The card issuer must therefore induce both sides of the market to accept its card services. As a result, the platforms’ sides are highly interdependent: more merchants will accept a card used by more consumers, and more consumers will demand a credit card the more widely it is accepted by merchants. A card issuer will consider this interdependency in setting its prices and policies on each side of the market.

The Court therefore held that when challenging such actions, a plaintiff must demonstrate anticompetitive effects on the two-sided platform as a whole to satisfy its initial burden under the rule of reason analysis. That is, plaintiff must prove (1) increased costs to the platform overall, (2) reduced output for the platform as a whole, or (3) lessened competition in the market for these two-sided platforms. *See id.* at 15. The Court rejected plaintiffs’ argument that increased merchant fees in themselves demonstrated an anticompetitive effect because it “wrongly focuses on only one side of the two-sided credit-card market.” *Id.* In a dissent, Justice Breyer took the view that there was ample evidence of anticompetitive harm, noting the District Court’s finding of direct evidence of price increases to merchants. Justice Breyer also argued that the majority erred in defining the relevant market for assessing competitive effects to include complementary products, a departure from established antitrust principles that define markets based on products that are competitive substitutes.

The Court was careful to note that, where indirect network effects operate in one direction only, the two-sided platform “behaves much like a one-sided market and should be analyzed as such.” *Id.* at 12-13. The Court identified newspapers selling advertising as a two-sided platform with one-sided network effects. While a newspaper’s value increases for advertisers as readership increases, readers are indifferent to the amount of advertising in the newspaper, and thus do not share similarly strong indirect network effects. *Id.* at 12. In this situation, courts do not need to consider both sides of the two-sided platform when defining the relevant market. *Id.* 12-13 (citing *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594 (1953)). Where the majority distinguished *Times-Picayune* from its holding, the dissent, by contrast, took the *Times-Picayune* case as controlling precedent and faulted the majority for failing to adhere to the holding in that case. The implication of the Court’s discussion of newspapers for other platforms that sell advertising but where consumers might be more sensitive to the volume of advertising—for example, on-line platforms—remains an open question after the decision, the answer to which may depend on a factual inquiry into the extent of the indirect network and feedback effects on such platforms.

III. Implications

The Court's *AmEx* decision is likely to have a far-reaching impact. It expands the fact-specific inquiry courts need to undertake when applying the rule of reason analysis in multi-sided markets. Before defining the relevant market, a court will now need to determine whether a company operates a two-sided platform and, if so, the magnitude and direction of the indirect network effects. Where strong, cross-directional indirect network effects exist, the analysis must consider both sides of the two-sided platform. This will be of most import to the growing number of online "transaction" platforms that match consumers with service providers of rides, lodging, groceries, etc.

Justice Thomas wrote the opinion, joined by Chief Justice Roberts and Justices Kennedy, Alito, and Gorsuch. Justice Breyer wrote the dissenting opinion, joined by Justices Ginsburg, Sotomayor, and Kagan.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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