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Merchant Restraints in *Ohio v. American Express*—Why the Supreme Court Got It Wrong

*Trent Earl*

I. Introduction

A forgotten wallet at dinner led to a revolution that influenced the way the world exchanges goods.¹ Nearly seventy years ago, Frank McNamara, after forgetting his wallet while eating at a restaurant in Manhattan, conceived the first credit card—the Diner’s Club Card.² In just a few short decades, payment cards like the Diner’s Club Card evolved from nice novelty items to fundamental purchasing tools for the majority of consumers. Today, over 70% of Americans have at least one credit card in their wallets, and a majority of those carry more than one card.³ The more recent advent of mobile payment systems, such as Apple Pay, has given consumers another alternative payment method. As more merchants and credit card conglomerates such as American Express (Amex), Visa, Mastercard, and Discover accept mobile payments, cashless payments have become increasingly prolific. It is no wonder that most Americans foresee that cash will become an archaic tool of the past.⁴ However, this relatively swift expansion of the payment card market has been coupled with “some of the most expensive and contested public and private antitrust litigation of the past quarter of a century.”⁵

Recent litigation centers on merchant restraints imposed by payment card companies in their merchant contracts. In particular, much

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². Id.
of today’s litigation focuses on whether payment card companies are engaging in anticompetitive behavior when they prevent merchants from incentivizing the use of a particular credit card at the point of sale through contractual restraints. The Supreme Court, in Ohio v. American Express, analyzed Amex’s non-discrimination contractual provisions, which prohibit merchants from “steering” cardholders toward using a payment card with lower transaction fees. The Court held that the plaintiffs failed to show that this particular type of restraint resulted in anticompetitive harm within the broad, two-sided market definition that they adopted. Thus, they were not able to sufficiently prove that anti-steering provisions violate antitrust law.

However, Amex’s merchant restraints are anticompetitive and cause harm to competition because they raise merchant fees and, subsequently, consumer prices to a supracompetitive level. Consequently, the Court incorrectly determined that the merchant restraints imposed in Amex’s merchant contract agreements did not violate the Sherman Act. Amex’s anti-steering provisions violate antitrust law whether the relevant market adopted by the Court includes both sides of the two-sided payment card network or limits the market definition to include only the affected side of the payment network.

II. EXECUTIVE SUMMARY

This paper analyzes the recent Supreme Court holding in Ohio v. American Express and discusses the economic implications of the two-sided market definition adopted by the majority. In order to better understand the novel difficulties faced by the Court in American Express, this paper will first briefly discuss the judicial history leading up to Ohio v. American Express, and the Supreme Court’s analysis of that history. Second, since the market definition played an outsized role in American Express and was hotly disputed by the justices, this paper discusses why the two-sided market definition is the correct market definition for these types of market restraints. A focus on the economic rationalization for the two-sided market definition is emphasized. Third, this paper explores the current card payment network and its functionality. Since card payment networks are the main focus in American Express, an understanding of how they function is

7. See infra Section VI.A.
crucial to an understanding of the Court’s decision. Finally, this paper examines the Court’s holding that Amex’s anti-steering provisions were not anticompetitive. Specifically, it argues that even under the majority’s market definition, anti-steering provisions are anticompetitive, and the Court should have held that “step one in the rule of reason analysis” was satisfied.

III. Ohio v. American Express

In 2010, the United States government and seventeen states sued Visa, Mastercard, and Amex in federal district court, alleging that the defendant’s contractual non-discrimination provisions “unreasonably restrain[ed] trade in violation of § 1” of the Sherman Act. Specifically at issue were the anti-steering provisions implemented in their merchant use contracts. By 2011, Visa and Mastercard had voluntarily agreed to rescind their anti-steering provisions and entered into consent judgments, leaving Amex as the sole defendant. The district court, after a seven-week bench trial, held that Amex’s anti-steering provisions violated § 1 of the Sherman Act in that they unreasonably restrained trade. The court determined the relevant market should be narrowly defined to only include network services between card companies and merchants. The court further held that Amex possessed sufficient market power to harm competition, and that anti-steering provisions had actual anticompetitive effects because they eliminate the incentive for card companies not to charge supracompetitive transaction fees.

The United States Court of Appeals for the Second Circuit reversed the district court’s decision. They determined the lower court erred by not including cardholders, the other side of the two-sided payment network, when defining the relevant market. The Second Circuit held that when both sides are included in one market, the net effects of Amex’s merchant restraints were not anticompetitive. The Second Circuit held that the district court had discounted the inter-

9. Id.
10. Id.
11. Id. at 192-93.
12. Id.
ests of cardholders, improperly focusing solely on merchant harm.\textsuperscript{13} Despite the harm suffered by merchants because of these restraints, the court ruled that the benefits cardholders receive due to the anti-steering provisions create a net effect in the market such that the non-discrimination provisions were not unreasonable restraints of trade.\textsuperscript{14}

The United States Supreme Court, in a 5-4 decision, affirmed the Second Circuit Court’s decision, holding that both sides of a two-sided platform should be included in the market definition.\textsuperscript{15} The Court further held the plaintiff states did not meet their initial burden of proof because they failed to show that Amex’s merchant restraints caused anticompetitive harm to consumers.\textsuperscript{16}

**IV. DEFINING THE RELEVANT MARKET IN A TWO-SIDED NETWORK**

The Supreme Court’s opinion in *American Express* largely focuses on how to properly define the relevant product market for card payment systems, specifically, and two-sided markets, generally. Establishing the relevant market is often the most fiercely litigated and most critical element in antitrust litigation.\textsuperscript{17} How courts ultimately define the relevant market is often the determinative factor in whether a challenged practice is deemed appropriate or anticompetitive—a broad relevant market definition typically benefits the defendant while a narrow definition typically favors the plaintiff.\textsuperscript{18} The relevant market is described as the “area of effective competition.”\textsuperscript{19} Accurately defining the relevant market requires combining multiple products into a single market when dictated by “commercial realities.”\textsuperscript{20}

\begin{footnotesize}
\begin{enumerate}
\item 13. *Id.* at 206.
\item 14. *Id.*
\item 16. *Id.* at 2284.
\end{enumerate}
\end{footnotesize}
A court’s arduous task of defining an appropriate relevant market is further complicated by the challenge of determining whether both groups, one group, parts of each group, or none of the interconnected groups should be included in the relevant market definition for two-sided networks.21 Correctly establishing what should be included is critical in evaluating the potential for genuine adverse effects on competition.22 Furthermore, innocent, profit-maximizing decisions in two-sided markets may be held as per se antitrust violations if a court incorrectly applies a one-sided market definition. Properly defining the relevant market in this context is absolutely crucial as courts, when engaging in rule of reason analysis, will weigh tradeoffs between pro- and anticompetitive effects of a certain policy within the court-defined relevant market.23 When defining the relevant market, the court establishes the zone of permissible trade-offs.24 Therefore, a relevant market that includes both sides of a two-sided market will be much broader and will necessarily include more tradeoffs for the court to consider than if it were to adopt a narrower definition that included only one side of the market.25 Whether it is appropriate to include both sides of the market or only one in defining the relevant market is where the majority and minority opinions in American Express diverge. The majority determined that commercial realities dictate that the relevant market should include both merchants and cardholders (i.e. both sides of the payment card network).26 The adoption of the broader market definition led to the Court’s holding that American Express had not violated antitrust law. The minority determined that the relevant market should have been confined solely to the market for merchant services. This determination led to the opinion that American Express was guilty of violating the Sherman Act. Although this paper argues that the majority in American Express ultimately reached a flawed holding, the Court correctly rea-

21. Ward, supra note 17, at 2060.
23. Ward, supra note 17, at 2059-60.
24. Id.
soned that both sides of two-sided markets must be examined to define the relevant market and determine any possible harm.

The unique economic characteristics inherent in a two-sided market dictate that an accurate market definition include both sides of the market.27 Two-sided markets occur when an intermediary firm “connect[s] two or more distinct groups of consumers that would benefit from interacting but face barriers to doing so.”28 This unique type of market has two distinct characteristics that set it apart from the typical one-sided market the Court commonly deals with in antitrust cases. First, two-sided markets consist of two distinct consumer groups for a firm’s product or service.29 Both groups of consumers are essential for the firm’s survival. Second, indirect network effects exist between the consumer groups such that the value one group derives from the product is directly influenced by the usage level of the other group.30 Shopping malls provide a simplified example of the two main qualities that characterize a two-sided market. First, malls connect two distinct consumer groups by furnishing space to merchants and connecting them with individuals willing to buy their merchandise. Neither group can survive in the market without the other. Second, the benefit to merchants of renting a space for their store will directly depend on how many people visit the mall each day. Additionally, the number of individuals visiting a certain mall on any specific day will directly depend on the number and quality of stores located within the mall. Thus, strong indirect network effects exist since the value that merchants derive from the mall is directly influenced by the level of usage of the individual consumers and vice-versa.

Amex (and all payment card networks) is the epitome of a two-sided market. Payment card networks connect merchants, who desire an easy and risk-free way of accepting payments and extending credit, with cardholders looking for a more convenient way to pay. Both merchants and cardholders derive more benefit the more they utilize

29. Note that the term two-sided market is used throughout this paper for ease of explanation. While much of the economic literature limits its analysis to markets with two distinct consumer groups, the same principles generally apply when any “n” number of distinct consumer groups are connected through an intermediary firm, “n” being greater than one.
30. Hesse & Soven, supra note 5, at 714.
this network. This interconnectivity creates unique economic characteristics that require a different economic analysis than a standard one-sided market. For this reason, the American Express Court was correct to include both sides of the market in their definition of the relevant market.

A. Differing Economics in Two-Sided Markets

American Express required the Court to deal with a unique set of economic principles that don’t necessarily apply to normal one-sided markets. The unique characteristics of two-sided markets make them distinct from typical markets. Two-sided markets are still susceptible to typical antitrust issues such as price fixing, tying, collusion, and other unreasonable restraints of trade prohibited by antitrust laws.31 However, the traditional analytical tools used by courts and economists to determine whether an antitrust violation has occurred need modification when examining two-sided markets, because profit-maximizing decisions made by intermediary firms in a two-sided market may differ drastically from typical profit-maximizing decisions in a one-sided market.32 If the standard tools of analysis are not modified when analyzing two-sided markets, perfectly legal, profit-maximizing decisions may be incorrectly determined to violate antitrust law. This may occur even when the market is sufficiently competitive and no unreasonable restraints on trade are present. Predatory pricing and price fixing are two examples of the inherent economic differences in two-sided markets and why an accurate market definition requires both sides of the market to be included.

1. Predatory pricing: illegally predatory or validly efficient?

Predatory pricing33 exemplifies the necessity to customize economic analysis when interpreting a firm’s business decisions in a two-

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32. Id.
33. Predatory pricing involves pricing below marginal cost in order to price out the competition in the market. This type of pricing scheme requires firms to have the ability to sustain business at a loss long enough to price all competition out of the market. Additionally, it requires the ability to prevent further entry into the market. Once all competition has been eliminated, firms can then recoup their losses charging monopoly-level prices. See Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222 (1993).
sided market. In a typical competitive market, a firm’s profit-maximizing decision in the long run will never be to set a product’s price below marginal cost (or average variable cost) for that product. Even in an entry-level economic scenario of a perfectly competitive market, a firm’s profit-maximizing decision will be to set a price equal to the marginal cost, and never lower. If a firm were to price below its marginal cost, the firm would lose money on each unit sold—a decision that is completely unsustainable when put into practice in an ordinary one-sided market. Therefore, when a firm in a typical market is pricing below its marginal cost, courts can reasonably assume, without much inquiry, that the firm is engaging in predatory pricing in an attempt to edge opponents out of the market and benefit from the ability to subsequently price at monopoly levels once competition has been sufficiently diminished.

Apart from a desire to drive out competition through this kind of pricing scheme, there is rarely a valid reason for a firm to price its goods in this way. Therefore, this type of pricing scheme has essentially become a per se antitrust violation in a typical one-sided market. Pricing at, or even below marginal cost, however, is quite common in two-sided markets as a valid form of competitive profit-maximization. The more each distinct consumer group utilizes the two-sided market, the more valuable the market becomes to the other consumer group. In order to maximize this relationship, intermediary firms may price in a way that caters to the consumer group with more elastic price elasticity of demand. Often, in order to attract sufficient participation in a two-sided market, firms will offer a severely

34. Marginal cost is simply the cost of production to produce one additional unit.
35. This type of scenario is hardly applicable to the “real world.” These scenarios typically dictate that transaction costs are excluded, goods are completely homogenous, and other assumptions that make this type of scenario implausible in the real world.
36. Monopoly pricing is pricing at a level such that profit is maximized. The ability to price at this level is the only way for firms to recoup the losses they incurred while attempting to price the other firms out of the market.
38. Elasticity of demand defines how responsive demand is to a change in price. The more elastic the demand, the more demand will change in response to changes in price. See United States v. E. I. du Pont de Nemours & Co., 351 U.S. 377, 400 (1956); Robert Pitofsky, New Definitions of Relevant market and the Assault on Antitrust, 90 COLUM. L. REV. 1805, 1814 (1990).
discounted price to the “harder-to-attract” group on one side at the expense of the more robust, “ready-and-willing” group on the other side.\footnote{Ward, supra note 17, at 2059–60.} In some cases, firms may even find it profitable to offer a group with a very elastic demand curve a price at, or even below, its marginal cost.\footnote{Benjamin Klein, Andres V. Lerner, Kevin M. Murphy & Lacey L. Plache, \textit{Competition in Two-Sided Markets: The Antitrust Economics of Payment Card Interchange Fees}, 73 ANTITRUST L.J. 571, 585 (2006).} This is illustrated by shopping malls allowing customers to enter the mall at no charge and by payment card companies offering rewards,\footnote{Not only are credit card rewards an example of consumers receiving a price below a firm’s marginal cost, credit card rewards are also one of the scarce examples where consumers may actually receive a negative price (a firm actually pays consumers to use their product).} such as airline miles and cash-back awards, to their cardholders simply for using their card to purchase items.\footnote{Credit card rewards and negative pricing will be thoroughly treated in the subsequent section.} These costs are shifted to the more robust consumer groups, such as shop owners renting a storefront or merchants utilizing the card payment system.\footnote{Robert Pitofsky, \textit{New Definitions of Relevant market and the Assault on Antitrust}, 90 COLUM. L. REV. 1805, 1814 (1990).} If these markets were analyzed utilizing the traditional tools courts use when looking at a typical market, courts would almost certainly arrive at the fundamentally incorrect conclusion that intermediary firms engaging in this type of pricing scheme within a two-sided market were guilty of predatory pricing.

\section*{2. Price fixing: violating antitrust laws has never been so hard}

Price fixing is another example of an antitrust violation that should be viewed with skepticism and analyzed differently when presented in the context of a two-sided market. This is not to say that courts should treat one-sided and two-sided markets differently when there is ample evidence of \textit{naked} price fixing. When there is clear evidence of per se price fixing, market definition is irrelevant. However, when allegations of price fixing are made without clear evidence such that rule of reason\footnote{See \textit{infra}, Section VI.A.} analysis is required, the court must include both sides of a two-sided network when defining the relevant market. The already difficult task of illegally setting a supracompetitive price in a
typical one-sided competitive market46 is made much harder in a two-sided market.47 Similar to firms in one-sided markets, firms in two-sided markets can still collude to set supracompetitive prices. However, the inherent difficulties48 faced by colluding, price-fixing firms in one-sided markets are exacerbated in two-sided markets, making price fixing much more difficult.49

In a competitive, two-sided market, colluding firms must be able to set prices for both consumer groups to effectively increase profits through price fixing.50 Otherwise, firms would only be shifting profits from the fixed-price consumer group to the group whose prices haven’t been set.51 This problem is even further exacerbated when markets consist of more than two consumer groups, as colluding firms must have the ability to fix prices for every consumer group in the market in order to effectively raise profits through price fixing.52

Further, even if firms have the ability to set prices for each consumer group in the market, the inherent indirect network effects53 existing between the consumer groups are likely to make price fixing an unsuitable business practice.54 Typically, firms in one-sided markets choose to fix prices because they are able to increase their profits by charging a higher price. Generally, the supracompetitive price overcomes the loss in quantity sold when marginal consumers refuse to buy the product at the higher price. However, firms in two-sided markets are not ordinarily faced with such an easy decision. Network effects that exist between the consumer groups can turn a small, initial decrease in demand by one consumer group into a catastrophic feedback loop that results in substantially decreased demand by both

46. See id.
47. Evans & Noel, supra note 27, at 670–73.
48. Typical problems for colluding, price-fixing firms include cheating, effectively dividing markets, managing relevant substitutes, division of profits, and enforcement. Even in one-sided markets, these problems regularly lead to the eventual dissolution of cartels setting supracompetitive prices. See Margaret C. Levenstein & Valerie Y. Suslow, Breaking Up is Hard to Do: Determinants of Cartel Duration, 54 J.L & ECON 455 (2011).
49. These problems are even further exacerbated when markets consist of more than two consumer groups.
50. Klein, supra note 41, at 577.
51. Ward, supra note 17, at 2061.
52. Hesse & Soven, supra note 5, at 715.
53. See Ward, supra note 17.
54. Id. at 2061.
groups.\textsuperscript{55} For example, if consumer group A’s demand falls, consumer group B’s demand will correspondingly fall regardless of whether its price is raised or not since part of the value that group B receives from the product derives from consumer group A’s use of the product.\textsuperscript{56} Additionally, if group B’s demand falls, group A’s demand will fall even further than it initially fell when its price was raised, since group A also derives some of its value from group B’s use.\textsuperscript{57} This will then affect group B’s demand, which will, in turn, affect group A’s demand, and so on and so forth. Therefore, a single price increase to one group can result in a substantial decrease in use by both groups. This indirect network effect makes it very difficult for firms in two-sided markets to profitably fix supracompetitive prices. Slight, initial changes in demand can cascade into a detrimentally lower output which even the most supracompetitive price cannot compensate for.\textsuperscript{58} Thus, price fixing allegations in the context of two-sided markets should be viewed much more skeptically than their one-sided counterparts. The constraints imposed by the market, rather than antitrust law, will typically be sufficient to discourage anticompetitive behavior. This places added pressure on courts to properly define relevant markets. Improperly determining that only one side of a two-sided market should be considered in the market definition may lead to fundamentally incorrect court decisions.

The inherent difficulty for firms to profitably engage in price fixing in a two-sided market inevitably makes price-fixing violations quite rare when compared with violations occurring in one-sided markets. Therefore, courts should approach price fixing allegations differently when analyzing two-sided markets. A court’s economic analysis drastically changes in the context of a two-sided market. From predatory pricing to price fixing to a myriad of other antitrust violations, a court must adapt its analytical tools in order to correctly determine the extent to which firms have engaged in illegal activity. Both sides of the two-sided market must be included in the definition of the relevant market. The court’s rule of reason analysis will only be correct if the market is correctly defined.\textsuperscript{59}

\textsuperscript{55} Klein, supra note 41, at 577.
\textsuperscript{56} Hesse & Soven, supra note 5, at 715.
\textsuperscript{57} Evans & Noel, supra note 27, at 680.
\textsuperscript{59} Nat'l Soc'y of Prof'l Engineers v. United States, 435 U.S. 679, 691 (1978).
V. Cash or Card: The Payment Card Network

Payment card networks are one of the largest and most discussed two-sided networks in existence today.\(^{60}\) In order to fully understand how the merchant restraints imposed by Amex affected competition in the market, an understanding of payment card networks is important. In addition to being perhaps the most widely discussed two-sided markets in economic literature, payment card networks affect more people than any other two-sided market. These networks and the two-sided network analysis that accompanies them plagued the Supreme Court in *American Express*. While the Court was not new to analyzing payment card networks and two-sided markets, generally, *American Express* was its first opportunity to explicitly define how the rule of reason should be applied in the context of a two-sided network.\(^{61}\) In order to properly understand the Supreme Court’s ruling, an understanding of the payment network structure, its rewards programs, and merchant restraints is essential.

A. The Network Structure

The world is becoming paperless. The simplicity of payment cards, coupled with the ever-increasing popularity of online shopping, has resulted in payment networks becoming more prolific than ever. As stated earlier, the majority of Americans believe the United States will become a cashless society within their lifetime.\(^{62}\) Currently, only 12% of Americans still prefer paying with cash over a card.\(^{63}\) All payment networks handle transactions in a similar manner. A consumer presents his or her card in order to pay for a transaction. The merchant sends the card information to its payment processor who forwards the card information to the bank issuing the card.\(^{64}\) The issuing bank will then decide whether to approve or deny the charge.\(^{65}\)

\(^{60}\) Klein, *supra* note 41, at 585.


\(^{62}\) Gonzalez-Garcia & Johnson, *supra* note 3.


\(^{65}\) Id.
Some cards, such as Visa and Mastercard, act simply as payment processors linking merchants with banks that issue their cards, who then approve or deny the charge. Other cards, such as Amex and Discover, act as both the payment processors and the issuing bank. Acting as both the lender and the processor allows payment card networks, like Amex and Discover, more freedom than other card companies when it comes to setting merchant fees.

This process is substantially paid-for through the charging of merchant fees. When a payment is processed, the issuing bank charges the cardholder’s account for the full amount of the transaction and then sends the payment to the merchant minus the interchange fees. For a small transaction fee, merchants can extend credit to customers without undertaking any financial risk. Consequently, many merchants are happy to pay a small transaction fee in order to facilitate the transaction and receive immediate payment. Moreover, part of the cost of the merchant fees is passed on to the consumer in the form of higher-priced goods. These fees are typically set at a level such that merchants are willing to accept the card at their stores, and issuing banks have the incentive to cover the risk inherent in issuing payment cards.

B. Competition in Payment Card Networks

Credit card companies must compete vigorously for customers. With regard to the efficiency of use, credit cards are one of the most homogenous products in any competitive market. No one card is significantly easier to use or more secure than any other payment card. Therefore, credit card companies can distinguish and market themselves to consumers in two ways: merchant acceptance and rewards programs. Some card companies then place restraints on merchants in order to preserve the effect these methods have of increasing demand for their card.

66. Id.
67. Id.
1. Merchant acceptance

As discussed above, indirect network effects exist in any two-sided market, including payment card networks.\textsuperscript{69} For example, the more merchants that accept a certain payment card, the more valuable that card will be to cardholders. This means that card companies cannot charge merchants any fee they desire because their card may not be widely accepted by merchants, which would exponentially decrease the value of the entire card network. Consequently, card companies are somewhat restricted in the fees they can charge merchants. This is evidenced in the fact that Amex, which notoriously charges higher merchant fees than other card networks, significantly lags behind the other major cards in regard to merchant acceptance.\textsuperscript{70}

Despite only being accepted by close to half of the merchants which accept Visa or Mastercard, American Express remains a profitable firm.\textsuperscript{71} While it is important for card companies to be mindful of the merchant fee that they charge, merchant acceptance is not always the most effective way to successfully compete in the market. Cardholders have a significantly more elastic demand than merchants. Therefore, successfully soliciting consumers to utilize one card over the other will have a significantly greater impact on the network than merely promoting merchant acceptance.

2. Reward programs: What’s in your wallet?

Adequate merchant participation is crucial for any firm hoping to survive in a payment card network. Ensuring robust consumer participation in the network is absolutely essential for a card company to be profitable in a payment card network. Since consumers have much more elastic demand for card payment services than merchants, firms typically focus their efforts on acquiring as many cardholders as possible.\textsuperscript{72} One of the most effective ways of promoting consumer participation is through reward programs. Reward programs used by dif-

\begin{itemize}
\item \textsuperscript{69} Hesse & Soven, supra note 5, at 714.
\item \textsuperscript{70} Konsko, supra note 64.
\item \textsuperscript{71} See Joe Resendiz, Where and How Widely are Visa, Mastercard, Discover and American Express Credit Cards Accepted?, VALUE PENGUIN, https://www.valuepenguin.com/where-visa-mastercard-american-express-discover-accepted (last visited Apr. 21, 2019).
\item \textsuperscript{72} See Ohio v. Am. Express Co., 138 S. Ct. 2274, 2281-82 (2018).
\end{itemize}
different card companies range from airline miles to actual cash back when used for certain purchases. When firms offer rewards programs for cards that are already free to use, they are selling their card services to cardholders for a negative price. In order for this seemingly paradoxical economic decision of setting a negative price for a good to be profitable, firms must recoup their losses by charging the group on the other side of the market a seemingly supracompetitive price. A major part of merchant fees collected by most card companies is used to fund the rewards programs they offer their cardholders. This is especially true for Amex, which typically offers its cardholders greater rewards than the other card companies. Merchants receive no benefit from these rewards programs even though they are the ones financing them through the fees they pay to the credit card companies. In fact, accepting cards with high fees arguably hurts merchants, as they must charge a higher price for their goods than they otherwise would without the merchant fees. Further, merchants see no increase in sales from rewards programs, as consumers typically just shift their purchases to the card with the greatest rewards programs—usually the card with the highest merchant fees.

3. Merchant restraints

Merchant restraints are contractual rules imposed on merchants as terms of use for payment card services. In American Express, multiple states challenged the legality of merchant restraints. They questioned whether the contractual restraints imposed on merchants in regard to their card acceptance policies violated antitrust law because the restraints precluded merchants from endorsing one card over another. Specifically, merchants were required to agree to a “non-
discrimination provision” which prohibited them from directly or indirectly steering consumers toward a card with a lower transaction fee at the point of sale. These provisions were placed into merchant contracts by card companies to ensure that their card usage did not decrease in response to a higher merchant fee. Since most merchants accept multiple cards, card companies depend on these restrictions to ensure that their cards are treated equally by each merchant, even though their fees to the merchant are higher than other cards accepted by the merchant.79

The district court was quick to point out that, at the very least, steering is pro-competitive and used by merchants in many different contexts.80 Merchants place certain goods at eye-level in their stores, offer “buy-one-get-one-free” discounts for select products, and use many other marketing tools to steer customers to a certain product.81 However, the pro-competitive nature of this activity is markedly absent in the credit card market. In a perfectly competitive market with no restraints, a merchant could simply steer consumers towards the card with the lowest merchant fee and offer the consumers a discount on the current transactions at the point of sale. Since the vast majority of consumers carry more than one brand of credit card,82 consumers could then decide if they wanted a 2% discount on the current transaction in lieu of a later reward of airline miles. Contractual provisions of this sort not only prevent merchants from competitively incentivizing consumers to use a lower-fee card, but also prevent cardholders from making the most efficient personal decision. As will be discussed below, these types of merchant restraints preclude merchants from rectifying the market imbalance created by unusually high fees. Further, merchant restraints require merchants to treat credit card transaction fees as general overhead costs and spread the transaction costs of their accepted cards across all card holders. Therefore, consumers who typically use cards with lower transaction fees, such as Discover, subsidize the benefits enjoyed by card holders using cards with higher transaction fees, such as Amex. Generally,

80. Id. at 150.
81. Id.
82. Gonzalez-Garcia & Johnson, supra note 3.
this means that poorer cardholders actually subsidize wealthier cardholder’s rewards programs, as cards with higher transaction fees (and corresponding rewards programs) are typically held by wealthier individuals. Whether merchants actually have the ability to effectively unbundle their general transaction costs and charge each cardholder differently depending on his or her preferred card was determined not to have been effectively shown in American Express. As will be argued below, if the states in American Express could have effectively proven merchants’ ability to price according to a cardholder’s purchasing decisions at the point of sale, the Court would have likely found step one in the rule of reason analysis to be satisfied. The poor subsidizing the rich due to competitive restraints is exactly what the Sherman Act was implemented to prevent. Consumer protection is sacrosanct to antitrust law, and contractual provisions promoting consumer harm merely to benefit a more elite class of consumers may not even require a rule of reason analysis. Merchant restraints that prohibit price competition without a countervailing procompetitive effect cannot withstand antitrust scrutiny.

VI. Anticompetitive Effects

The other intensely contested issue in American Express, aside from determining the definition of the market, was the extent of the anticompetitive effects of American Express’s merchant restraints. The majority incorrectly held that Amex’s anti-steering provisions did not violate antitrust law. Specifically, the Court incorrectly determined that the plaintiff states failed to carry their burden of showing that the challenged conditions had anticompetitive effects.

The first section of the Sherman Act prohibits unreasonable restraints of trade. Anticompetitive harm can be attributed to horizontal and vertical restraints. Horizontal restraints are agreements

83. Aaron Klein, Why the Supreme Court Decision in Ohio v. Amex Will Fatten the Wealthy’s Wallet (At the Expense of the Middle Class), BROOKINGS (June 25, 2018), https://www.brookings.edu/research/ohio-v-amex/.
between competitors in a market to impose certain restraints.\textsuperscript{87} Vertical restraints are agreements between firms at different levels of distribution to impose certain restraints.\textsuperscript{88} Both parties in \textit{American Express} conceded that Amex’s anti-steering provisions were vertical restraints.\textsuperscript{89} Typically, vertical restraints are scrutinized utilizing rule of reason analysis.\textsuperscript{90} Both parties agreed that rule of reason analysis was appropriate to determine if Amex’s vertical restraints constituted unreasonable restraints of trade.\textsuperscript{91}

\textbf{A. Rule of Reason Review}

When reviewing an alleged antitrust violation, the court either (1) determines that the practice or restraint is per se unreasonable or (2) engages in a rule of reason analysis to decide if the law has been violated. Restraints that are per se unreasonable are “certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable.”\textsuperscript{92} By applying this test, the court can find that a particular practice unreasonably restrains trade without having to delve into the complex economic analysis of defining the relevant product market or determining concentration of market power—the two elements most commonly disputed in antitrust litigation.\textsuperscript{93} Sufficient experience with particular types of restraints enables the court to apply this simplified technique of decision-making and determine that certain restraints carry a conclusive presumption of unreasonableness.\textsuperscript{94} Examples of these well-established restraints of trade that the court has held to be per se unreasonable are price fixing,\textsuperscript{95} tying arrangements,\textsuperscript{96} explicit division of markets,\textsuperscript{97} and group boycotts.\textsuperscript{98} When presented with these restraints of trade that are decidedly anti-

\textsuperscript{88} Id.
\textsuperscript{89} Am. Express Co., 138 S. Ct. at 2284.
\textsuperscript{90} Leegin Creative Leather Prods., 551 U.S. at 882.
\textsuperscript{91} Am. Express Co., 138 S. Ct. at 2284.
\textsuperscript{93} Broadcast Music, Inc. v. CBS, Inc., 441 U.S. 1, 8 (1979).
\textsuperscript{95} United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 210 (1940).
\textsuperscript{96} Int’l Salt Co. v. United States, 332 U.S. 392 (1947).
\textsuperscript{97} Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899).
\textsuperscript{98} Fashion Originators’ Guild of Am. v. FTC, 312 U.S. 457, 668 (1941).
competitive, the court can determine that the Sherman Act has been violated without defining a relevant market. Therefore, when sufficient evidence is present to show that these specific restraints occurred, one-sided and two-sided markets are treated the same, and the courts do not need to delve into the specialized economics required of each type of market.

When challenged restraints are not so obviously unreasonable as to allow the court to pass judgment without engaging in an in-depth review of market conditions, rule of reason analysis is used to determine the competitive effect of the restraint in question. Both the majority and dissenting opinions in American Express agreed rule of reason was the proper approach to evaluate Amex’s challenged restraints. Unlike per se analysis, the rule of reason requires an inquiry into the relevant product market and the concentration of market power within that market. As discussed in Section IV, the scope of the relevant market, defined by the Court, significantly impacts whether challenged conditions pass scrutiny when analyzed using the rule of reason. The majority in American Express determined that Amex’s anti-steering provisions were not anticompetitive when both consumers and merchants in the card payment network were combined into a single market. However, even with the broad, two-sided market definition promulgated by the majority, this paper argues that Amex’s merchant restraints are anticompetitive and should have been ruled illegal under the rule of reason.

The Court requires an inquiry into a three-step burden-shifting analysis when analyzing a challenged restraint under the rule of reason. This burden-shifting analysis, and whether the burdens were met, was vehemently disputed between the Justices in American Express.

The first step in the rule of reason analysis requires the plaintiff to identify the challenged conduct that is supposedly anticompetitive and show that it causes harm to competition. A plaintiff can prove his or her prima facie case at step one in two ways. First, plaintiffs can

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directly show actual anticompetitive effects that the challenged practice has caused.104 Second, they can indirectly show that anticompetitive effects exist by illustrating that the defendant has market power in the defined market and that there is plausible harm to competition.105 Once a prima facie case of competitive harm is shown the burden then shifts to the defendants who have the opportunity to prove countervailing pro-competitive effects that arise out of the challenged conduct.106 If pro-competitive effects are shown, the burden shifts back to the plaintiffs to either rebut the evidence of pro-competitive effects shown by the defendant or show that there are less restrictive alternatives that the defendant can employ to achieve the same pro-competitive results.107

1. Step one

In American Express, the Court should have determined that the plaintiff states carried their burden of presenting a prima facie case in step one of the rule of reason analysis. Even accepting the broad, two-sided market definition described by the majority, there is sufficient evidence to show that Amex’s anti-steering provisions cause actual competitive harm. To sufficiently satisfy the burden required by step one, it must be demonstrated that Amex’s anti-steering provisions had anticompetitive effects on the two-sided market as a whole.108 In other words, plaintiff states had to establish that the merchant restraints had a net anticompetitive effect resulting in harm to competition considering the effect of the restraint on both merchants and cardholders.109 Proof of this harm can be shown either through direct or indirect evidence.110 Amex’s anti-steering provisions violate Section one of the Sherman Act for two reasons. First, anti-steering provisions allow Amex to charge a supracompetitive merchant transaction fee. The cost of this fee is then passed on to cardholders in the form of higher-priced goods. Second, allowing card companies to in-

104. Id.
105. Id.
106. Id. at 460.
107. Id.
109. Id.
110. Id. at 2284; FTC v. Ind. Fed’n of Dentists, 476 U.S. at 460.
clude anti-steering provisions in their merchant contracts drastically decreases incentives to charge a competitive transaction fee.

Evidence that Amex’s anti-steering provisions resulted in supracompetitive merchant transaction fees is sufficient to satisfy the required burden in step one of the court’s rule of reason analysis. This remains true whether the majority’s or the dissent’s market definition is adopted. The district court record provided direct evidence that transaction fees exceeded the competitive level when subjected to anti-steering contractual provisions.\footnote{United States v. Am. Express Co., 88 F. Supp. 3d 143, 197-215 (E.D.N.Y. 2015), rev’d and remanded, 838 F.3d 179 (2d Cir. 2016), aff’d sub nom. Ohio v. Am. Express Co., 138 S. Ct. 2274 (2018).} However, Justice Thomas, speaking for the majority, stated that he was “unconvinced” that Amex’s anti-steering provisions resulted in anticompetitive harm to the market as a whole.\footnote{Id. at 2287.} The Court cited as evidence that the district court failed to include cardholders in their market definition.\footnote{Id. at 2289.} The majority wrongly assumed that when cardholders are included in the relevant market, the net effect of anti-steering provisions is not anticompetitive.\footnote{Id. at 2287.} Including cardholders in the relevant market, however, exacerbates the anticompetitive effect of Amex’s contractual restraints.

The district court provided direct evidence that merchants pass the cost of higher transaction fees on to cardholders in the form of higher retail prices.\footnote{Am. Express Co., 88 F. Supp. 3d 195.} Therefore, cardholders pay for their own rewards programs in the form of higher-priced goods. This would not be an issue if Amex rewarded its cardholders equal to, or more than, the increase in retail prices. However, evidence shows that Amex’s increases in merchant fees were not entirely spent on rewards for cardholders.\footnote{Id. at 2278; Shampine, supra note 25, at 4–5.} Additionally, almost one-third of cardholders never even redeem the rewards they accrue through purchases.\footnote{3 in 10 Have Never Redeemed Credit Card Rewards, BANKRATE (Apr. 12, 2017), https://www.prnewswire.com/news-releases/3-in-10-have-never-redeemed-credit-card-rewards-300438538.html.} Therefore, at least a portion of the increased retail prices, caused by anti-steering provisions, are borne by Amex cardholders with no offsetting reward.
The fact that Amex’s provisions create a net burden on cardholders is not the only economic harm caused by the restraints. Amex’s contractual provisions also prevent cardholders from making utility-maximizing decisions at the point of sale as well.\textsuperscript{118} Therefore, even if Amex sufficiently offset the burden of higher retail prices with its rewards programs, the merchant restraints would still have an anticompetitive effect on the market as a whole.

Anti-steering agreements preclude cardholders from making a utility-based purchasing decision at the point of sale. For example, a cardholder may prefer an immediate 2% discount offered by a merchant for using a different credit card rather than the airline reward miles he would receive from making the purchase. This may be true even if the airline miles technically have a higher cash value than the immediate 2% discount offered by a merchant. Anti-steering provisions not only prevent merchants from rectifying a market imbalance by offering incentives to use cards with lower fees, but also preclude cardholders from making the most efficient choice at the point of sale. Thus, anti-steering provisions reduce utility throughout the market for both merchants and cardholders. Evidence of increased prices, in addition to decreased market utility, is sufficient to show a prima facie case of competitive harm in the market.\textsuperscript{119}

Further, not every consumer subjected to higher retail prices caused by Amex’s anti-steering provisions is an Amex cardholder. As discussed above, anti-steering provisions require merchants to treat supracompetitive transaction fees as general overhead.\textsuperscript{120} Merchants then distribute the additional costs from abnormally high transaction fees over all consumers not just Amex cardholders.\textsuperscript{121} Therefore, consumers who do not regularly use an Amex credit card for purchases actually subsidize the rewards programs Amex cardholders enjoy. These consumers pay higher retail prices with no offsetting Amex reward whatsoever. Given that Amex cards are typically reserved for wealthier individuals, elite members of society are generally those

\textsuperscript{118} Shampine, supra note 25, at 4–5.


\textsuperscript{121} Id.
who benefit from this type of system. The lower class subsidizes these benefits, as its members typically use low-transaction fee methods of payment that do not generate rewards from frequency of use, such as cash or debit cards. The anti-steering contractual provisions in American Express facilitate consumer harm in order to benefit an elite class of consumers at the expense of the poor. This Robin-Hood-in-reverse system causes significant harm to competition in the form of supracompetitive prices. Given the significant harm to consumers caused by these restraints, the Court should have ruled that step one in the rule of reason analysis was satisfied.

B. Anti-Steering Provisions Drastically Decrease Incentives to Charge Competitive Transaction Fees

In addition to creating supracompetitive retail prices, anti-steering provisions significantly reduce the incentives for card companies to charge a competitive merchant transaction fee. Amex’s anti-steering merchant restraints preclude competition among card companies at the point of sale. This eliminates significant incentives for card companies to keep their merchant transaction fees low, since merchants are not allowed to offer alternatives that could economically benefit their customers. Thus, consumers are precluded from making competitive choices based on lower transaction fees at the point of sale. Removing this level of competition creates higher transaction fees. Justice Breyer, in his dissent, effectively characterized the anticompetitive effect of Amex’s merchant restraints. He stated:

122. Klein, supra note 83.
123. Id.
125. Shampine, supra note 25, at 5.
If American Express’ merchant fees are so high that merchants successfully induce their customers to use other cards, American Express can remedy that problem by lowering those fees or by spending more on cardholder rewards so that cardholders decline such requests. What it may not do is demand contractual protection from price competition.126

While competition for merchant acceptance does somewhat restrain what card companies can charge merchants for their services, supracompetitive transaction fees still prevail when competition is restricted by merchant restraints.127

Allowing these restraints to persist strengthens the already significant barriers to entry that prospective card companies must overcome in order to enter the transaction market. Higher barriers to entry for new competition further eliminate the incentives of operating card companies to charge competitive transaction fees.128 New card companies wishing to enter the market cannot compete by instituting a market model that promotes lower transaction fees in order to acquire more merchant acceptance. Without anti-steering provisions, firms wishing to enter the market may be able to acquire market share by lowering transaction fees. Consumers, made aware of the economic benefit they will receive in terms of a lower retail price at the point of sale, will likely choose to use the card that most benefits them.129 However, anti-steering provisions prevent card companies from competing at the point of sale. While lowering transaction fees may help new card companies compete in terms of merchant acceptance and consequently, more potential cardholders, merchants are prevented from offering incentives to their customers who use cards with lower transaction fees since there is no incentive for consumers to use their new card over any other one in the highly concentrated market.130 These anticompetitive practices are obstacles that many prospective firms cannot overcome when seeking to enter the market. Promoting higher barriers to entry in this way will pre-

130. Id.
vent sufficient entry from counteracting supracompetitive prices in the market. This is especially likely given that the market for credit card transactions is already extremely concentrated.

Anti-steering provisions have anticompetitive effects on the credit card transaction market. This is true regardless of whether a two-sided or one-sided market definition is adopted. The substantial competitive harm created by these provisions is evidenced by supracompetitive merchant and consumer prices. For this reason, step one in the rule of reason analysis is satisfied. Although the Court did not address steps two and three it is likely they too are satisfied. Even if Amex could sufficiently show a pro-competitive effect that arises out of these restraints, many less-restrictive alternatives exist that could have been used to produce the same result.

VII. CONCLUSION

The Court in American Express was correct in adopting the two-sided market definition. This definition is the most economically sound and encompasses the reality of the market. However, the Court incorrectly determined that Amex’s anti-steering provisions did not violate antitrust law. Even using the broad, two-sided market definition, anti-steering provisions have anticompetitive effects on the market as a whole because they increase merchant fees and retail prices while decreasing incentives for card companies to compete. The Court erred in holding that step one in the rule of reason analysis was not satisfied. Amex’s anti-steering contractual provisions cause harm to competition by raising retail prices, eliminating consumers’ utility-maximizing decisions at the point of sale, and decreasing incentives to charge a competitive merchant transaction fee. Therefore, Amex’s anti-steering provisions unreasonably restrain trade in violation of the Sherman Act.