UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, et al.,
Plaintiffs

v.

AMERICAN EXPRESS CO., et al.,
Defendants

No. 10-CV-04496 (NGG) (RER)

[redacted] PUBLIC VERSION
[redacted]

PLAINTIFFS' PRE-TRIAL MEMORANDUM

June 20, 2014

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Abbreviations

Amex	Defendants American Express Company and American Express Travel Related Services Company, Inc.
Bernheim I	Expert Report of B. Douglas Bernheim (Apr. 2, 2013) (DX6463)
Bernheim II	Rebuttal Expert Report of B. Douglas Bernheim (May 20, 2013) (DX6501)
Gilbert I	Report of Richard J. Gilbert on the Procompetitive Effects of American Express' Non-Discrimination Provisions (Apr. 2, 2013) (DX6470)
Katz I	Expert Report of Michael L. Katz (Apr. 2, 2013) (PX1489)
Katz III	Sur-Rebuttal Report of Michael L. Katz (July 3, 2013) (PX1589)
Katz IV	Supplemental Report of Michael L. Katz (Aug. 19, 2013) (PX1584)
Ordover I	Expert Report of Janusz A. Ordover (Apr. 2, 2013) (DX6465)
Plaintiffs	Plaintiffs United States of America and the States of Arizona, Connecticut, Idaho, Illinois, Iowa, Maryland, Michigan, Missouri, Montana, Nebraska, New Hampshire, Ohio, Rhode Island, Tennessee, Texas, Utah, and Vermont
Schmitt I	Expert Report of Ann Schmitt (Apr. 2, 2013) (PX1487)

Introduction

The country's credit card networks charge merchants over $50 billion annually to process credit-card transactions. In a free market, price competition among the networks would help protect merchants from high prices. Competition could take the form of merchants encouraging customers to pay with a low-cost network's cards in exchange for price concessions or other benefits from the network. Another basic competitive step would be for merchants to inform customers about the card networks' relative costs so that customers would be able to choose to pay with lower-cost cards. But for years, Amex, MasterCard, and Visa – networks that together process about 95% of credit-card transaction volume – imposed on merchants restrictions obstructing such price competition.

The United States and seventeen States brought this lawsuit against Amex, MasterCard, and Visa under Section 1 of the Sherman Act, 15 U.S.C. § 1, to free merchants from the networks' restrictions and to secure the benefits of competition for them and their customers. MasterCard and Visa consented to this Court's order enjoining their anticompetitive practices and thus are not defendants at trial. But Amex clings to Anti-Steering Rules that interfere with competition among card networks for the business of millions of merchants that accept Amex. As a result, Amex's Rules continue to deprive all of those merchants of the full benefits of Plaintiffs' settlements with MasterCard and Visa. This case presents the opportunity to fix the "American Express problem." *See In re Payment Card Interchange Fee & Merchant Discount Antitrust Litig.*, No. 05-MD-1720, 2013 WL 6510737, at *20 (E.D.N.Y. Dec. 13, 2013) (internal quotation marks omitted).

It is clear why Amex imposes its Anti-Steering Rules. Amex charges merchants the highest prices, on average, of any card network, so merchants have every incentive to encourage their customers to pay in other ways. At trial, merchants will explain how they would like to use discounts and other competitive tools to do exactly that. Merchants also will describe how greater competition among the card networks will help them negotiate lower fees. *See infra* Part I.C.

The evidence will show how Amex's Anti-Steering Rules have obstructed competition from other card networks for years. For example, a Discover executive will describe how his company tried to win merchant business from Amex and other high-priced card networks by charging lower prices, but found that Amex's Rules (and then-existing MasterCard and Visa rules) blocked merchants from rewarding Discover for those low prices. A former Visa executive will recount how, in the 1990s, Visa succeeded in capturing merchant business from Amex merely by emphasizing Visa's lower prices and helping merchants communicate their "preference" for Visa. In response to Visa's efforts, Amex tightened its Anti-Steering Rules to put an end to that type of competition. *See infra* Part I.B.

Faced with the plain language and unmistakable impact of its Anti-Steering Rules, Amex will defend its conduct with an unabashed attack on the notion that price competition is a good thing. Confirming the powerful impact of its Rules, Amex claims that, if it were required to free merchants from those restraints, so many merchants would encourage their customers to use less expensive payment forms that Amex's entire business model would be in jeopardy. That argument may be litigation hyperbole, but in any case, it is legally irrelevant. Amex's supposed "fear[s] that [its] product will not prove sufficiently attractive . . . to compete in a free market" cannot justify Rules that are "inconsistent with the basic policy of the Sherman Act." *See NCAA v. Bd. of Regents of Univ. of Oklahoma*, 468 U.S. 85, 116-17 (1984). And if merchants and their customers value what Amex provides, Amex will adapt, compete, and continue to thrive without its Anti-Steering Rules. *See infra* Part III.A.

Amex's Rules have plain anticompetitive effects: they restrain the price competition that would otherwise discipline card networks from charging merchants higher fees – fees that merchants' customers ultimately pay as higher retail prices. Against these real-world harms, Amex presents formalistic defenses, asserting that Plaintiffs have not properly defined a relevant antitrust market or demonstrated that Amex has market power. When anticompetitive effects have not been proven directly, inquiry into issues of market definition and market power can help assess the likely competitive effects of particular conduct. But those issues need not take center stage in this case because Plaintiffs will demonstrate that Amex's rules have actual adverse effects on competition. *See infra* Part I. As this Court has held, "Plaintiffs may carry their initial burden by proving actual adverse effects directly and are not limited to establishing market power, as Defendants argue." *United States v. American Express Co.*, No. 10-CV-4496, 2014 WL 1817427, at *7 (E.D.N.Y. May 7, 2014) ("*Amex*").

Moreover, Amex's "market definition" and "market power" defenses cannot be squared with Second Circuit precedent, Amex's own statements, or the evidence that Plaintiffs will present at trial. In *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 338-42 (S.D.N.Y. 2001), *aff'd*, 344 F.3d 229, 238-40 (2d Cir. 2003) ("*Visa*"), the district court held that there was a relevant antitrust market for general purpose credit and charge ("GPCC") card network services, and the Second Circuit affirmed that decision. Amex itself relied heavily on the analysis in *Visa* when pursuing its own antitrust claims against Visa and MasterCard, and it was ultimately able to use that authority to extract rich settlements from its competitors. After this lawsuit was filed, Amex reversed course and walked away from the market defined in *Visa*. But the market realities that supported the existence of a GPCC card network services market in *Visa* remain realities today. There is no basis to ignore those market realities in this case. *See infra* Part II.A.

Visa also provides a roadmap for determining that Amex wields market power. Following that roadmap, Plaintiffs will establish that Amex has a high market share in the concentrated GPCC card network services market, uses the "insistence" of its cardholders to drive merchant acceptance of its cards, and has generated more than $1 billion in profit with "Value Recapture" initiatives raising prices to merchants without significant cancellations. *See infra* Part II.B. Plaintiffs will also show that there is a distinct market for GPCC card network services provided to travel-and-entertainment merchants and that Amex has even greater power in that market. *See infra* Part II.C.

Finally, Amex has two other principal defenses. First, Amex asserts that prohibiting competition over merchant fees is necessary to avoid "free-riding" on the Amex brand. But Amex cannot prove that true "free-riding" would occur, and there are less competitively restrictive ways than the Anti-Steering Rules to address any that would. *See infra* Part III.C. Second, Amex contends that it should be judged by a special antitrust standard because it must attract both merchants and cardholders. This is Amex's "two-sided platform" defense. While it is certainly true that card networks need both cardholders and merchants, there is no precedent to support Amex's position that plainly anticompetitive practices harming merchants – and ultimately tens of millions of their customers (including those who pay with other credit cards, debit cards, checks, or cash) – can be excused because Amex rewards a fraction of those customers (*i.e.*, its cardholders) with some of the bounty that Amex reaps from avoiding price competition. *See infra* Part IV.E.

Argument

Amex's Anti-Steering Rules will be judged under the rule of reason, which requires a three-step inquiry. First, "Plaintiffs have an initial burden of demonstrating that Defendants' behavior adversely affected competition." *Amex*, 2014 WL 1817427, at *5. Second, after Plaintiffs "meet this burden, it would fall to Defendants to demonstrate the pro-competitive effects of the anti-steering rules." *Id.* Third, only if Amex succeeds in proving that the Rules have pro-competitive effects, "the burden would shift back to Plaintiffs to show that any 'legitimate competitive benefits' could be had through less restrictive means." *Id.*

Plaintiffs may satisfy their initial burden of establishing an adverse effect on competition in either of two ways. *See Tops Mkts., Inc. v. Quality Mkts., Inc.*, 142 F.3d 90, 96 (2d Cir. 1998). One of those ways involves demonstrating directly how the defendant has "disrupt[ed] the proper functioning of the price-setting mechanism" or otherwise interfered with the normal operations of a competitive market. *See FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 461-62 (1986). Part I of this Memorandum summarizes the direct evidence demonstrating that Amex's Anti-Steering Rules have such actual adverse effects. The second way for a plaintiff to carry its initial burden involves proof that the defendant has market power and is engaged in conduct likely to cause an anticompetitive effect. *See also Amex*, 2014 WL 1817427, at *5 ("Market power is an alternative method by which a plaintiff may establish a Section 1 violation if unable to prove that the challenged conduct has an actual adverse effect on competition."). Part II shows that Amex has market power in both the relevant market for GPCC card network services to all merchants and the separate relevant market for GPCC card network services to travel-and-entertainment merchants. Part III discusses the second and third steps of the rule-of-reason analysis, and Part IV shows that Amex's arguments fail to address how the Anti-Steering Rules harm competition.

I. Direct Evidence Proves That Amex's Anti-Steering Rules Cause Actual Adverse Effects on Competition.

A. Amex's Anti-Steering Rules Disrupt the Proper Functioning of the Market.

In a well-functioning market, a seller can use a low price to encourage buyers to purchase its products, rather than those of its higher-priced competitor. Recognizing that prices serve this essential signaling function, the Supreme Court has described price as the "central nervous system of the economy," *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940), and has condemned conduct "likely . . . to disrupt the proper functioning of the price-setting mechanism of the market . . . even absent proof that it resulted in higher prices." *Indiana Fed'n of Dentists*, 476 U.S. at 461-62.

Amex's Anti-Steering Rules break the fundamental link between lower prices and more sales. The Rules prohibit merchants from (1) offering customers discounts or other incentives to pay with cards that cost merchants less than Amex cards; (2) informing customers that they would prefer for them to pay with lower-cost cards; (3) displaying the logos of low-cost cards more prominently than the Amex logo; and even (4) informing their customers how much it costs to accept different cards. The Anti-Steering Rules thus confront merchants with a take-it-or-leave-it proposition: accept Amex cards whenever customers present them or refuse Amex cards at all times and lose customers who insist on using those cards. *See infra* Part II.B.2. But if Amex's Rules did not limit merchants' freedom to encourage customers to pay with low-cost cards more frequently, merchants could "choose how much of Amex's services they purchase" and "how much they will purchase from Amex's competitors." *See Amex*, 2014 WL 1817427, at *11.

About 6.4 million merchant locations in a wide variety of industries accept Amex cards,[1] and Amex cardholders can make 94% of all their credit card purchases at those merchants.[2] All of those merchants' Amex contracts contain some version of the Anti-Steering Rules. If Amex's Rules were not in place, merchants could deter card networks from charging unjustifiably high prices by using discounts, preference programs, and other tools to encourage customers to pay with low-cost cards. Even the possibility that merchants would use these tools would likely help to discipline prices.

In other facets of its business, Amex recognizes the critical link between low prices and more sales. For instance, Amex offers cardholders rewards points and other benefits (which effectively reduce the price that cardholders pay for cards) as a way to encourage them to use Amex cards rather than another credit card. Similarly, Amex pays large corporations substantial sums to select Amex (rather than another commercial-card issuer) as the provider of cards for employees to use for business purchases. In its travel agency business, Amex steers customers to "preferred" airlines, hotels, and rental car companies.[3] And when one airline tried to increase a fee charged to travel agencies (including the part of Amex providing travel agency services) for booking flights, Amex responded by steering its customers to other airlines, and the airline reversed its decision to increase the fee. By contrast, Amex's Anti-Steering Rules restrict

[1] PX1559, at 10 (Nilson Report, No. 1034 (Feb. 2014)). These 6.4 million merchant locations are operated by about 3.4 million different merchants. *See* PX1985.

[2] PX0018, at 3 (AMEXNDR07619647-669, at 649) (showing U.S. spend coverage in 2010 as 94%); PX0639, at 85 (AMEXNDR07604658-744, at 742) ("97% T&E Spend Coverage and 94% overall Spend Coverage in 2010"); PX0990 (AMEXNDR13955939) (chart showing total spend coverage in 2010 as 93.7%); *see also* DX6896 (AMEXNDR19229434) (reporting U.S. spend coverage of 96% in 2011).

[3] *See* PX1685 (AMEXNDR08498685-689, at 686) (recognizing that Amex tries to "sell and promote only preferred suppliers, and . . . actively sell away from non-preferred suppliers").

merchants from using similar tools to ignite greater competition among card networks for their business.

Amex's expert economists admit that the Anti-Steering Rules prevent merchants from responding to the other networks' lower prices. As Professor Bernheim explained: "When a consumer presents an Amex card for payment, the merchant has an incentive to steer the consumer toward [a lower-cost alternative card]. Without the [Anti-Steering Rules], the merchant could steer . . . ."[4] Professors Gilbert and Ordover concur.[5] Amex argues that blocking interbrand competition in this way is a good thing. *See infra* Part III.A. Plaintiffs, however, recognize it as the hallmark of a Sherman Act violation. *See Indiana Fed'n of Dentists*, 476 U.S. at 459 (condemning restraint that "imped[ed] the ordinary give and take of the market place") (internal quotation marks omitted); *NCAA*, 468 U.S. at 117 (condemning restraint "seeking to insulate [defendants] from the full spectrum of competition" because the "Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable") (internal quotation marks omitted); *Nat'l Soc'y of Prof'l Engineers v. United States*, 435 U.S. 679, 692-93 (1978) (condemning restraint that "deprives the customer of the ability to utilize and compare prices in selecting" the relevant product) (internal quotation marks omitted); *Geneva Pharms. Tech. Corp. v. Barr Labs., Inc.*, 386 F.3d 485, 489 (2d Cir. 2004) (emphasizing that the "antitrust laws . . . safeguard consumers by protecting the competitive process").

B. Amex's Anti-Steering Rules Obstruct Card Networks from Competing for Merchant Business.

The Discover card network's experience demonstrates how the Anti-Steering Rules have disrupted the competitive process by insulating Amex from low-price competition. In the late

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[4] DX6463 (Bernheim I) ¶ 76.

[5] *See* DX6470 (Gilbert I) ¶¶ 213, 240; DX6465 (Ordover I) ¶ 15.

1990s, Discover perceived that many merchants were frustrated by increasing credit card fees and would be willing to encourage customers to use low-cost cards. To try to take advantage of that competitive opening, Discover promoted its low fees and simple rate structure to merchants. Discover's efforts failed. Discover could not win additional market share because Amex's Anti-Steering Rules (and then-existing rules of MasterCard and Visa) restricted merchants from encouraging customers to pay with lower-cost Discover cards. Having learned that low, easy-to-understand prices would not generate additional business, Discover changed its merchant pricing to more closely match the rest of the industry and raised its prices to levels approximating those of Visa and MasterCard. Discover would be open to trying its low-price strategy again, if Amex's Rules no longer preordained its failure.

Visa's experience illustrates another way that the Anti-Steering Rules have blocked competition among card networks. In the early 1990s, Amex expanded its merchant-acceptance network by adding more retail merchants to its stable of travel-and-entertainment merchants. Visa responded by creating a new "merchant relations" group to explain Visa's advantages over Amex, especially Visa's lower prices. Visa distributed "profit improvement calculators" to show how much money merchants could save by shifting business from Amex cards to Visa cards. Visa also provided merchants with materials bearing the Visa logo or the phrase "We Prefer Visa," which merchants could display at the point of sale to encourage their customers to pay with Visa cards. Visa's efforts worked. Consumers used Visa cards more often, and Amex's share of credit card spending dropped from 24.7% to 19.2%.[6] Although Amex made marginal

[6] *See* DX6501 *(*Bernheim II) ¶ 16; PX0161, at 4-5 (AMEX0003280001-018, at 004-005) (summarizing report to Amex Board of Directors that "the Amex Card's growth rate was adversely impacted in areas where Visa actively promoted its preference programs" and that "the stakes were high and that successfully blunting the Preference campaigns was a key element in the struggle for worldwide market share").

attempts to compete on the merits, Amex's ultimate response was to block Visa's efforts. Amex revised its Anti-Steering Rules to prohibit merchants from stating or displaying a "preference" for Visa or any other card network.

Restrictions on "preference" campaigns are now part of every Amex merchant contract, and Amex vigilantly enforces them. For example, in 2003, [redacted] displayed the slogan "We Prefer MasterCard" on the part of its website where customers enter their payment card information. Amex learned of this and threatened to terminate its contract with [redacted]. Fearing the loss of Amex cardholders as customers, [redacted] agreed to remove all "preference" language from its website. Amex continued to monitor [redacted]. In 2006, after noticing a residual advertisement stating that [redacted] preferred MasterCard, Amex contacted [redacted] and got the preference language promptly removed.

C. Amex's Anti-Steering Rules Deny Merchants Tools to Reduce Costs and Share Savings with Customers.

U.S. merchants pay over $50 billion per year to accept credit cards,[7] and those costs often represent one of their largest operating expenses. If freed from Amex's Anti-Steering Rules, many merchants would encourage customers to use cards that cost them less.[8] At trial, merchants will testify that they would consider using various tools to encourage customers to pay with low-cost cards:

- [redacted] could award miles and offer in-flight benefits;
- [redacted] could use free upgrades, unlimited mileage, and increased rewards points;
- [redacted] could offer in-kind benefits like free ring tones;

[7] PX2482, at 12 (Nilson No. 1041 (May 2014)).

[8] *See* PX1328, at 16 (NOVUS00025757-797, at 773).

- [redacted] could use signage to communicate its payment preferences to customers;
- [redacted], a firm that arranges leisure travel, could offer free breakfasts or exclusive transportation between airports and hotels; and
- [redacted] a company that processes card payments for [redacted] could charge lower convenience fees for less expensive cards.

These are only some of the ways that merchants could reduce their card-acceptance costs. Merchants will also explain that merely having the opportunity to implement these kinds of programs would put them in a better position to negotiate with card networks for lower rates. Merchants regularly rely on competition among suppliers to negotiate lower prices for needed goods and services, and they expect that greater competition among card networks would help them keep those costs in check, too.

Merchants' customers would benefit from increased competition among card networks in two ways. First, customers would enjoy an immediate benefit from discounts or other incentives that merchants offered to encourage them to pay with low-cost cards. Second, when merchants have the tools to stop card networks from raising acceptance costs, merchants will face less pressure to raise the prices they charge their customers. And if merchants can lower their costs of accepting credit cards, competitive pressure would push many of them to pass savings along to their customers in the form of lower prices. These benefits would flow through to all customers (including those who pay with rewards-free credit cards, debit cards, checks, cash, and other forms of payment) because "part of the price of card services [is] reflected in higher prices charged by merchants who accept[] the cards, and these higher prices [have] to be charged indiscriminately to all purchasers." *See* 2B Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 562b, at 377 (3d ed. 2007) [hereinafter Areeda & Hovenkamp] (discussing *Visa*).

Merchants could also pass savings along to all of their customers by improving the quality of the service they provide.

D. Amex's Anti-Steering Rules Make Innovation Less Likely.

In addition to their adverse effects on price competition among card networks, Amex's Anti-Steering Rules diminish the networks' incentives to improve their products. In 2009, [redacted] added logos for "MasterCard SecureCard" and "Verified by Visa" to the checkout page on its website to encourage customers to pay with cards offering enhanced fraud protection. Amex provided similar fraud-protection services to merchants in the United Kingdom and could have provided them to [redacted] and other U.S. merchants. But rather than competing by bringing its own fraud-protection innovation to the United States, Amex instead invoked the Anti-Steering Rules to interfere with efforts to promote MasterCard and Visa innovations. Amex notified [redacted] that its display of the other networks' logos violated one of the Anti-Steering Rules and demanded that [redacted] change its checkout page. [redacted] complied. That episode illustrates how Amex's Rules discourage innovation not only from Amex, but also from MasterCard and Visa. All networks have less incentive to improve their products because improvements cannot attract as much merchant business as they would if merchants had the freedom to encourage customers to take advantage of them.

II. Market Analysis Proves that Amex Has the Ability To Cause Adverse Effects on Competition.

As an alternative to proving directly that Amex's Anti-Steering Rules have actual adverse effects on competition, Plaintiffs may "demonstrate[] 'adverse effect' indirectly by establishing that [Amex] ha[s] sufficient market power to cause an adverse effect on competition." *Tops*

Mkts., Inc. v. Quality Mkts., Inc., 142 F.3d 90, 96 (2d Cir. 1998).[9] "Evaluating market power begins with defining the relevant market." *Geneva Pharms.*, 386 F.3d at 496.

A. The Relevant Markets Include Only General Purpose Credit and Charge Card Network Services.

Antitrust cases often seek to define a relevant market to "provide[] the context against which to measure the competitive effects of an agreement." *Geneva Pharms.*, 386 F.3d at 496. Relevant markets have both geographic and product dimensions. *See AD/SAT, Div. of Skylight, Inc. v. Associated Press*, 181 F.3d 216, 226 (2d Cir. 1999). The parties here agree that the relevant geographic market is the United States, but they disagree about the relevant product market. Plaintiffs will prove that there is a relevant product market consisting of general purpose credit and charge ("GPCC") card network services provided to merchants and, as discussed in Part II.C below, that there is another relevant product market consisting of GPCC card network services provided to *travel-and-entertainment* merchants. Amex contends that the relevant product markets also include debit card network services, but that argument is at odds with the holding in *Visa*, with the positions that Amex has taken in prior litigation and official filings, and with the evidence that will be presented at trial.

1. Courts in the Second Circuit Have Held That General Purpose Credit and Charge Card Network Services Constitute a Relevant Market.

The district court in *Visa* held that "general purpose card network services . . . constitute a product market because merchant consumers exhibit little price sensitivity and the networks provide core services that cannot reasonably be replaced by other sources." *United States v. Visa*

[9] To succeed without evidence of actual adverse effects on competition, a plaintiff must show both that a defendant possesses market power and that there are "other grounds to believe that the defendant's behavior will harm competition market-wide." *K.M.B. Warehouse Distribs., Inc. v. Walker Mfg. Co.*, 61 F.3d 123, 129 (2d Cir. 1995). The evidence discussed in Part I provides "other grounds" to find that Amex's Anti-Steering Rules harm competition among networks at millions of Amex-accepting merchants.

U.S.A., Inc., 163 F. Supp. 2d 322, 338 (S.D.N.Y. 2001). In reaching that conclusion, the court explicitly adopted the opinion of the United States's expert economist, Professor Michael Katz (who is also Plaintiffs' expert here), that "there would be no loss to network transaction volume in the face of even a 10% increase in price for network services" because the card networks' customers (banks in that case) could not have provided network services themselves and it was "implausible" that those customers would have stopped buying network services "in response to such a small increase in price." *Id.* at 339. The Second Circuit affirmed the district court's market definition. *See United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 238-39 (2d Cir. 2003) ("agree[ing]" with district court's finding that there was a relevant market consisting of "the network services market for general purpose cards").

Similarly, Judge Gleeson granted summary judgment against defendants who maintained, as Amex does here, that the relevant market included GPCC and debit card network services. As he explained, there was "no genuine issue of material fact requiring trial with respect to the fact that the relevant market, at its broadest, is the provision of general purpose credit and charge card services." *In re Visa Check/Mastermoney Antitrust Litig.*, No. 96-CV-5238, 2003 WL 1712568, at *3 (E.D.N.Y. Apr. 1, 2003).

2. Amex Has Admitted That General Purpose Credit and Charge Card Network Services Constitute a Relevant Market.

Amex has long acknowledged that there is a relevant market for GPCC card network services. When merchants question how Amex's price compares to the average price they pay to accept Visa and MasterCard credit and debit cards, Amex emphasizes that "we do not compete with debit so we didn't include it in [the rate] analysis."[10] And in the decade before this case was

[10] PX0010 (AMEXNDR10545506); *see also* PX0068 (AMEXNDR10721513-515, at 514) (explaining that comparing Amex to Visa and MasterCard "on a credit to credit basis" would be a "more accurate comparison" than a comparison including debit).

filed, Amex consistently and repeatedly represented to courts and government agencies that it competes with other GPCC card networks, but not with debit card networks. Amex's tune changed only after Plaintiffs brought this case.

In *Visa*, Amex supported the United States's GPCC card network services market, arguing that there was "no evidence" that debit cards, cash, and checks "'substantially constrain the price-increasing ability' of credit and charge card networks."[11] Amex told the Federal Reserve in 2005 that it "consider[s] our market to be general purpose charge and credit cards" and that "debit is a different market."[12] Amex echoed that position in a 2007 presentation to the Government Accountability Office.[13]

When Amex sued Visa and MasterCard seeking billions of dollars, it alleged that there was a relevant market consisting of "general purpose card network services."[14] In July 2007, one of Amex's expert economists, Professor George Hay (who is also one of Amex's experts here), opined that the *Visa* district court's "finding that general purpose card network services constitute a separate relevant antitrust market was correct and remains applicable to the present case."[15] Amex later moved for summary judgment on the issue of market definition, arguing that

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[11] PX1478, at 5 (Brief of American Express Company as Amicus Curiae, *United States v. Visa U.S.A., Inc.*, No. 98-CV-7076 (S.D.N.Y. Sept. 22, 2000)).

[12] PX0254, at 2 (AMEX-DOJ-10141639-650, at 641).

[13] PX0004, at 2 (AMEX-DOJ-10058045-066, at 046) ("We consider our market to be general purpose charge and credit cards; debit is a different market.").

[14] PX0106, ¶ 75 (Complaint, *American Express Travel Related Servs. Co. v. Visa U.S.A., Inc.*, No. 04-CV-08967 (S.D.N.Y. Nov. 15, 2004)); *see also id.* ¶ 152 ("Consumers do not consider debit cards to be reasonably interchangeable with general purpose credit and charge cards.").

[15] PX0058, at 23 (Expert Report of George A. Hay , *American Express Travel Related Servs. Co., Inc. v. Visa U.S.A., Inc.*, No. 04-CV-08967 (S.D.N.Y. July 16, 2007) (AMEXNDR06664101-232, at 127)).

the relevant market was "the same relevant markets that were found" in *Visa* (*i.e.*, the market for GPCC card network services).[16]

In yet another case, at least as recently as September 2008, Amex continued to maintain that "the relevant market . . . is general purpose cards – the same market approved in *Visa* by the Court of Appeals."[17] Amex adhered to that position in its SEC filings as well. As in prior filings, Amex's Form 10-K filed in February 2010 recognized that "[t]he ability to substitute debit cards for credit and charge cards is limited because there is no credit extended and the consumer must have sufficient funds in his or her demand deposit account to pay for the purchase at the time of the transaction."[18]

[16] *See* PX1498, at 15 (Amex Mem. Supp. Mot. Partial Summ. J. on Count I, *American Express Travel Related Servs. Co.v. MasterCard Inc.*, No. 04-CV-08967 (S.D.N.Y. June 9, 2008)). MasterCard agreed to pay $1.8 billion to settle Amex's claim before Amex's summary judgment motion was resolved. *See* PX1407, at 78 (American Express Co., Annual Report (Form 10-K), Feb. 27, 2009); Press Release, "American Express Settles Antitrust Claims Against MasterCard for $1.8 Billion" (June 25, 2008), *available at* http://www.sec.gov/Archives/edgar/data/4962/000000496208000015/exhibit99_1.txt.

[17] PX2195, at 44 (Amex Mem. Supp. Mot. Summ. J., *Marcus Corp. v. American Express Co.*, No. 04-CV-05432 (S.D.N.Y. Sept. 22, 2008)); *see also* PX2072, at 11, ¶ 20 (Declaration of Richard J. Gilbert Regarding Liability, *Marcus Corp., v. American Express Co.*, No. 04-CV-05432 (S.D.N.Y. May 6, 2008)) ("Professor Sibley supplies no reason to reject previous judicial determinations that there is a single relevant market for general-purpose credit and charge cards.").

[18] PX1408, at 22 (American Express Co., Annual Report (Form 10-K), Feb. 26, 2010); *accord* PX1407, at 21 (American Express Co., Annual Report (Form 10-K), Feb. 27, 2009); PX1406, at 20 (American Express Co., Annual Report (Form 10-K), Feb. 28, 2008); PX1405, at 22 (American Express Co., Annual Report (Form 10-K), Feb. 28, 2007) ("The ability to substitute debit cards for credit and charge cards is limited because the consumer must have sufficient funds in his or her demand deposit account to cover the transaction in question."); PX1404, at 21 (American Express Co., Annual Report (Form 10-K), Mar. 6, 2006) (same); PX1403, at 21 (American Express Co., Annual Report (Form 10-K), Mar. 10, 2005) (same); PX2004, at 16 (American Express Co., Annual Report (Form 10-K), Mar. 12, 2004) (same).

Plaintiffs filed this case in October 2010. Amex's next Form 10-K claimed for the first time that debit cards "are also perceived as an alternative to credit or charge cards."[19]

3. Standard Tools for Defining Relevant Markets Focus Antitrust Analysis on Where Competitive Harms Are Possible.

A "distinct product market comprises products that are considered by consumers to be 'reasonably interchangeable' with what the defendant sells." *Visa*, 344 F.3d at 239 (alterations omitted and quoting *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956)). The "reasonably interchangeable" standard recognizes that "the ability of consumers to switch to a substitute restrains a firm's ability to raise prices above the competitive level." *Geneva Pharms.*, 386 F.3d at 496. To apply that standard, the Second Circuit employs the "hypothetical monopolist test." That test defines a relevant market as "any grouping of sales whose sellers, if unified by a hypothetical cartel or merger, could profitably raise prices significantly above the competitive level." *See AD/SAT, Div. of Skylight, Inc. v. Associated Press*, 181 F.3d 216, 228 (2d Cir. 1999) (italics and internal quotation marks omitted); *see also United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 335 (S.D.N.Y. 2001) (explaining that "a market is properly defined when a hypothetical profit-maximizing firm selling all of the product in that market could charge significantly more than a competitive price, *i.e.*, without losing too many sales to other products to make its price unprofitable").[20]

[19] PX1409, at 23 (American Express Co., Annual Report (Form 10-K), Feb. 28, 2011).

[20] This definition is akin to that in the U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines §§ 4.1.1, 4.1.2 (2010) (PX2288, at 8-10) [hereinafter Horizontal Merger Guidelines] (describing hypothetical monopolist test and explaining that the "Agencies most often use a . . . five percent" price increase when applying it). Courts often rely on the Horizontal Merger Guidelines to inform their approach to market definition. *See, e.g.*, *Park West Radiology v. CareCore Nat'l LLC*, 675 F. Supp. 2d 314, 327-28 (S.D.N.Y. 2009); *Emigra Group LLC v. Fragomen, Del Rey, Bernsen & Loewy*, 612 F. Supp. 2d 330, 352 (S.D.N.Y. 2009); *New York v. Kraft Gen. Foods, Inc.*, 926 F. Supp. 321, 359-61 (S.D.N.Y. 1995).

By concentrating on whether price increases could occur, the hypothetical monopolist test ensures that market definition focuses antitrust analysis on where anticompetitive harms are possible. As applied here, the test essentially asks whether, if Amex, MasterCard, Visa, and Discover merged into one company, that firm would impose price increases. If so, then GPCC card network services would be a relevant market. Amex's contrary position – that the relevant market includes debit and GPCC card network services – implies that merchants could simply stop accepting GPCC cards and rely exclusively on debit cards if a hypothetical monopolist of GPCC card network services tried to raise prices. The evidence will demonstrate that such a view is wholly unrealistic.

The hypothetical monopolist test recognizes that market boundaries are not impenetrable. It is almost always true that some consumers switch between products within a relevant market and products outside it, and some may even do so in response to small changes in the relative prices of those products. But the presence of *some* consumer switching does not by itself imply anything about the proper definition of a relevant market. Rather, the hypothetical monopolist test inquires whether there is *enough* consumer switching to prevent a small, but significant, price increase.[21]

[21] *See Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 612 n.31 (1953) ("For every product, substitutes exist. But a relevant market cannot meaningfully encompass that infinite range. The circle must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn; in technical terms, products whose 'cross-elasticities of demand' are small."); *United States v. Rockford Mem'l Corp.*, 898 F.2d 1278, 1284-85 (7th Cir. 1990) (Posner, J.) (affirming market definition of "the provision of inpatient services by acute-care hospitals in Rockford and its hinterland" even though some "people who live in Rockford . . . use hospitals outside the area"); *United States v. H & R Block, Inc.*, 833 F. Supp. 2d 36, 57 (D.D.C. 2011) ("The Court finds that pen-and-paper is not part of the relevant market because it does not believe a sufficient number of consumers would switch to pen-and-paper in response to a small, but significant increase in [tax-preparation software] prices."); *see also* PX1589 (Katz III) ¶¶ 155, 174.

4. Expert Testimony and Other Evidence Show That General Purpose Credit and Charge Card Network Services Are a Relevant Market.

Applying the hypothetical monopolist test, Professor Katz determined that the relevant market here consists of GPCC card network services and excludes debit card network services. Professor Katz calculated that a hypothetical monopolist of GPCC card network services would profitably raise the average price to merchants by 5%, unless doing so would cause a loss of 23% or more of its charge volume. Professor Katz then found it economically implausible that merchants accounting for almost one quarter of all GPCC card volume would stop accepting those cards altogether (and accept only debit cards and other payment forms) if they faced a 5% price increase.[22] Because a monopolist of GPCC card network services would likely impose such a price increase, Professor Katz concluded that GPCC card network services constitute a relevant antitrust market.[23]

Recent industry developments further confirm this market definition. The Dodd-Frank Wall Street Reform and Consumer Protection Act contains a provision – known as the Durbin Amendment – that requires card networks to allow merchants, in limited circumstances, to use discounts and in-kind incentives to encourage customers to pay with debit cards.[24] The Durbin Amendment also required the Federal Reserve to implement regulations reducing the largest

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[22] *Cf. Visa*, 163 F. Supp. 2d at 339 (holding that relevant market included only GPCC card network services when it was "implausible" that a price increase would cause networks to lose enough sales to make price increase unprofitable).

[23] *See* PX1489 (Katz I) ¶¶ 189-191. Professor Katz also analyzed whether a hypothetical monopolist of GPCC card network services would "find it profitable to raise the net, two-sided price charged for credit and charge card network services," *id.* ¶ 188, and that approach yielded the same conclusion: there is a relevant market consisting of only GPCC card network services, *see id.* ¶¶ 158-165.

[24] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 1075, Pub. L. No. 111-203, 124 Stat. 1376, 2068 (July 21, 2012) (codified at 15 U.S.C. § 1693o-2(b)(2)).

component of the fees that merchants pay to accept debit cards (debit card interchange fees) to a level that would be "reasonable and proportional" to costs.[25] After the final regulations took effect, debit card interchange fees fell by 37% – from an average of 1.24% of transaction value to 0.78%.[26] If debit card network services and GPCC card network services were in the same market, one would have expected a 37% decline in debit fees to cause merchants to take advantage of debit cards' lower costs either by steering their GPCC customers to debit cards or by ceasing to accept GPCC cards.[27] There is no evidence that either has happened. Nor is there any evidence that GPCC card networks lowered their prices in response to the dramatic decline of debit prices, as one would expect if the GPCC card networks feared that merchants would shift business from GPCC cards to debit cards. These facts show that merchants do not see debit card acceptance as a close replacement for credit card acceptance.

5. For Both Merchants and Consumers, Debit Cards Are Often Poor Substitutes for Credit Cards.

Amex contends that debit card network services belong in the same relevant market with GPCC card network services because debit cards and GPCC cards are functionally interchangeable – that is, merchants' customers can use either type of card to pay for goods or services. That argument suffers from several defects.

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[25] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 1075, Pub. L. No. 111-203, 124 Stat. 1376, 2068 (July 21, 2012) (codified at 15 U.S.C. § 1693o-2(a)(2)); *see also* Federal Reserve System, Regulation II, 76 Fed. Reg. 43,394 (July 20, 2011) (codified at 12 C.F.R. § 235.3).

[26] *See* PX2485, at 16 (Board of Governors of the Federal Reserve System, *2011 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions* (Mar. 5, 2013)).

[27] *See Geneva Pharms. Tech. Corp. v. Barr Labs. Inc.*, 386 F.3d 485, 496-97 (2d Cir. 2004) (concluding that a branded drug and its generic equivalent were in separate markets in part because of a large and growing gap between prices of the branded and generic drugs); *see also* PX1489 (Katz I) ¶¶ 196-199.

First, "reasonable interchangeability" defines the bounds of a relevant market. *See supra* Part II.A.3. While evidence of "functional" interchangeability can be a factor in defining an appropriate market, it is only an "indication that consumers of one product might be willing to switch to the other in the face of a non-trivial price increase" because it does not incorporate any consideration of price or customer preference. *See Geneva Pharms.*, 386 F.3d at 496. Accordingly, courts exclude functionally interchangeable products from a relevant market if the hypothetical monopolist test or other evidence demonstrates that the products are not reasonably interchangeable.[28]

Second, Amex emphasizes *cardholder* usage of debit and GPCC cards, but this case challenges restraints on competition in the market in which *merchants* buy card network services. *See Amex*, 2014 WL 1817427, at *2 ("This case concerns one side of [the] market: card acceptance by merchants."). Although cardholder demand drives merchant demand for card network services, defining a relevant market here requires focusing on merchants[29] – a group that Amex largely ignores.

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[28] *See, e.g.*, *Geneva Pharms.*, 386 F.3d at 496 (reversing summary judgment that "the entire warfarin sodium market, including Coumadin [and generics], was the appropriate market," despite "the chemical equivalence between Coumadin and generics"); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 424-25 (2d Cir. 1945) (Hand, J.) (defining relevant market to include only "virgin" ingot and excluding "secondary" ingot, even though "for most purposes ['secondary'] competes upon a substantial equality with 'virgin'"); *United States v. H & R Block, Inc.*, 833 F. Supp. 2d 36, 54 (D.D.C. 2011) (concluding that the relevant market included only tax-preparation software and excluded other tax-preparation services, even though "[a]ll tax preparation methods provide taxpayers with a means to perform the task of completing a tax return").

[29] *Cf. In re Visa Check/Mastermoney Antitrust Litig.*, No. 96-CV-5238, 2003 WL 1712568, at *3 (E.D.N.Y. Apr. 1, 2003) ("That consumers might switch to another form of payment in the event of a surcharge on their credit card transactions does not alter the fact that there is no cross-elasticity of demand at the merchant level between defendants' [credit card] products and all other forms of payment.") (italics omitted).

Third, merchants do not consider GPCC card network services and debit card network services to be functionally interchangeable because some of their customers prefer to pay with GPCC cards, while others prefer to pay with debit cards, and merchants want to serve as many customers as possible, however they prefer to pay. Even people who use both debit cards and GPCC cards regularly tend to use one kind of card for particular kinds of transactions and the other kind for other transactions (*e.g.*, debit for groceries, credit for airline tickets). As a result, a merchant that accepted only debit cards would risk losing sales of those customers who prefer to use GPCC cards to pay for its products.[30]

[redacted] twice promoted low-cost debit cards, and those promotions confirmed that its customers who pay with GPCC cards tend not to switch to debit cards. Between 2003 and 2006, [redacted] offered discounts on future purchases to customers paying with PIN debit cards, and it found that the promotion encouraged only its customers who had been paying with checks to switch to debit cards. When [redacted] offered a similar deal between 2008 and 2012, customers switched primarily from signature debit cards to PIN debit cards. There was almost no movement from credit cards to PIN debit cards during either period. Thus, [redacted] concluded that some of its customers prefer to use debit cards and others prefer to use credit cards, and that they are essentially distinct populations. Other merchants agree.

Finally, even from a cardholder's point of view, debit cards often are not functionally interchangeable with GPCC cards. Debit cards are "pay now" products that remove funds from a

[30] Additionally, debit cards and GPCC cards are not functionally interchangeable for merchants that rely on consumers' access to credit as security. *See* PX2243, at 14 (Amex Reply Br. Supp. Mot. for Summ. J., *Marcus Corp. v. American Express Co.*, No. 04-CV-05432 (S.D.N.Y. Dec. 10, 2008)) ("In particular, merchants whose businesses require placing a 'hold' on the cardholder's credit line while the merchants' services are being used (e.g., car rental firms and hotels) did not want offline debit cards at any price because debit cards are linked only to a bank account (which can be emptied) and, thus, do not offer the assurance of creditworthiness that a hold on a charge or credit card provides.").

cardholder's bank account immediately upon purchase, while GPCC cards allow cardholders to "pay later." Debit cards may also limit the total dollar volume of transactions that can be completed in a single day, which makes it harder for cardholders to use them for large purchases, such as airline tickets. In addition, cardholders often find debit cards less convenient in paying for some travel-and-entertainment expenses. When hotels or rental car companies place "holds" on funds as security against damage to their property, cardholders paying with debit cards lose access to funds in their bank accounts as long as the "hold" is in place. Cardholders paying for such items with credit cards, however, experience only a temporary reduction in their available credit.

B. Amex Has Market Power in the Market for General Purpose Credit and Charge Card Network Services to All Merchants.

Market power is "the 'power to control prices or exclude competition.'" *Visa*, 344 F.3d at 239 (quoting *United States v. E.I. du Pont deNemours & Co.*, 351 U.S. 337, 391 (1956)).[31] Although a plaintiff need not prove that a defendant possesses market power when (as here) there is proof of actual adverse effects on competition,[32] "market power remains a highly relevant factor in rule of reason analysis because market power bears a particularly strong relationship to a party's ability to injure competition." *Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc.*, 996 F.2d 537, 546 (2d Cir. 1993).

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[31] *See also K.M.B. Warehouse Distribs., Inc. v. Walker Mfg. Co.*, 61 F.3d 123, 129 (2d Cir. 1995) ("Market power may be shown by evidence of specific conduct indicating the defendant's power to control prices or exclude competition.") (internal quotation marks omitted); *Commercial Data Servers, Inc. v. Int'l Bus. Machs. Corp.*, 262 F. Supp. 2d 50, 73 (S.D.N.Y. 2003) (recognizing that market "power may be demonstrated by direct evidence of specific conduct indicating the defendant's ability to control price or exclude competition").

[32] *See Amex*, 2014 WL 1817427, at *7 ("The Second Circuit . . . has consistently held that market power is not a requirement under the rule of reason if a plaintiff can prove actual adverse effect on competition.").

Visa "provides useful guidance for . . . understanding how a court might determine market power in this particular two-sided market." *See Amex*, 2014 WL 1817427, at *10. There, the district court concluded that "both [Visa and MasterCard] have market power in the general purpose card network services market, whether measured jointly or *separately*," 163 F. Supp. 2d at 342 (emphasis added), and the Second Circuit agreed, 344 F.3d at 239. Both courts emphasized three types of evidence supporting the market-power finding: (1) high market share; (2) cardholder insistence; and (3) continued merchant acceptance despite price increases. *See Visa*, 163 F. Supp. 2d at 340-42; *Visa*, 344 F.3d at 239-40.[33] Similar evidence here demonstrates that Amex possesses market power today.

1. Amex's Market Share Equals Levels That the Second Circuit Held Sufficient to Establish Market Power in the Relevant Market.

In concluding that MasterCard and Visa separately possessed market power, the *Visa* district court found that "both have large market shares in a highly concentrated network market with only four significant competitors." *Visa*, 163 F. Supp. 2d at 341. The Second Circuit agreed. *See Visa*, 344 F.3d at 240. At the time, MasterCard's market share stood at approximately 26%. *Id.* Amex endorsed that reasoning when, in an antitrust suit against MasterCard (ultimately settled for $1.8 billion), it argued that MasterCard's market share was "sufficient to establish its . . . possession of market power" and criticized MasterCard for

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[33] The courts also recognized that the card networks had caused actual adverse effects on competition. *See Visa*, 163 F. Supp. 2d at 342 ("[F]urthermore plaintiff has demonstrated that both Visa and MasterCard have raised prices and restricted output without losing merchant customers."); *Visa*, 344 F.3d at 240 (noting that defendants "have demonstrated their power in the network services market by effectively precluding their largest competitor from successfully soliciting any bank as a customer for its network services and brand"). Such proof of actual adverse effects on competition is "a strong indicator of market power" that "arguably is more direct evidence of market power than calculations of elusive market share figures." *Todd v. Exxon Corp.*, 275 F.3d 191, 206 (2d Cir. 2001) (Sotomayor, J.).

"offer[ing] absolutely no basis to depart from" *Visa*'s holding.[34] By the same logic, Amex possesses market power today: in 2012, spending by Amex cardholders accounted for more than 26% of purchase volume on all GPCC cards in the United States.[35]

Amex's role as a gatekeeper to 26% of GPCC cardholder spending provides it with significant market power over merchants. If this case were about Amex's market power over cardholders, Amex's 26% market share would raise questions because the fact that the other networks process the remaining 74% of GPCC sales suggests that *cardholders* could shift their spending to other networks if Amex abused them. But "[t]his case concerns . . . card acceptance by merchants." *See Amex*, 2014 WL 1817427, at *2. And *merchants* cannot shift their business to other networks when Amex raises their prices, unless they are willing to stop accepting Amex altogether and risk losing the 26% of GPCC sales accounted for by Amex cardholders. *See id.* at *11 (recognizing that "merchants do not choose how much of Amex's services they purchase, nor, for that matter, do they determine how much they will purchase from Amex's competitors"). With so many sales at stake, it is not surprising that many merchants – indeed, all of the Top 100 retailers that accept credit cards – are unwilling to take the risk.[36]

2. Cardholder "Insistence" Gives Amex Market Power Over Merchants.

In *Visa*, the district court attributed the defendant card networks' market power to the fact that merchants "cannot refuse to accept Visa and MasterCard even in the face of significant price

[34] *See* PX1497, at 25-26 (Amex Mem. Opp'n MasterCard Mot. Summ. J. on Count V, *American Express Travel Related Servs. Co. v. MasterCard Inc.*, No. 04-CV-08967 (S.D.N.Y. June 9, 2008)).

[35] PX1489 (Katz I) ¶ 221 & tbl.18.

[36] *See* PX1487 (Schmitt I) ¶ 87 (showing that [redacted] was the only merchant among the 100 largest retailers in 2010 that accepted some credit cards, but not Amex cards); PX0017, at 7 (American Express Company, Annual Report, 2013) (reporting that [redacted] now accepts Amex).

increases because the cards are such preferred payment methods that customers would choose not to shop at merchants who do not accept them." *Visa*, 163 F. Supp. 2d at 340. The Second Circuit also recognized that such evidence tended to prove market power. *See Visa*, 344 F.3d at 240.

Similarly, merchants must accept Amex because many of Amex cardholders so strongly prefer to pay with Amex that they will "walk away" from or "spend less" at any merchant that does not accept Amex. Amex refers to those cardholders as "insistent,"[37] and it recognizes that cardholder insistence allows it to charge merchants high prices. As Amex's Vice Chairman explained: "What gets us a premium discount rate is cardmember insistence."[38] Internal Amex documents that explore "Why [Amex] can charge more" identify "Amex [cardholder] Insistence" as a top reason.[39]

Amex recognizes that three groups of its cardholders have the highest levels of insistence. First, enrollees in Amex's Membership Rewards program receive at least 1 point for every dollar they spend on their Amex cards, and they can redeem those points for gift certificates, merchandise, frequent flyer miles, statement credits, and other goods and services. A 2011

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[37] *See* PX0124, at 6 (AMEXNDR13599599-618, at 604). In prior cases, Amex has recognized its "comparatively higher insistence levels" than Visa and MasterCard. *See* PX1495, at 16 (Amex Mem. Opp'n Marcus Mot. for Summ. J., *Marcus Corp. v. American Express Co.*, No. 04-CV-05432 (S.D.N.Y. Nov. 3, 2008)). But after this case was filed, Amex apparently adopted "new communications guidelines" instructing employees to "h[o]ld back on some specifics regarding insistence." PX2414 (AMEXNDR09550440); *see also* PX2415 (AMEXNDR18914832-835, at 834) (questioning how "DOJ suit affect[s] our ability to demonstrate value to merchants" and reporting that "there is chatter that we can't use the word insistence").

[38] PX1484, at 358:25-360:8 (Gilligan (*Amex v. Visa*) 5/10/07 Dep.).

[39] *See* PX0027, at 4 (AMEXNDR08400757-777, at 760); *see also* PX0769, at 7 (AMEXNDR10174218-234, at 224) ("Rate is based on value delivered to specific industries by way of high spending, loyal, insistent customers.").

survey found that 84% of Amex cardholders were enrolled in one of Amex's loyalty programs.[40] According to Amex, many of those cardholders "are addicted to their points and usually only shop at establishments that accept" Amex,[41] making Membership Rewards and other loyalty programs "the glue that holds . . . together" Amex's strategy to charge merchants high prices.[42]

Second, large companies often arrange for employees to use corporate cards for travel-and-entertainment expenses (*e.g.*, airfare, lodging, meals), and small business owners may carry GPCC cards designed to meet their needs. In the first half of 2013, Amex cards accounted for more than 60% of corporate-card spending and more than 50% of spending on small business GPCC cards.[43] And an Amex survey of corporate cardholders found that 70% were required by their companies to put business expenses on their Amex cards.[44] Those Amex corporate cardholders are highly insistent because "MOST of them HAVE TO use their cards when paying for . . . business expenses. . . . [I]f a merchant does not take the [Amex] card, [Amex] Corporate [cardholders] can't spend there."[45]

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[40] *See* PX0815, at 4 (AMEXNDR10977279-336, at 284).

[41] PX1689 (AMEXNDR08568533-563, at 547).

[42] PX1484, at 358:6-24 (Gilligan (*Amex v. Visa*) 5/10/07 Dep.); *see also* PX2421, at 197:12-199:24, 314:3-315:13 (McCurdy (MDL 1720) 3/24/09 Dep.) (stating that "the insistence of [Amex] card members in using their card" is a principal "element[] of value that Amex delivers" to merchants, and that "Membership Rewards is an effective vehicle to encourage card members to put their spending on American Express"); PX2091, at 87:3-11 (Glenn (*Amex v. Visa*) 4/10/07 Dep.) (testifying that rewards program enrollees are one of the "core elements" of the insistence that Amex cardholders exhibit to merchants).

[43] PX2486, at 2 (AMEXNDR19488051-080, at 053) (reporting 64.3% share for Amex corporate cards and 52.7% share for OPEN, Amex's small business cards).

[44] PX0634, at 7 (AMEXNDR07563105-221, at 112) (reporting that 51% of total U.S. survey respondents were "[r]equired to use [the] Amex Corporate Card for all business expenses when possible" and another 19% were "[r]equired to use [the] Amex Corporate Card for all business expenses with no exception").

[45] PX1689 (AMEXNDR08568533-563, at 547).

Third, according to research conducted for Amex, 10% of Amex cardholders regularly carry Amex cards but no other GPCC cards.[46] Merchants would put sales to many of those customers at risk if they did not accept Amex cards.

To quantify insistence among its cardholders, Amex has retained Brookfield Research, a consumer-research firm, to conduct periodic cardholder surveys that Amex calls "Value Story Research." The 2011 survey reported high insistence levels among Amex cardholders, finding that "39% . . . say they would not have purchased and/or would have spent less if American Express had not been accepted on their last purchase occasion."[47] Brookfield also prepared separate reports on cardholder insistence in particular industries ranging from supermarkets, to car rental agencies, to lodging establishments. There are few examples of merchants actually cancelling Amex, but when [redacted] (a chain of gas stations often located near [redacted] stores) did so, even more customers actually deserted [redacted] than Brookfield had estimated.[48]

Amex incorporated the Brookfield survey results into assessments of the prices charged to merchants in different industries. Amex used the findings to estimate the profits that a merchant would lose from making fewer sales to insistent Amex cardholders if the merchant stopped accepting Amex. That estimated "value" from insistent cardholders, in turn, helped Amex calculate the "highest 'rational' price" premium over Visa credit cards that merchants in a

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[46] PX0815, at 10 (AMEXNDR10977279-336, at 290).

[47] *Id*. at 7 (AMEXNDR10977279-336, at 287).

[48] *See* PX0031 (AMEXNDR12149668-693, at 668) (reporting that cardholder "insistence . . . appears to be . . . almost double the claims research insistence numbers"). [redacted] later resumed accepting Amex cards.

particular industry would pay before cancelling Amex.[49] These pricing assessments identified industries where Amex was charging merchants prices sufficiently below the "highest 'rational' price" that Amex could profitably "recapture" the "value" by raising prices. *See infra* Part II.B.3.

Amex also developed a computer model – called a "value tool" – that its client managers used to calculate Amex cardholder insistence for specific merchants.[50] Client managers incorporated the insistence figures generated by the "value tool" into sales presentations designed to ward off merchant cancellation threats and justify price increases by showing merchants that they would lose money if they stopped accepting Amex. For example, when Amex raised prices for the entire airline industry, it often reminded airlines that billions of dollars of sales came from Amex's "highly insistent customers" and warned them that "[i]t is essential to accept American Express."[51]

Although Amex claims that its high merchant prices reflect the high "value" of its product, merchants dispute that Amex provides more value than MasterCard or Visa. [redacted]

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[49] *See* PX0124, at 6 (AMEXNDR13599599-618, at 604).

[50] *See* PX1689 (AMEXNDR08568533-563, at 535-536).

[51] *See, e.g.*, PX1252, at 25 (AMEXNDRDB04120493-519, at 518) ([redacted]); PX0231 (AMEX-DOJ-10073054-056, at 055) ([redacted]; PX0007, at 11 (AMEX-DOJ-10015664-687, at 674) ([redacted]; PX0047, at 4 (AMEXNDR10163323-329, at 327) ([redacted]; *see also* PX1218, at 5 (AMEXNDR18983329-336, at 334) ([redacted]); PX0517, at 7 (AMEXNDR03676019-027, at 026) ([redacted]).

[52] PX0043, at 16 (AMEXNDR09032950-3081, at 2965) (showing that, [redacted]

[redacted]

Despite dissatisfaction with Amex, merchants' internal analyses show that giving up Amex would be costlier than continuing to pay Amex's high prices. For example, [redacted] estimated that, if it dropped Amex, it would lose a significant portion of its sales to Amex cardholders, and the savings on the remaining sales would not make up for the margin on the lost sales. [redacted] therefore, concluded that it needed to continue accepting Amex. Other merchants, including [redacted], [redacted] and [redacted] have performed similar studies and likewise concluded that it would be unprofitable for them to stop accepting Amex.

[redacted], the [redacted] largest retailer in the United States, was one of the few merchants to try to drop Amex, but it quickly reversed course when it realized how strongly many of its customers insisted on paying with Amex cards. Dissatisfied with paying Amex significantly more than Visa and MasterCard, in [redacted] asked Amex for a lower discount rate. Amex tried to convince [redacted] of its "value," stressing its cardholders' "insistence" and warning that "nearly $[redacted] million, or [redacted]% of [redacted] charge volume [from Amex cards] would be at risk if American Express were no longer accepted."[55] But [redacted] still announced that it would stop accepting Amex cards on [redacted] Amex planned to

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[53] *Id*. at 14 (AMEXNDR09032950-3081, at 2963).

[54] *Id*. at 22 (AMEXNDR09032950-3081, at 2971).

[55] PX0048, at 3-4 (AMEXNDR05696703-718, at 716-717); *see also* PX1974, at 3 ([redacted] at 319) (emphasizing Amex's "very insistent and loyal base comprised of corporate, small business and membership rewards enrollees"); PX1969 ([redacted] at 367) (Amex advising [redacted] that "canceling our agreement will have a large negative impact on your business" because of "the insistent spend of our Cardmembers").

retaliate by encouraging cardholders to move their business from [redacted] to other drugstores and had even prepared a mailing to offer [redacted] customers a $[redacted] gift card for a new or transferred prescription. But none of that was necessary because a groundswell of customer outcry convinced [redacted] that it had made a mistake, and [redacted] resumed accepting Amex within hours of stopping.

3. Amex Exercised Its Market Power Through the Profitable "Value Recapture" Price Increases.

The *Visa* district court, in support of its finding that Visa and MasterCard separately possessed market power, relied on evidence that those networks had "recently raised [prices] charged to merchants a number of times," without losing enough merchants to make the price increase unprofitable. *Visa*, 163 F. Supp. 2d at 340. The Second Circuit approved the district court's reasoning. *See Visa*, 344 F.3d at 240. Amex, too, has repeatedly and profitably raised the prices it charges to merchants.

As Visa and MasterCard prices rose over time, Amex's "premium" – the amount that Amex charges merchants over and above Visa and MasterCard's own supracompetitive prices – declined. In response, Amex analyzed its pricing one industry at a time to identify merchant segments that were most dependent on insistent Amex cardholders and thus were most vulnerable to price increases. Between 2006 and 2009, Amex raised the prices that merchants paid on 65% of Amex's U.S. charge volume[56] by increasing discount rates, imposing additional fees, and reducing other payments to merchants. Amex referred to these systematic efforts to raise merchant prices as "Value Recapture."

Amex understood that the merchants subjected to Value Recapture received nothing of value in exchange for paying higher prices. For example, when Amex was planning to force

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[56] PX0121, at 3 (AMEXNDR11964457-469, at 459).

68,000 small merchants to pay a new monthly fee, one executive wrote, "I am increasingly concerned about the scope of impact . . . . [W]e are increasing cost without any real corresponding benefit."[57] Ultimately, however, Amex imposed the new fee anyway "[p]urely . . . *because we can* and it will generate incremental . . . revenue."[58] Amex bestowed its "Platinum Award" on two employees instrumental in raising prices to 61,000 small merchants and thus producing "ANNUAL incremental revenue of $30 [million] with NO additional associated costs."[59]

When confronted with the Value Recapture price increases, very few merchants stopped accepting Amex. Amex experienced no cancellations when it implemented Value Recapture at large hotels and restaurant chains. Small merchants likewise absorbed substantial Amex price increases without appreciable cancellations. After raising the monthly flat fee charged to its smallest merchants by nearly 20%, Amex observed that "the fee increase did not lead merchants to cancel more frequently."[60] Amex then re-raised the flat fee by another 33%, for a total price increase of over 50%.[61] Again, there were negligible merchant cancellations.[62] By 2010, Amex

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[57] PX0784 (AMEXNDR10311380).

[58] PX1168 (AMEXNDR18084021-023, at 021) (emphasis added); *cf.* PX0034, at 56 (AMEXNDR16582514-578, at 569) (equating "increasing price just because 'you can,' without concern for what the competition does" with "[p]ricing based on 'market power'").

[59] PX0954 (AMEXNDR13178530-532, at 531).

[60] *See* PX0584, at 6 (AMEXNDR06473777-869, at 846); *see also* PX0054, at 10 (AMEXNDR11960722-778, at 732) (reporting that only 1.4% of 133,000 small merchants affected by value recapture called to complain, only 37% of those callers threatened to stop accepting or suppress usage of Amex, and only 26% of those who made a threat became inactive).

[61] *See* PX0584, at 3-4 (AMEXNDR06473777-869, at 843-844); PX0008, at 3 (AMEXNDR11014485-495, at 487).

[62] PX0008, at 5 (AMEXNDR11014485-495, at 489).

was internally celebrating that Value Recapture had delivered significant benefits "w[ithout] merchant cancellations."[63] And during discovery in this case, Amex's top pricing executives were unable to name a single merchant that stopped accepting Amex in response to a Value Recapture price increase.

Value Recapture has been highly profitable for Amex. Its first round of price increases in 2005 was relatively modest, yielding $16 million in pre-tax income.[64] But as Amex began raising prices more broadly, its incremental pre-tax income resulting from Value Recapture ballooned from $77 million in 2006, to $198 million in 2007, to $285 million in 2008, to a forecasted $335 million in 2009.[65] Amex estimated that Value Recapture price increases would generate cumulative benefits of more than $1.3 billion by 2010.[66] But this case was filed in October 2010, and Amex subsequently suspended new Value Recapture initiatives for 2011.[67]

4. High Barriers to Entry Protect Amex's Market Power.

The *Visa* district court found that "there are significant barriers to entry into the general purpose card network services market" and that the "difficulties associated with entering the

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[63] PX0436, at 13 (AMEXNDR00773100-209, at 113).

[64] PX0372, at 8 (AMEXNDR00143486-538, at 493).

[65] *See* PX0028, at 14 (AMEXNDR09610361-455, at 375) (Feb. 2, 2010 Merchant Pricing Update to Operating Committee); *see also* PX0436, at 13 (AMEXNDR00773101-209, at 113) (April 29, 2010 Merchant Services Americas Business Unit Review reporting that Value Recapture delivered benefits of $79 million in 2006, $205 million in 2007, $299 million in 2008, and $354 million in 2009 and was projected to deliver an additional $432 million in 2010).

[66] PX0028, at 14 (AMEXNDR09610361-455, at 375).

[67] *Cf. Chicago Bridge & Iron Co. v. FTC*, 534 F.3d 410, 435 (5th Cir. 2008) ("The probative value of [post-acquisition] evidence is deemed limited not just when evidence is actually subject to manipulation, but rather is deemed of limited value whenever such evidence *could arguably* be subject to manipulation."); *Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1384 (7th Cir. 1986) (Posner, J.) ("Post-acquisition evidence that is subject to manipulation by the party seeking to use it is entitled to little or no weight.").

network market are exemplified by the fact that no company has entered since Discover did so in 1985." *Visa*, 163 F. Supp. 2d at 341-42. Entry is no easier today. Launching a new general purpose card network still requires substantial time and money. And a new entrant still would face "a 'chicken-and-egg' problem of developing merchant acceptance without an initial network of cardholders who, in turn, are needed to induce merchants to accept cards in the first place."[68] In view of these difficulties, it is not surprising that nearly thirty years have now passed since the last new firm (Discover) entered the market.[69]

C. Travel-and-Entertainment Merchants Are Especially Vulnerable to the Anticompetitive Effects of Amex's Anti-Steering Rules.

Travel-and-entertainment ("T&E") merchants (such as airlines, hotels, car-rental agencies, and restaurants) are especially vulnerable to the anticompetitive effects of Amex's Anti-Steering Rules, and so it makes sense to analyze separately the Rules' effects in a relevant market consisting of GPCC card network services provided to T&E merchants.[70] Proof of

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[68] *See* PX0106 ¶ 81 (Complaint, *Amex v. Visa*, No. 04-CV-08967 (S.D.N.Y. Nov. 15, 2004)); *see also* PX1591, at 8 (excerpt from April 2013 remarks by Ken Chenault describing merchant coverage as "a chicken-and-egg situation" and explaining, "I can't tell you exactly who's the chicken and who's the egg. You need more customers to drive relevance to get more merchant coverage. You need more merchant coverage to have relevance for the customer. So you've got to do both.").

[69] Although Amex contends that [redacted] and other firms specializing in online and mobile technology will disrupt the payments industry, it has not identified any firm poised to do so. [redacted] and other firms have little incentive to compete directly with the existing GPCC card networks because they rely on those networks to serve their customers.

[70] The relevant market for GPCC card network services provided to T&E merchants could be called a "submarket" of the broader market for GPCC card network services provided to all merchants. *See Geneva Pharms.*, 386 F.3d at 496 ("Reasonable interchangeability sketches the boundaries of a market, but there may also be cognizable submarkets which themselves constitute the appropriate market for antitrust analysis."); *Bogan v. Hodgkins*, 166 F.3d 509, 516 (2d Cir. 1999) (recognizing that "a submarket may function as the relevant market for antitrust purposes").

Amex's market power in the narrower T&E market independently satisfies Plaintiffs' burden in the first step of the rule of reason.

1. A Separate Relevant Market Consists of General Purpose Credit and Charge Card Network Services to Travel-and-Entertainment Merchants.

When a defendant treats all of its customers similarly, distinguishing among different groups of customers adds little to the antitrust analysis. But when a defendant can charge different prices to different customers for the same services (*i.e.*, engage in price discrimination), certain customers may be uniquely or especially vulnerable to anticompetitive practices. Courts therefore recognize that, in such circumstances, a relevant market may be defined around those uniquely vulnerable customers. *See E.I. du Pont de Nemours & Co. v. Kolon Indus., Inc.*, 637 F.3d 435, 448 (4th Cir. 2011) (complaint properly pled a "distinct relevant geographic market" including only U.S. consumers who "pay more than consumers elsewhere"); *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*, 431 F.3d 917, 935 (6th Cir. 2005) (concluding that "a reasonable trier of fact could find that leisure or price-sensitive passengers represent a separate and distinct market" from other airline passengers); *U.S. Anchor Mfg., Inc. v. Rule Indus., Inc.*, 7 F.3d 986, 997-98 (11th Cir. 1993) (explaining that "the ability to discriminate against a distinct group of customers by charging higher prices for otherwise similar products demonstrates the existence of market power with respect to that group" and concluding that high-priced line of anchors "may have constituted its own market" because of evidence of "price discrimination against a distinct group of consumers"); *see also PepsiCo, Inc. v. Coca-Cola, Inc.*, 315 F.3d 101, 106 & n.1 (2d

Cir. 2002) (stating that plaintiff's attempt to define a relevant market "confined" to certain customers "in theory, may have merit").[71]

Amex charges different prices for its GPCC card network services to merchants in different industries – that is, Amex price discriminates. Amex's ability to increase prices to T&E merchants without affecting other merchants' pricing prompts inquiry into whether a relevant market can be defined around T&E merchants. Professor Katz made this inquiry. He applied the hypothetical monopolist test in two different ways, and he found in each instance that a hypothetical monopolist of GPCC card network services would likely be able to raise prices to T&E merchants by 5% without losing enough business to make the price increase unprofitable. He therefore concluded that there is a separate relevant market for GPCC card network services provided to T&E merchants.[72]

2. Amex Has Market Power in the Market for General Purpose Credit and Charge Card Network Services to Travel-and-Entertainment Merchants.

The evidence of Amex's market power over T&E merchants is even more compelling than the evidence of its power in the broader market for GPCC card network services provided to all merchants.

First, Amex's 34% share of purchases made with GPCC cards at T&E merchants exceeds its 26% share at merchants generally.[73]

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[71] The U.S. Department of Justice and Federal Trade Commission also define markets around customers vulnerable to price discrimination. *See* PX2288, at 12-13, 14-15 (Horizontal Merger Guidelines §§ 4.1.4, 4.2.2).

[72] *See* PX1489 (Katz I) ¶¶ 158-171.

[73] *See* PX1489 (Katz I) ¶ 223 & tbl.20.

Second, T&E merchants face higher levels of Amex cardholder insistence than merchants in other industries. T&E merchants often depend on corporate customers for substantial portions of their sales. Amex cards account for more than 60% of all corporate card sales, and 70% of Amex corporate cardholders work at companies that require employees to use their Amex cards for business travel expenses.[74] As Amex previously admitted, these circumstances "create[] a level of cardmember 'insistence' on using the card that is higher [in the T&E industry] than that in other industries."[75] Amex's consumer cardholders also strongly insist on paying T&E merchants with Amex. According to Amex, "79% of American Express Consumer Cardmembers agree they would choose an airline that accepts American Express over one that does not, all else being equal."[76] Such high levels of insistence allow Amex to charge higher prices to T&E merchants than other merchants.[77]

Third, because so many customers of T&E merchants demand to pay with Amex, the prices that Amex charges are "100% controllable,"[78] and it has therefore been able to impose dramatic Value Recapture price increases on those merchants. In 2005, Amex generated $[redacted] in pre-tax income by raising prices to hotels and found that "merchant pushback has been

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[74] *See supra* notes 43-44.

[75] *See* PX2195, at 33-34 (Amex Memo. Supp. Mot. for Summ. J., *Marcus Corp. v. American Express Co.*, No. 04-CV-05432 (S.D.N.Y. Sept. 22, 2008)).

[76] PX0213, at 19 (AMEX-DOJ-10015252-276, at 271) ([redacted]); *see also* PX0119, at 2 (AMEXNDR10167887-905, at 902) ([redacted]); PX0769, at 6 (AMEXNDR10174218-234, at 223) ([redacted]; PX0112, at 19 (AMEXNDR09577686 - 763, at 709) (Amex presentation to [redacted] explaining that Amex "aim[s] to be an indispensable payment partner" by providing access to "Highly Insistent" cardholders).

[77] *See* PX0124, at 7 (AMEXNDR13599599-618, at 605) (displaying the "Current [Amex] Discount Rate" by industry); PX1240, at 17 (AMEXNDR19210087-106, at 103) (showing that airlines and car rental have the two highest "[t]otal insistence" levels of any industry).

[78] PX0961, at 4 (AMEXNDR13350359-369, at 363); *cf. supra* note 31 and accompanying text.

minimal."[79] Price increases to travel agents and tour operators yielded another $[redacted] in incremental profits for Amex, again with "minimal" pushback.[80] Following those early successes, Amex continued imposing Value Recapture price increases on T&E merchants, targeting airlines, hotels, car rental agencies, restaurants, and other travel industries in 2007 and 2008. By mid-2008, Amex predicted that Value Recapture initiatives aimed at North American T&E merchants would cumulatively generate $[redacted] in pre-tax income by the end of the year.[81]

Between 2007 and 2010, Amex implemented three separate rounds of Value Recapture price increases on restaurants because of "high insistence" among cardholders to pay with Amex.[82] Those price increases affected more than 280,000 merchants in all, and Amex calculated that they would collectively generate more than $[redacted] in annual pre-tax income when fully implemented.[83] In a presentation designed to help its sales force defend the 2010 price increases, Amex advised that they could "address[] the objection that in the restaurant, the consumer belongs to the merchant and not American Express" by explaining: "Even customers who are familiar and loyal to your restaurant are affected by card acceptance. Almost half would not return, would return less often, and/or would spend less . . . if American Express was not

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[79] PX0553, at 3 (AMEXNDR04939387-423, at 390).

[80] PX0553, at 4 (AMEXNDR04939387-423, at 391).

[81] PX0860, at 2 (AMEXNDR11536055-063, at 059).

[82] *See* PX0974, at 5 (AMEXNDR13571825-839, at 830); PX0672, at 9-12 (AMEXNDR08214852-880, at 861-864).

[83] *See* PX0672, at 9-13 (AMEXNDR08214852-880, at 861-865).

accepted."[84] The approach worked. After delivering "100% of [the 2010 Value Recapture] messages," Amex experienced "[n]o cancellations."[85]

Amex's treatment of [redacted] also illustrates its market power over T&E merchants. As the [redacted] largest U.S. airline, [redacted] carries about [redacted] million passengers each year to and from destinations in the United States, Canada, and Mexico, and it depends on credit card users for more than [redacted]% of its revenues. Even though [redacted] pays more to accept Amex than it pays to accept any other GPCC card and receives no unique services from Amex, [redacted] believes that it cannot stop accepting Amex without alienating Amex's many insistent cardholders. Amex has played on that fear, informing [redacted] that "31% of American Express Cardmembers agree that they are more loyal to American Express than they are to [redacted]."[86]

Over an eleven-year period, Amex increased the price charged to [redacted] on six separate occasions, cumulatively hiking its discount rate by over [redacted]%. Between 2007 and 2010 alone, Amex raised [redacted] discount rate by a total of [redacted]% as part of its industry-wide Airline Value Recapture program, and [redacted] received no additional benefits. Although [redacted] tried to persuade Amex not to impose some of these price increases, Amex refused. Amex also refused to modify its Anti-Steering Rules to allow [redacted] to offer its customers discounts for paying with lower-cost cards. And when [redacted] expressed

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[84] PX0957, at 17 (AMEXNDR13238899-9045 at 8916).

[85] PX1000, at 5 (AMEXNDR14144923-944, at 928).

[86] PX0111, at 16 (AMEXNDR10160798-826, at 814).

its "disappointment at the steep increase in discount rate," an Amex pricing executive celebrated the price increases internally as "terrific news and a big win . . . !"[87]

III. Amex Cannot Prove That Its Anti-Steering Rules Have Pro-Competitive Effects.

In the second step of the rule-of-reason analysis, "the burden shifts to the defendants to offer evidence of the pro-competitive effects of their agreement." *Geneva Pharms. Tech. Corp. v. Barr Labs. Inc.*, 386 F.3d 485, 507 (2d Cir. 2004). Amex cannot carry this burden. Its primary argument amounts to a claim that Amex should not have to risk competing for merchants' business. Its professed concern with the exclusionary behavior of Visa and MasterCard cannot excuse its own anticompetitive conduct. And its free-riding defense suffers from numerous flaws.

A. Protecting Amex from Competition Is Not a Pro-Competitive Effect.

Foremost, Amex argues that it needs its Anti-Steering Rules to sustain its current business model, which is based on offering so-called "premium" cards to attract high-spending cardholders and charging merchants higher fees to finance benefits for those cardholders. Without the Anti-Steering Rules, some merchants would offer Amex cardholders discounts or other benefits for using another network's cards, communicate a preference for use of another network's cards, or display another network's logo more prominently. According to Amex, those steps would somehow make cardholders feel embarrassed or otherwise uncomfortable and lead them to use their Amex cards less frequently.[88] Amex asserts that, as cardholders use its

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[87] PX0122 (AMEXNDR11876521-523, at 521, 523).

[88] Merchants, however, have every incentive to make their customers feel comfortable as they find ways to encourage increased use of lower-cost cards. Moreover, Amex cannot prove that consumers would feel uncomfortable when they receive offers for discounts or other benefits for paying with lower-cost cards, see logos of lower-cost cards displayed more prominently, or learn that a merchant prefers that they use lower-cost cards. *Cf. Geneva Pharms.*, 386 F.3d at 507

cards less, some merchants would cease accepting its cards altogether, triggering further declines in card usage, which Amex calls a "downward spiral" or "negative feedback loop." In short, Amex describes a world without its Anti-Steering Rules as a place where networks compete harder for merchant business and where prices may go down as a result. Amex argues that the Rules do not violate the Sherman Act because they prevent that world from emerging.[89] Accepting that argument as a pro-competitive justification would turn on their head well-established antitrust principles favoring vigorous competition.

The Supreme Court rejected a similar claim in *NCAA v. Board of Regents of University of Oklahoma*, 468 U.S. 85 (1984). The NCAA limited the number of televised college football games and argued that its plan was "necessary to protect live attendance." *Id.* at 116. The Court, however, found a "fundamental reason for rejecting this defense":

> The NCAA's argument . . . is . . . based on . . . a fear that the product will not prove sufficiently attractive to draw live attendance when faced with competition from televised games. At bottom the NCAA's position is that ticket sales for most college games are unable to compete in a free market. The television plan protects ticket sales by limiting output – just as any monopolist increases revenues by reducing output. By seeking to insulate live ticket sales from the full spectrum of competition because of its assumption that the product itself is insufficiently attractive to consumers, petitioner forwards a justification that is inconsistent with the basic policy of the Sherman Act. The Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable.

(describing "the burden [on] the defendants to offer *evidence* of the pro-competitive effects of their agreement") (emphasis added).

[89] Citing some community-oriented activities, such as promoting small businesses on "Small Business Saturday," Amex seems to imply that the Anti-Steering Rules should be legal because they allow Amex to spend more on those activities. *See* DX6463 (Bernheim I) ¶ 57; DX6470 (Gilbert I) ¶¶ 182-183. But anticompetitive conduct cannot be justified by claims that the resulting profits will be put to good use. *See, e.g.*, *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 423 (1990) (condemning agreement among lawyers to fix their fees, even though "the quality of representation may improve when rates are increased").

Id. at 116-17 (footnote, internal quotation marks, and alteration omitted). Just as the NCAA feared that its football games would not attract enough spectators to the stadium if fans were able to watch more games on television, Amex fears that its cards will not attract enough charge volume if merchants have greater freedom to encourage their customers to pay in other ways. *NCAA* teaches that such fears cannot justify suppressing competition.[90]

In *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986), the Supreme Court again rejected a defense akin to what Amex offers here. Attempting to defend a "work rule" that prohibited its members from competing over whether to submit dental x-rays requested by insurers, a group of dentists argued that, "if insurance companies are permitted to determine whether they will pay a claim for dental treatment on the basis of x rays [alone], there is a danger that they will erroneously decline to pay for treatment that is in fact in the interest of the patient." *Id.* at 451, 462-63. The Court, however, held that the dentists' argument was legally flawed:

> The premise of the argument is that, far from having no effect on the cost of dental services chosen by patients and their insurers, the provision of x rays will have too great an impact: it will lead to the reduction of costs through the selection of inadequate treatment. . . . The argument is, in essence, that an unrestrained market in which consumers are given access to the information they believe to be relevant to their choices will lead them to make unwise and even dangerous choices. Such an argument amounts to nothing less than a frontal assault on the basic policy of the Sherman Act.

Id. at 463 (internal quotation marks omitted). Similarly to the dentists, Amex believes that merchants' freedom to encourage customers to pay with lower-cost cards would have "too great an impact" and that it would "lead to the reduction of costs" through a series of "unwise . . .

[90] Amex sometimes asserts with little explanation that it uses the Anti-Steering Rules to ensure a "level playing field" when it competes with other networks. But "keeping a level playing field between various competitors" is not a pro-competitive justification for restraining competition. *See Visa*, 163 F. Supp. 2d at 405.

choices." But *Indiana Federation of Dentists* explains that such an argument cannot justify the Anti-Steering Rules.

Finally, when a trade association of engineers adopted a "canon of ethics prohibiting competitive bidding by its members," the Supreme Court rejected its justification that the canon was needed to "minimiz[e] the risk that competition would produce inferior engineering work endangering the public safety." *See Nat'l Soc'y of Prof'l Engineers v. United States*, 435 U.S. 679, 681 (1978). The Court reasoned:

> [The Society's] ban on competitive bidding prevents all customers from making price comparisons in the initial selection of an engineer, and imposes the Society's views of the costs and benefits of competition on the entire marketplace. It is this restraint that must be justified under the Rule of Reason, and petitioner's attempt to do so on the basis of the potential threat that competition poses to the public safety and the ethics of its profession is nothing less than a frontal assault on the basic policy of the Sherman Act.
>
> The Sherman Act reflects a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services. The heart of our national economic policy long has been faith in the value of competition. The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain – quality, service, safety, and durability – and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers. Even assuming occasional exceptions to the presumed consequences of competition, the statutory policy precludes inquiry into the question whether competition is good or bad.

Id. at 695 (internal quotation marks and citation omitted). Amex has used the Anti-Steering Rules, just as the engineers used their ethical canon – to impose its own "views of the costs and benefits of competition on the entire marketplace." *See id.* Although the stakes were much higher in *National Society of Professional Engineers* – human lives, not merely rewards points, were on the line – the Supreme Court still refused to excuse conduct harming competition.

At bottom, Amex's position amounts to a claim that it simply cannot compete with other card networks in a free market. But that view cannot be reconciled with Amex's arguments that it provides valuable services to merchants. If merchants receive enough value from Amex to justify its high price, Amex will continue to thrive without the Anti-Steering Rules. And if Amex's current strategy would be less effective when it faces competition for both cardholder and merchant business, then Amex can apply its considerable talents to adapt to a more competitive environment.

B. Theoretical Misconduct of Visa and MasterCard Cannot Justify the Anti-Steering Rules' Competitive Harms.

Amex claims that it needs the Anti-Steering Rules to protect itself from Visa and MasterCard engaging in "exclusionary" practices. As a matter of law, however, the risk that Visa or MasterCard might engage in exclusionary conduct cannot justify Amex's Anti-Steering Rules because "[a]nother company's alleged violation of antitrust laws is not an excuse for engaging in your own violations of law." *See United States v. Apple Inc.*, 952 F. Supp. 2d 638, 708 (S.D.N.Y. 2013); *see also Indiana Fed'n of Dentists*, 476 U.S. at 465 ("That a particular practice may be unlawful is not, in itself, a sufficient justification for collusion among competitors to prevent it."); *Fashion Originators' Guild of Am., Inc. v. FTC*, 312 U.S. 457, 468 (1941) (rejecting argument that restraint of trade was necessary to protect against piracy of clothing designs). Should exclusionary conduct actually occur, Plaintiffs remain ready to challenge efforts to obstruct competition in the credit card industry, and Amex also may bring its own antitrust action if Visa or MasterCard violates the Sherman Act,[91] just as it brought a previous antitrust lawsuit yielding billions of dollars from those firms.

Moreover, many of Amex's examples of allegedly "exclusionary" conduct actually involved vigorous competition. Thus, while Amex cites the "We Prefer Visa" program from the early 1990s as the kind of activity that its Anti-Steering Rules prevent, that program entailed

[91] *See* 15 U.S.C. § 15.

plainly pro-competitive efforts to educate merchants about Visa's price advantage over Amex and communicate merchants' resulting preferences to customers. Far from demonstrating Visa's propensity for exclusionary conduct, these activities illustrate one kind of legitimate competition that Amex's Rules obstruct. *See supra* Part I.

C. Amex's Free-Riding Claims Do Not Justify the Anti-Steering Rules' Competitive Harms.

Amex claims that it invests in particular activities that bring high-spending customers into merchants' stores and that, if merchants encouraged customers to pay with another credit or charge card, Amex would not be compensated for delivering those customers to the merchant. According to Amex, it needs the Anti-Steering Rules to prevent this type of "free riding." There are several flaws in its argument.

First, Amex cannot establish the factual predicates of a free-riding defense. Merchants cannot free ride on Amex rewards programs and promotions that require cardholders to use their Amex cards because, if a merchant steers a cardholder to another card, the cardholder will not receive the benefit, and Amex will not incur the costs of rewards points or the special offer. Similarly, merchants are not free riding on Amex's efforts to bring them customers when merchants explicitly pay for those efforts, as they often do (*e.g.*, Business Insights market research reports). And to the extent that Amex claims that even displaying its logo is a privilege for which merchants ought to pay separately, Amex overlooks that many merchants choose to operate "clean stores" (*i.e.*, locations without any signage indicating which networks' cards are accepted) and that Amex has tried to persuade such merchants to display its logo. Those efforts suggest that Amex benefits from display of its logo more than merchants. Moreover, some merchants display Amex's logo only because the Anti-Steering Rules require them to do so when they display any card network logo.

Second, Amex has adopted and enforced its Anti-Steering Rules to block other card networks from attracting more merchant business with low prices, not to stop merchants from free-riding. Amex executives admit that, when they faced intensified competition from Visa, they tightened the Anti-Steering Rules to prohibit merchants from stating or displaying a "preference" for Visa or any other card network. *Cf. Visa*, 163 F. Supp. 2d at 401, 404-05 (rejecting justifications, including a free-riding justification, when "evidence shows that defendants' motives are to restrict competition").

Third, Amex cannot prove that any benefits that the Anti-Steering Rules accomplish by reducing the potential for free riding outweigh the Rules' anticompetitive effects. That failure of proof dooms Amex's free-riding defense. *See Visa*, 344 F.3d at 243 (concluding that "defendants have failed to show that the anticompetitive effects of their exclusionary rules are outweighed by procompetitive benefits"); *N. Am. Soccer League v. NFL*, 670 F.2d 1249, 1261 (2d Cir. 1982) (dismissing claimed pro-competitive effects as not supported by evidence and finding that others were "not substantial and are clearly outweighed" by anticompetitive effects).[92]

Finally, even if Amex could meet its burden under the second step of the rule of reason, it would fail in the third step because "any legitimate competitive benefits offered by defendant[] could have been achieved through less restrictive means." *Geneva Pharms.*, 386 F.3d at 507. Amex could protect itself from merchant free riding through a mechanism far less restrictive than the Anti-Steering Rules' direct interference with interbrand competition among networks. Amex

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[92] *See also* PX1498, at 27 n.12 (Amex Mem. Supp. Mot. Partial Summ. J. on Count I, *American Express Travel Related Servs. Co. v. MasterCard Inc.*, No. 04-CV-8967 (S.D.N.Y. June 9, 2008)) (conceding that, "once an antitrust plaintiff demonstrates that a restraint harms competition, the burden shifts to the defendant to prove that such harm is outweighed by its pro-competitive virtues").

could simply charge merchants separately for all of its marketing services, as it already does for many of them. *Cf. Chicago Prof'l Sports Ltd. P'ship v. NBA*, 961 F.2d 667, 675 (7th Cir. 1992) (Easterbrook, J.) ("When payment is possible, free-riding is not a problem because the 'ride' is not free."); 8 Areeda & Hovenkamp ¶ 2223b3, at 422 (concluding that "free riding would not be a problem" if seller could "price the service and the product separately").

IV. Amex's Arguments Fail To Address How Its Anti-Steering Rules Harm Competition.

Throughout this litigation, Amex has sought to distract the Court from the ways that its Anti-Steering Rules harm the competitive process. None of Amex's arguments undercuts Plaintiffs' proof that the Anti-Steering Rules impede competition among card networks for merchant business.

A. Like *United States v. Visa*, This Case Seeks To Remove Card Network Rules That Interfere with the Competitive Process.

The courts in *Visa* drew a roadmap for evaluating whether a GPCC card network possesses market power. *See supra* Part II.B. That roadmap leads to the conclusion that Amex has market power, so Amex glosses over the courts' analyses and instead accuses Plaintiffs of taking positions here that conflict with those of the United States in *Visa*. Amex is mistaken.

In *Visa*, the United States challenged network rules that obstructed other networks from competing to sell more of their GPCC card network services to banks that issue cards to consumers. Plaintiffs here similarly challenge card network rules that obstruct other networks from competing to sell more of their GPCC card network services to merchants. Both cases seek to eliminate artificial restraints on the competitive process.

Amex, however, focuses on how the cases affect only Amex itself. Thus, Amex has argued that its 20% market share during the *Visa* litigation left it too weak to "compete effectively," that the government's "very goal" in bringing the *Visa* case was to help Amex capture "5% additional share," and that that "DOJ inexplicably reversed course by suing Amex" after it had reached a 25% market share.[93] But the *Visa* district court did not see Amex as weak. To the contrary, it characterized "American Express and Discover [as] successful issuers" in the portion of the market where competition was not restrained, *Visa*, 163 F. Supp. 2d at 389, and it correctly predicted that both firms would be able to compete effectively in other portions of the market if the challenged restraints were removed, *id.* at 383 (recognizing that, "[w]hile abolishing the [challenged restrictions] will undoubtedly help American Express and Discover, its primary effect will be to increase competition and consumer welfare"). Moreover, the United States brought the *Visa* case to remove obstacles to competition – not to benefit Amex (or Discover or any other firm) – because the antitrust laws were enacted for "the protection of competition, not competitors." *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962). In short, Amex appears to favor vigorous antitrust enforcement when other card networks restrict competition from Amex, but not when Amex itself restricts competition from other networks.

B. Unlike Many Vertical Restraints, Amex's Anti-Steering Rules Harm Interbrand Competition.

Amex and its economists often emphasize that the Anti-Steering Rules are provisions in vertical agreements between Amex and merchants.[94] While horizontal agreements violate the Sherman Act more often than vertical agreements, that is because vertical agreements normally restrain only intrabrand competition between sellers of the same brands of goods (*e.g.*, the competition between Macy's and Nordstrom in selling Ralph Lauren shirts) and "the primary

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[93] *See* Defs.' Mem. Supp. Mot. Summ. J. at 1-2 (docket no. 282).

[94] Vertical agreements are between firms that operate at different levels of an industry (*e.g.*, Amex and merchants), and horizontal agreements are between firms that compete against each other (*e.g.*, MasterCard and Visa). *See Anderson News, LLC v. Am. Media, Inc.*, 680 F.3d 162, 182 (2d Cir. 2012).

purpose of the antitrust laws is to protect interbrand competition" between sellers of different brands of goods (*e.g.*, the competition between the Ralph Lauren and Calvin Klein brands of shirts). *See State Oil Co. v. Khan*, 522 U.S. 3, 15 (1997). Amex's Anti-Steering Rules obstruct interbrand competition among Amex, MasterCard, Visa, and Discover to attract more merchant business, and so Amex cannot find refuge in cases allowing firms to impose vertical restraints that increase interbrand competition and suppress only intrabrand competition. *See Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 890-92 (2007) (explaining ways that some vertical restraints "can stimulate interbrand competition . . . by reducing intrabrand competition"); *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54-55 (1977) (recognizing that some "[v]ertical restrictions promote interbrand competition").

Although Amex also may try to analogize its Anti-Steering Rules to most-favored-nation clauses used by other businesses, analogies cannot substitute for competitive analysis. Most-favored-nation clauses can be "standard devices by which buyers try to bargain for low prices, by getting the seller to agree to treat them as favorably as any of their other customers." *Blue Cross & Blue Shield United of Wisc. v. Marshfield Clinic*, 65 F.3d 1406, 1415 (7th Cir. 1995). But they also can be misused in ways that harm competition and consumers.[95] Whether any particular type of most-favored-nation clause violates the Sherman Act requires case-by-case analysis, and this case will assess the legality of only Amex's Anti-Steering Rules. Because no other contractual provisions are at issue, Amex's references to most-favored-nation clauses elsewhere in the economy seek to distract from the real issue: how its Rules suppress competition among card networks.

[95] *See United States v. Delta Dental of R.I.*, 943 F. Supp. 172, 192 (D.R.I. 1996) (denying motion to dismiss Section 1 claim alleging that most-favored-nation clause had "sustained or increased consumer prices for dental services by preventing participating . . . dentists from discounting fees").

C. Some Small Merchants Do Not Accept Amex Cards Because Amex Chooses To Charge High Prices and To Insist on Other Unattractive Terms.

Amex often cites the fact that some merchants do not accept Amex cards as evidence that it lacks market power. That argument is deeply flawed.

First, because most merchants that do not accept Amex cards are very small, focusing on the number of merchants that do not accept Amex obscures how much credit-card commerce flows through merchants bound by the Anti-Steering Rules. A presentation to Amex's Board of Directors explained that 75% of merchants that accept some credit cards, but not Amex cards, are smaller than "your local florist."[96] By contrast, among the 100 largest U.S. retailers in 2010, 98 take credit cards, and all 98 of those take Amex.[97] Because small merchants account for so little business, Amex teaches its new employees that a "simple comparison" between the number of merchants that accept Amex cards and the number of merchants that accept other networks' cards is "not meaningful" and that Amex instead "focuses on Spend Coverage as a reliable measure of determining [merchant] acceptance."[98] Amex reports to investors that its Spend Coverage is higher than 90%,[99] and its internal documents show that Spend Coverage is 94%.[100]

Second, card networks' own decisions affect how many merchants accept their cards, and Amex has chosen a path that does not appeal to some small merchants. In the past, both Amex

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[96] PX0890, at 40-41 (AMEXNDR12025313-398, at 353-354).

[97] *See supra* note 36.

[98] PX0016, at 11 (AMEXNDR07604880-957, at 890). Amex describes Spend Coverage as an estimated percentage of Amex cardholders' GPCC card purchases that they can make at merchants that accept Amex cards. *See id.* at 6 (AMEXNDR07604880-957, at 885).

[99] *See* PX1411, at 7 (American Express Co., Annual Report (Form 10-K), Feb. 21, 2013) ("We estimate that, as of the end of 2012, our merchant network in the United States accommodated more than 90% of our Cardmembers' general-purpose card spending.").

[100] *See supra* note 2.

and Discover were accepted by fewer merchants than MasterCard and Visa. Discover partnered with acquirers – companies that arrange for merchants to accept credit cards – to expand its merchant network, and it is accepted today by nearly as many merchants as MasterCard and Visa. By contrast, Amex has resisted working as extensively with acquirers, which has made Amex less convenient than other networks for merchants to deal with.

Third, Amex has made the strategic decision to charge merchants high prices, knowing that such prices cause some merchants not to accept its cards. That is the sort of behavior in which firms with market power engage. *Cf. Port Dock & Stone Corp. v. Oldcastle Northeast, Inc.*, 507 F.3d 117, 123 (2d Cir. 2007) (recognizing that the "danger to customers from monopolization . . . is the danger that the monopolist will raise prices and restrict output"). Accordingly, the fact that some merchants do not accept Amex actually tends to undermine Amex's – and support Plaintiffs' – arguments about Amex's market power.

Fourth, Amex ignores how its high fees combined with its Anti-Steering Rules discourage merchants from accepting its cards. Because of the Anti-Steering Rules, merchants today face the all-or-nothing choice of either accepting Amex cards whenever customers try to use them or refusing them at all times. Without the Anti-Steering Rules, however, merchants would have greater control over how much of their business flows through the Amex network. That increased freedom would make acceptance more attractive to merchants, so more small merchants would tend to accept Amex cards.

D. Amex Rarely Negotiates the Anti-Steering Rules or Its Discount Rate.

Amex also wrongly contends that it cannot have market power because it negotiates with merchants. That argument proceeds from the mistaken assumption that firms with market power always dictate their terms when, in fact, even monopolists negotiate. For example, the D.C. Circuit affirmed that Microsoft had monopoly power, *see United States v. Microsoft Corp.*, 253

F.3d 34, 51-56 (D.C. Cir. 2001), but some of the "prices that [Microsoft's] customers paid were negotiated and, as a consequence, were both discounted and unique to each transaction," *Deiter v. Microsoft Corp.*, 436 F.3d 461, 468 (4th Cir. 2006).[101] Similarly, a group of related alarm companies was found to have monopolized its industry, despite evidence that the companies did "not have unfettered power to control the price of their services" and had "not always been able to receive the standard they [had] set for themselves, the so-called 'Minimum Basic Rates', . . . or annual service charges." *See United States v. Grinnell Corp.*, 236 F. Supp. 244, 254, 257 (D.R.I. 1964), *aff'd in relevant part*, 384 U.S. 563, 576 (1966) (concluding that defendant had "perfected the monopoly power to exclude competitors and fix prices").

Despite emphasizing the frequency of its negotiations, Amex actually negotiates with only its largest merchants. More than 99.9% of Amex's merchant contracts contain entirely standard language (including standard Anti-Steering Rules) that Amex makes non-negotiable. And the few merchants with which Amex does negotiate report that Amex refuses to remove the Anti-Steering Rules from their contracts. Major merchants [redacted] and [redacted] all tried to negotiate the elimination or modification of these Rules, but Amex would not budge. Although Amex has identified about 150 of its 3.4 million merchants who have negotiated partial exceptions to the Anti-Steering Rules, the vast majority of those exceptions either (a) authorize steering only to the merchant's own card (*i.e.*, co-brand or private-label card) in the merchant's own store (and still restrict competition from most GPCC cards); or (b) allow only limited-term promotions of GPCC cards, often with

[101] For example, Microsoft offered concessions to IBM in negotiating their Windows 95 deal, and that deal was not finalized until about 15 minutes before the public launch of Windows 95. *See United States v. Microsoft Corp.*, 84 F. Supp. 2d 9, 40-41 (D.D.C. 1999) (findings 124 and 125).

significant strings attached.[102] And a restraint need not eliminate all competition for it to violate the Sherman Act.[103]

Similarly, the few merchants with which Amex discusses contractual terms often find Amex unwilling to negotiate its discount rate. And even when Amex makes a financial concession, the merchant rarely receives much benefit. For example, during 2009 contract negotiations with [redacted] Amex tried to raise [redacted] discount rate from [redacted]% to [redacted]%. When [redacted] resisted, Amex agreed that [redacted] would pay [redacted]% in the first year of the new contract and [redacted]% for at least the next four years. But that sort of "concession" does not suggest that Amex lacks market power. Amex still raised [redacted] discount rate, and [redacted] still ended up paying significantly more to accept Amex ([redacted]% on average) than to accept Visa and MasterCard ([redacted]%), even though Amex concedes that Visa has market power.[104]

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[102] *See* PX2484, corrected app. 3.

[103] *See Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 649 (1980) (agreement on credit terms was per se unlawful, even though conspirators continued to compete on prices, because agreement "extinguish[ed] one form of competition among the sellers"); *Paramount Famous Lasky Corp. v. United States*, 282 U.S. 30, 44 (1930) (holding that agreement among competitors to arbitrate disputes was illegal, even though other competition among them was not restrained, because "to establish violation of the Sherman Anti-Trust Act, it is not necessary to show that the challenged arrangement suppresses all competition between the parties").

[104] In the first year of the contract, Amex also gave [redacted] $[redacted] in cash and $[redacted] to use exclusively on marketing programs jointly promoting both Amex and [redacted] PX1618, at 2 (AMEXNDR00010731-797, at 733). Beginning in the second year, [redacted] had the option of either using $[redacted] a year on joint marketing programs or receiving $[redacted] in cash. These funds amounted to slightly higher than [redacted] percent of the discount fees that [redacted] pays to Amex, and [redacted] did not consider them to offset the increase in the discount rate because its previous Amex contract also provided marketing funds.

E. Standard Antitrust Principles Apply to Firms Like Amex that Operate Two-Sided Platforms.

Amex tries to muddy the waters by drawing on recent economic literature on "two-sided platforms."[105] Economists use that phrase to describe firms that sell two distinct products to two distinct groups of buyers if the buyers of the first product find that product more attractive when there are more buyers for the second product (and vice versa). GPCC card networks operate two-sided platforms because (all else equal) merchants find a network more attractive when more people carry its cards, and cardholders find a network more attractive when more merchants accept its cards.

Merchants and cardholders pay separate prices. Merchants pay per-transaction fees (the discount rate) and other fees. Cardholders pay annual fees, interest, and other charges (*e.g.*, currency conversion fees), offset to some extent by rewards points and other benefits that cardholders may receive. In addition to these real-world prices, some economists construct a hypothetical price that the platform does not actually charge and that its customers do not actually pay. They call that price the platform's two-sided "price level" or "net price" and calculate it by combining the separate prices paid by the customers on each side of the platform (here, merchants and cardholders). Economists refer to the manner in which the platform

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[105] Economists sometimes refer to two-sided platforms as "two-sided markets," but the phrase "two-sided platform" more accurately conveys the idea that such a platform links together two separate antitrust markets. Indeed, one of Amex's economists has described "markets with two-sided platforms" as a "more informative description" than "two-sided markets." *See* PX2153 (Janusz A. Ordover, *Comments on Evans & Schmalensee's "The Industrial Organization of Markets with Two-Sided Platforms"*, Competition Pol'y Int'l, Spring 2007, at 181, 181). Similarly, Amex's other expert economists distinguish between two-sided platforms and antitrust markets. *See* DX6470 (Gilbert I) ¶ 44 (explaining that "[p]ayment card networks are *two-sided platforms*"); DX6463 (Bernheim I) ¶16 n.2 (explaining that the "term 'two-sided market' is used in the economics literature and is not related to the notion of antitrust markets").

allocates price between the different customers on each of its sides as the platform's "price structure."

Two-sidedness is a relevant market fact, and Professor Katz has explained that Amex operates a two-sided platform. Indeed, Professor Katz incorporated two-sided considerations throughout his economic analysis and concluded that Amex's Anti-Steering Rules harm competition. Amex contends that Professor Katz's conclusion lacks adequate support because he did not calculate and analyze what Amex considers the appropriate hypothetical two-sided price level. Amex insists that Plaintiffs cannot prevail without such proof. That position is seriously mistaken.

To begin with, Plaintiffs will demonstrate that the Rules interfere with the competition among card networks that would otherwise tend to discipline the prices they charge merchants. *See supra* Part I. As a matter of law, that proof is sufficient to justify relief. Plaintiffs need not also demonstrate an effect on Amex's two-sided price level, or any other price. *See FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 461-62 (1986) (holding that defendant's rule was "likely enough to disrupt the proper functioning of the price-setting mechanism of the market that it may be condemned even absent proof that it resulted in higher prices").

Moreover, antitrust courts have analyzed two-sided industries for decades, yet never required evidence on two-sided price levels. For example, economists point to newspapers as a classic example of a two-sided industry, and the Supreme Court also has recognized that "every newspaper is a dual trader in separate though interdependent markets" for advertisers and for readers. *See Times-Picayune Publ'g Co. v. United States,* 345 U.S. 594, 610 (1953). But the Court focused its analysis in that case on "solely one of these markets . . . the advertising market, not . . . readership," and did not examine two-sided price levels. *Id.* In *Visa,* the Second Circuit acknowledged that credit card networks separately compete both for issuing "banks' business" and "for merchants," but it concentrated on how, "[a]s a result . . . of the challenged policies, only two rival networks are effectively able to compete for the business of issuer banks," without discussing effects on competition for merchants. *Visa*, 344 F.3d at 239-40.[106] Plaintiffs know of no case that has even mentioned evidence of a two-sided price level, much less required an antitrust plaintiff to supply such evidence.

Amex's two-sided, price-level calculation also suffers from at least two inherent conceptual flaws. First, Amex's calculation considers only prices paid by merchants and Amex cardholders, and it ignores how Amex's Anti-Steering Rules affect other customers of merchants. By protecting Amex from price competition, the Rules inflate merchants' costs and thus cause merchants to charge higher prices to all customers, including those who use other credit cards, debit cards, checks or cash. *See* 2B Areeda & Hovenkamp ¶ 562b, at 377 (explaining that, in *Visa*, "part of the price of card services was reflected in higher prices charged by merchants who accepted the cards, and these higher prices had to be charged indiscriminately to all purchasers").

Second, Amex's calculation uses low cardholder prices to offset high merchant prices and thus presumes that restrictions on competition for merchant business can be excused if the ill-gotten profits are deployed to compete more vigorously for cardholders.[107] The Supreme

[106] *See also Realcomp II, Ltd. v. FTC*, 635 F.3d 815, 829 (6th Cir. 2011) (explaining that the "value . . . to home sellers" of including their home on a website displaying real estate listings "increases with the number of home buyers . . . using the site"); *United States v. Microsoft Corp.*, 253 F.3d 34, 55 (D.C. Cir. 2001) (noting that "most consumers prefer operating systems for which a large number of applications have already been written [and] most developers prefer to write for operating systems that already have a substantial consumer base").

[107] In other words, Amex focuses exclusively on the two-sided price level and fails to consider the significance of price structure.

Court has explained, however, that "the freedom to compete . . . cannot be foreclosed with respect to one sector of the economy because certain private citizens or groups believe that such foreclosure might promote greater competition in a more important sector of the economy." *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972); *see also United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 370 (1963) (rejecting argument that "anticompetitive effects in one market could be justified by procompetitive consequences in another").[108]

Even if Amex's two-sided price level were relevant to the legal analysis of Amex's Anti-Steering Rules, it would be Amex's – not Plaintiffs' – burden to make the required showing on the two-sided price. In the first step of the rule of reason, a plaintiff must show only that "the defendants' challenged behavior had an *actual* adverse effect on competition as a whole *in the relevant market*." *Geneva Pharms.*, 386 F.3d at 506-07 (second emphasis added, internal quotation marks omitted). Here, the relevant markets are where GPCC card networks compete to sell services to *merchants, see supra* Parts II.A, II.C.1,[109] and Plaintiffs will demonstrate that the Anti-Steering Rules harm competition in those markets, *see supra* Part I. By insisting that Plaintiffs also must offer evidence of effects on its two-sided price level, Amex seeks to impose

[108] Even if Amex's two-sided price level calculation were an appropriate tool for antitrust analysis, Amex could not prove that cardholders benefit enough to outweigh how its Anti-Steering Rules harm merchants because Amex does not spend every dollar that it extracts from merchants on cardholder benefits. Amex's Chief Financial Officer has admitted that Amex is "able to get a premium pric[e] with merchants" and "take[s] that premium pricing, and part of it we drop to the bottom line, but part of it we invest in better value propositions for" cardholders. PX1475, at 2 (William Blair Growth Stock Conference, June 12, 2013). Amex's own profits cannot be used to offset harms to merchants. *See Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 116 (1986) (explaining that it would be a "perverse result" to "hold that the antitrust laws protect competitors from the loss of profits due to . . . price competition"); *Drug Mart Pharm. Corp. v. Am. Home Prods. Corp.*, 472 F. Supp. 2d 385, 402 (E.D.N.Y. 2007) ("[T]he antitrust laws are not intended to protect profit margins but consumer welfare.") (internal quotation marks omitted).

[109] *See also Amex*, 2014 WL 1817427, at *2 ("This case concerns one side of [the] market: card acceptance by merchants.").

on Plaintiffs the additional burden of proving how the Rules affect competition for *cardholders*. But if alleged pro-competitive benefits on the cardholder market were to be considered, they should be considered along with any other allegedly pro-competitive benefits of the Anti-Steering Rules – in the second step of the rule of reason, where Amex bears the burden of proof. *See supra* Part III.

Amex could not meet that burden. Professor Katz identified serious flaws in how Professor Bernheim calculated Amex's two-sided price level, such as the failure to make appropriate adjustments for changes in Amex's accounting practices, improper inclusion of amounts paid to Amex's co-brand partners, failure to account for changes in Amex's merchant mix, and use of an invalid measure of cardholder rewards.[110]

[110] *See* PX1589 (Katz III) ¶¶ 443-47, 452-55; PX1584 (Katz IV) ¶¶ 10-12.

Conclusion

Amex's Anti-Steering Rules impede the competitive process and lack redeeming pro-competitive effects. Accordingly, the Court should find that Amex has violated Section 1 of the Sherman Act by adopting and enforcing the Rules.

Dated: June 20, 2014

Respectfully submitted,

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