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'Hipster' Antitrust Meets Two-Sided Markets

Multi-Sided Markets

The debate should not be about whether two-sided markets deserve a ''special'' analysis, economist George S. Ford writes. What should be debated is whether two-sided markets can receive an *accurate* economic analysis — particularly in the digital age.

BY GEORGE S. FORD

Internet access has changed many things about our lives and our economy, including the increased importance of what economists describe as ''two-sided'' markets. Unlike traditional ''one sided'' markets involving a single product exchanged directly between buyers and sellers, a two-sided market occurs when a firm acts as an intermediary ''platform'' between buyers and sellers. A flea market is a two-sided market, for instance, where the location serves as a platform on which buyers and sellers meet. Amazon.com Inc. and eBay Inc. also serve as platforms, conveniently linking buyers and sellers at a centralized location. And, in turn, internet service providers such as AT&T Corp. and Comcast Corp. offer a platform that links users and content providers.

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As both sides of the market benefit from the relationship, the platform may choose to allocate the total price for its intermediary service between the two sides of the market. These allocated prices need not be equal for both sides, and the conditions may warrant a positive charge only to one side of the market, or even a negative charge to one side of the market. The possibilities are endless, and so in two-sided markets, simplistic ideas about prices being related to costs are thrown out the window.

To understand the economics of a two-sided market, consider a prototypical example used by economists: the modern business plan of a ''gentleman's club.'' The club offers a platform on which dancers and patrons meet. Dancers pay a ''house fee'' to the club for the right to dance and earn tips, and the patrons pay a ''cover charge'' to the club for the right to enter the facility to observe the dancing. Charge the dancers too much and the talent goes elsewhere, reducing the interests of patrons. Charge the patrons too much then the tips are insufficient to attract the talent. Thus, a key feature of a two-sided market is that the prices charged to each side of the platform are related — if price goes up on one side of the market, then price on the other side correspondingly goes down. Success or failure of a plat-

form may hinge critically on the way prices are balanced across the two sides of the market.

Antitrust and Two-Sided Markets

Although economists have been writing about two-sided markets for decades and the concept is merely an extension of an older idea of ''network effects,'' how antitrust law should handle two-sided markets remains a relatively new issue for the courts. With the prices on each side of the market potentially detached from costs, the one-sided market mindset that dominates antitrust thinking becomes nearly useless. Yet, courts and those that operate in them move deliberately. Baby steps are expected as the concepts of two-sided markets enter antitrust litigation, but progress is being observed.

Take, for instance, the case of *U.S. v. American Express*, 838 F.3rd 179 (2d Cir. 2016), which involves the terms and conditions of credit-card use by consumers and vendors. Credit cards operate in a two-sided market, and considerable research has focused on the properties of credit-card markets. For consumers, the value of a credit card depends primarily on where it can be used. For stores, the value of a credit card depends on how many customers use it. American Express Co., among others, acts as a ''platform'' between the two, levying prices on both sides of the market. Consumers pay interest on debt and sometimes receive ''rewards'' such as airline miles (a negative price), while stores pay a service fee when a customer uses her card (which helps fund any negative price on the consumer side). But if Amex raises merchant fees ''too high,'' merchants will defect from the network. In turn, if fewer merchants accept Amex, that reduces the value of the card to consumers.

What raised the Justice Department's ire in *U.S. v. American Express* was Amex's decision to strengthen contractual restraints designed to control how merchants treat Amex cardholders at the point of sale. These restraints, known as non-discrimination provisions (NDPs) were designed to ensure that merchants could not state a preference for any payment card network (e.g., Mastercard or Visa) other than Amex. Historically, Amex has charged higher merchant fees than its rivals, motivating such provisions.

Despite the well-established two-sided nature of the market, the DOJ's litigation strategy was to define the relevant market for antitrust analysis as the market for network services (i.e., only the merchant-side, upstream part of the market). So, a threshold question at bar in this case was whether the alleged anticompetitive conduct can be limited to just one side of the market, or must plaintiffs demonstrate that the alleged offending conduct affects both sides of the market? The economic literature, and common sense, dictates that we should look at the latter, though the DOJ placed its bet on the former.

The DOJ bet wrong.

According to the Second Circuit, ''[s]eparating the two markets here — analyzing the effect of Amex's vertical restraints on the market for network services while ignoring their effect on the market for general purpose cards — ignores the two markets' interdependence. Separating the two markets allows legitimate competitive activities in the market for general purposes to be penalized no matter how output-expanding such activities may be.'' In fact, the court took great pains to point out that the two-sided platform at issue in this case is a single firm operating within the broader ''network services'' credit-card industry.

As the court explained, the ''relationship between the two consumer sides of a platform that provide network services is not the same as the relationship between the various platforms competing with one another within the [credit-card platform] industry.'' Stated another way, the court found that the vertical restraints in this case ''are agreements between Amex and its merchants, not agreements between competing payment-card networks.'' Thus, the court reasoned, because the NDPs at issue affected competition for cardholders as well as for merchants, plaintiffs had the ''burden to show that the NDPs made *all* Amex customers on both sides of the platform — i.e., both merchants and creditors — worse overall.'' (Emphasis in original.)

U.S. v. American Express will prove an important case for antitrust litigation. From a theoretical perspective, the Second Circuit's decision appears to be the correct one — competitive (or anticompetitive) activity by platforms in two-sided markets must be analyzed using the tools of two-sided markets. The DOJ erred in its litigation strategy, choosing to analyze the market in a way the market did not operate.

Attack of the Antitrust 'Hipsters'

Given the importance of this case, *Amex* is on *certiorari* at the U.S. Supreme Court in *Ohio v. American Express*, and the court recently heard oral arguments in the case. While it is impossible to predict with any certainty how the court will ultimately rule, there are some who claim that if the court upholds the Second Circuit, gloom and doom will befall our economy.

Take, for example, a recent op-ed by Lina Khan of the Open Markets Institute in The New York Times. Khan, a recent law school graduate, has been at the forefront of what former Federal Trade Commission Commissioner Joshua Wright coined ''hipster'' antitrust, a growing populist movement that views antitrust as the panacea for the world's ills. Given this bias, ''hipster'' antitrust essentially seeks to do away with the consumer welfare standard (the *raison d'être* of antitrust) and use the cudgels of the Sherman Act, Clayton Act, and FTC Act to remedy unemployment, income disparity, unequal wealth accumulation, and even political power by applying an extreme bias against American businesses — economics be damned. Because ''hipster'' antitrust offers no theoretical foundation for its prescriptions, nor any replacement for the consumer welfare standard (which is merely the sum of all benefits to the economy), nothing is lost by simply labeling ''hipster'' antitrust as a ''big is bad'' standard, harking back to the antitrust practices in force long before economic reasoning mercifully dismantled such simplistic thinking.

Consistent with this world view, Khan submits that if the court upholds the Second Circuit, then ''the most powerful companies in the economy'' — naming Alphabet Inc. (Google's parent company), Amazon.com Inc., Apple Inc., Facebook Inc., and Uber Technologies Inc. in particular — would be granted ''de facto antitrust immunity,'' and would therefore be allowed to engage in ''anticompetitive activity with one set of users, so long as they can plausibly claim that the harmful conduct enabled them to benefit another group.''

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To support her broad legal generalization, Khan resorts both to the ad hominem and the inapposite.

First, the ad hominem: The theory of two-sided markets is nothing more than a ''slipper[y]'' concept ginned up by ''reports paid for by the credit card industry,'' according to Khan. Apparently, she is unaware of the vast economic literature on the topic of two-sided markets, including papers by Nobel laureate Jean Tirole. The Social Science Research Network, for instance, lists 673 papers on two-sided markets dating back nearly two decades. Perhaps the seminal article on antitrust and two-sided markets by David Evans was released in 2002 and published a year later. Moreover, two-sided market theory is merely an extension of the concept of ''network effects,'' an idea that can be traced at least back to an economics paper from 1974. Rich economics literature exists on both network effects and its two-sided market offspring, and nearly all of this research has nothing to do with litigation in the credit-card industry. In fact, the idea was primarily developed for the analysis of communications networks (e.g., telephones and fax machines) and later for computer hardware and software. The analysis of two-sided markets is as legitimate as it comes; it is a well-developed field in economics that is advancing quickly.

Second, the inapposite: According to Khan, ''markets serving different groups of users have been around for centuries'' and, therefore, require no ''special analysis.'' Nothing could be further from the truth. Two-sided markets are special and thus require special analysis. Under Khan's view, there would be no reason to add Einstein's work to Newton's because the planets have circled the sun for billions of years. Or, courts should ignore DNA evidence because murderers were successfully convicted long before its development. Humans have engaged in trade since prehistoric times, but economic science as we know it today was developed only in the early 19th century by a few French engineers such as the great Jules Dupuit. The economic theories Khan embraces, to the extent there are any, were most plausibly crafted by Antoine Augustin Cournot in 1838 and Joe Bain in 1956 (although, to be fair, some apologies are due here to Cournot and Bain). As with all sciences, economics is on a never-ending journey to better explain how exchange happens in the real world.

Khan's claim that the Second Circuit's logic grants ''de facto'' antitrust immunity to platforms in two-sided markets is likewise fallacious. As a simple reading of the Second Circuit's decision reveals, the court expressly pointed out that there were several ways that the Justice Department could have met its burden to show that Amex's behavior caused anticompetitive harm, but it failed to do so. For example, the court noted that the DOJ might have met the obligation by showing either that cardholders engaged in fewer credit-card transactions (*i.e.*, reduced output), that card services were worse than they might otherwise have been (*i.e.*, decreased quality), or that Amex's pricing was set above competitive levels within the credit-card industry (*i.e.*, supracompetitive pricing). The DOJ's problem was not ''de facto'' legal immunity; the DOJ's problem was that it failed to offer convincing proof at trial. Put simply, the DOJ ignored the economic realities of the credit-card market, and that was a fatal mistake.

Despite Khan's claims, the debate should not be about whether two-sided markets deserve a ''special'' analysis. They do. They are special. What should be debated is whether two-sided markets can receive an *accurate* economic analysis — particularly in the digital age. As acting FTC Chair Maureen Ohlhausen astutely observed, ''Antitrust law has changed as our understanding of market dynamics has gotten more sophisticated, and it should continue to evolve as we refine our predictive tools. If those tools suggest that competition will be harmed and consumers made worse off from the behavior of any firm, even a platform, antitrust enforcers should act.''

And an affirmative ruling by the Supreme Court in *Ohio v. American Express* certainly will do nothing to impede enforcement if warranted. An affirmative ruling in *Ohio v. American Express* will drag the antitrust authorities — perhaps kicking and screaming — into the modern age of economic thinking on two-sided markets.

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