UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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IN RE: AMERICAN EXPRESS ANTI-STEERING RULES ANTITRUST LITIGATION (II)

This Document Relates To:
CONSOLIDATED CLASS ACTION

11-MD-02221 (NGG) (RER)
ECF Case

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THE MARCUS CORPORATION,
on behalf of itself and all similarly situated persons,

13-CV-07355 (NGG) (RER)

Plaintiff,

– against –

AMERICAN EXPRESS COMPANY, et al.,

Defendants.

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REDACTED – PUBLIC VERSION

SUPPLEMENTAL MEMORANDUM OF AMERICAN EXPRESS IN SUPPORT OF FINAL APPROVAL

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June 1, 2015

Introduction

The American Express Defendants ("Amex") submit this memorandum in response to the Court's April 30, 2015, request for submissions regarding how, if at all, the Court's review of the class settlement agreement in these cases (the "Agreement") is affected by either (i) the Court's Decision / Findings of Fact and Conclusions of Law and Permanent Injunction (collectively, the "DOJ Decision") in United States v. American Express (the "DOJ Action"), or (ii) the documents and communications disclosed in the so-called "Friedman Materials."[1] (See Order re: Motion for Final Approval of Class Settlement, dated April 30, 2015.)

Amex respectfully submits that neither the DOJ Decision nor Mr. Friedman's conduct changes the fact that the Agreement should be approved as a fair, reasonable, and adequate settlement for all the reasons previously shown. The Agreement is a valuable compromise that would give the Class the benefit of immediate and certain changes to Amex's nondiscrimination provisions ("NDPs") while appropriately taking account of the substantial risk that the Class would face in trying to pursue injunctive relief that goes beyond what the Government Plaintiffs were prepared to seek in their parallel litigation.

As for the Friedman Materials, these communications show extremely poor judgment by Mr. Friedman and reveal sanctionable violations of the protective orders issued in these cases (violations that will be the subject of separate motion practice in the near future). However, at a recent conference before Judge Orenstein in MDL 1720, none of the objectors identified evidence of disloyalty by Mr. Friedman to merchant class members among the thousands of pages of materials they had seen. Moreover, while Mr. Friedman was very much involved in the negotiation of the Agreement, so too were other Class Counsel. Those negotiations were

[1] Specifically, the Friedman Materials are the materials produced pursuant to stipulations and orders reflected in Docket Entries 557, 561, 562, and 565.

facilitated by a respected, experienced mediator who confirmed the integrity of the settlement process. Regardless of Mr. Friedman's conduct, there has been no suggestion made that the loyalties of other Class Counsel—who had independent legal and fiduciary duties to the class members—were at all compromised by Mr. Friedman's conduct.

I. The DOJ Decision Does Not Call Into Question the Fairness of the Class Settlement.

The Agreement will require Amex to adopt rule changes that provide Class members—for the first time—with the ability to surcharge credit transactions without also requiring them to surcharge debit transactions. (Agreement, Dkt. No. 306-2, ¶ 8(e).) These rules changes will have the effect of resolving concerns raised by some merchants—the so-called "American Express problem"—by "unlocking" merchants' rights under the MDL 1720 settlement to steer to debit through parity surcharging of credit cards. (Amex. Mem. in Supp. of Final Approval, dated July 11, 2014, Dkt. No. 508, at 8-9.) Today, Visa and MasterCard have left unaltered their absolute prohibition of any surcharging of debit cards, while Amex's longstanding NDPs permit such surcharging only on a parity basis across all debit and credit cards. (Id.) Some merchants have argued that the interaction of these rules means that merchants that accept both Amex credit and charge cards and Visa and MasterCard debit cards (the majority of merchants) are effectively prevented from surcharging or viably threatening to surcharge credit and charge cards. Indeed, a number of merchants that have objected to the Agreement here complained in MDL 1720 that as Amex-accepting merchants they were blocked from the benefits of the MDL 1720 settlement because Amex's NDPs coupled with Visa and MasterCard's prohibitions on surcharging debit card transactions meant they could not implement any surcharges on credit cards. (Id.)

If approved, the Agreement squarely addresses this concern. It does so by providing for changes to Amex's NDPs that would take effect immediately and without the uncertainty of

years-long trial and appeal processes. By contrast, even assuming merchants were to win at trial, it could take many years for them to achieve in the courts final, certain (*i.e.*, unappealable) relief with respect to surcharging.

In their respective prior submissions, Amex and Class Counsel showed that these considerations support approval of the Agreement under Rule 23 as a hard-fought compromise that is both procedurally and substantively fair. The decision in the DOJ Action does not show otherwise.

First, certain merchants have objected to the Agreement on the ground that they are less interested in surcharging as opposed to other kinds of steering, such as discounting. (See, e.g., Home Depot Obj., Dkt. No. 410, at 6-7; IKEA US Obj., Dkt. No. 430-24, at 4-7.) But the expanded relief these objectors seek is covered by the Permanent Injunction in the DOJ Action. If the Permanent Injunction is upheld on appeal, merchants will gain the rights they say they want. (See Agreement ¶ 35.) And, if the Permanent Injunction does not survive appeal, it will confirm that these merchants seek relief to which they are not entitled under the antitrust laws. Either way, there is no merit to the objection that the Agreement does not include relief that, to the extent it is actually warranted, merchants will separately obtain through the DOJ Action.

Second, the Court's willingness to grant the Government relief regarding certain provisions of the NDPs does not mean that the Class is entitled to rule changes under the Agreement with respect to different provisions that prohibit other kinds of steering. The compromise reflected in the Agreement is that merchants will gain the right to engage in parity surcharging of credit cards versus debit cards, but Amex will still be permitted to prohibit differential surcharging of credit cards. As the Court has noted, the prohibitions on such differential surcharging are provisions of the NDPs that were not at issue in the DOJ Action

because DOJ decided not to challenge them. (DOJ Decision at 26 ("the Government is expressly not seeking to allow merchants to differentially surcharge American Express cards vis-à-vis its competitors' cards (i.e., charge a premium to consumers for using an Amex card), though such steering is at issue in the multi-district litigation action against American Express that is also before this court").)

Moreover, Amex has well-founded arguments that, whatever the case may be about the NDPs generally, the provisions regarding surcharging in particular will be found lawful when the issue is litigated. As set forth in Amex's pending summary judgment papers in the Individual Merchant Plaintiffs' action, the only Courts of Appeals to consider contractual no-surcharge provisions have concluded that they do not result in antitrust injury or unreasonably restrain trade. (See, e.g., *Tennessean Truckstop, Inc. v. NTS, Inc.*, 875 F.2d 86, 90 (6th Cir. 1989); *Kartell v. Blue Shield of Mass., Inc.*, 749 F.2d 922, 925, 931 (1st Cir. 1984); *see also* Mem. of Law in Supp. of Defs.' Mt. for Partial Summ. J., dated Sept. 26, 2013, Dkt. No. 277-1, at 20-25.) And, even were the Court to find a triable issue of fact on this question, at trial, Amex will have strong arguments that consumer welfare is furthered by contractual provisions protecting Amex cardmembers from being charged higher prices than from efforts to use surcharging to influence customers' choice of payment cards. Indeed, a premise of the DOJ Decision was that the Court's ruling would result in consumer benefit through lower prices resulting from reduced payment acceptance costs and/or direct discounts. However, the direct impact of surcharging would be increased prices to consumers. Full consideration of whether that may or may not ultimately lead to a second order effect of reduced payment costs for merchants that might then get passed in some form to customers to outweigh the direct impact will require vastly different competitive effects analyses in any merchant trial.

In short, even if the DOJ Decision were to be upheld on appeal and the Class is able to benefit from the Court's findings on market definition and market power, the core of what the Class seeks goes beyond what the Government Plaintiffs sought to change. And in seeking changes to Amex's merchant contract provisions regarding differential surcharging, significant risks remain that the DOJ Decision in no way eliminates. The compromise regarding surcharging rights within the Agreement appropriately reflects these risks and is within the "range of reasonableness" taking into account "the uncertainties of law and fact." *Wal-Mart, Inc. v. Visa U.S.A., Inc.*, 396 F.3d 96, 119 (2d Cir. 2005).

Third, some merchants have objected to the Agreement on the grounds that they do not see value in being able to steer to debit through parity surcharging of credit. (See, e.g., National Retail Federation Obj., Dkt. No. 385, at 8-9; Individual Merchant Plaintiffs Obj., Dkt. No. 399-1, at 11-12.) Professor Hemphill has also raised doubts about the value of parity surcharging, including based on his assumptions about the limited substitutability of credit and debit. (Hemphill Report at 16, 29.) And, while Amex respectfully disagrees, Amex recognizes that the Court's findings regarding debit substitutability are consistent with these assumptions. (DOJ Decision § III(A)(2).) Nevertheless, there can be no question that many merchants do in fact believe that steering from credit to debit is feasible and will have value. The record in the DOJ Action, for example, includes the testimony of Ben Mitchell who explained that the goal of Official Payments was to drive every transaction towards debit and that it had been successful in moving transactions in this way. (Ex. 1, DOJ Action, Tr. 6179:15-6180:14.)[2] Similarly, the Individual Merchant Plaintiffs, in the expert report submitted on their behalf by Professor Vellturo, are unequivocal that "what really matters" in the "but-for" world is for merchants to be

[2] All citations in the form of "Ex. __" refer to the Exhibits to the Declaration of John LaSalle dated June 1, 2015 and filed with this memorandum.

able to "credibly use[] differential pricing of AmEx vis-à-vis debit to shift transaction volumes to this less costly form of payment and drive down AmEx merchant fees." (Ex. 2, Vellturo Sur-Rebuttal Report ¶ 213, at 81.) The Agreement allows for such "differential pricing of AmEx vis-a-vis debit" and, as discussed, thereby addresses the "American Express problem" that objectors in MDL 1720 complained of as an obstacle to implementing surcharging in favor of debit under that settlement. Again, this compromise is well within the bounds of reasonableness that governs this Court's Rule 23 inquiry.

Finally, with respect to procedural fairness, nothing has happened to call into question that—as affirmed by a well-respected and skilled mediator—the Agreement resulted from "hard fought", "arms' length" negotiations. (Decl. of Kenneth R. Feinberg, Dkt. No. 369, ¶ 10.) While the Court subsequently ruled against Amex in the DOJ Decision, Class Counsel had no basis to assume that result, let alone to assume, even now, how all subsequent appeals will be resolved. Class Counsel's settlement negotiations should not be second-guessed by virtue of then unknown, and as yet still unknowable, facts.

II. The Friedman Materials Do Not Affect the Court's Review of the Agreement.

The Friedman Materials reflect communications between Gary Friedman and Keila Ravelo. Ms. Ravelo, who represented MasterCard until her departure from Willkie Farr & Gallagher LLP last fall, was not a party to the Protective Order in these cases. She had no right to receive the Amex confidential information that Amex produced in this matter.[3] In breach of the Protective Orders, Mr. Friedman nonetheless provided Ms. Ravelo with Amex Confidential Information from MDL 2221 and Marcus. The evidence is clear that Mr. Friedman's violation

[3] While Ms. Ravelo was within the scope of the MDL 1720 Protective Order, Amex's third party production in that proceeding was a fraction of its production in this case, and the materials discussed herein were not among the materials that Ms. Ravelo had a right to see.

of the Protective Order was knowing. For example, the documents he forwarded included materials that prominently state, [redacted] They also included [redacted].

The disclosure of such materials to Ms. Ravelo not only reflects poor judgment, it is sanctionable conduct. Amex intends to pursue appropriate sanctions against Mr. Friedman in a separate filing. Mr. Friedman's protective order violations do not, however, justify rejecting the Agreement. Nor is Amex aware of anything else in the Friedman Materials that should affect the Court's Rule 23 analysis.

As an initial matter, while objectors have not as yet had an opportunity to review all of the Friedman Materials because of certain unresolved objections, they have reviewed thousands of pages of such materials and at a recent hearing before Magistrate Judge Orenstein in MDL 1720, objectors were unable to articulate any basis from the documents they have viewed that would support a challenge to the settlement in MDL 1720. (See Ex. 3, Transcript of May 26, 2015, Status Conference in MDL 1720 at 9-12.) And, in contrast to MDL 1720, Ms. Ravelo is not counsel in, and her former client MasterCard is not a party to, this action, making the Friedman Materials even less relevant to the Court's review of the Settlement Agreement here (even as that distinction makes Mr. Friedman's breaches of protective orders in this case more significant).

Moreover, while Mr. Friedman played a leading role in the settlement negotiations in this case, his court-appointed co-counsel Mark Reinhardt participated, as did the Patton Boggs firm. (See, e.g., Feinberg Decl. ¶¶ 4, 8.) There is nothing in the Friedman Materials that

suggests the settlement negotiations between Amex and these other Class Counsel were somehow tainted by Mr. Friedman's inappropriate conduct. They each had their own independent fiduciary duties to the Class. They also each had their own economic incentive to ensure the best settlement possible to maximize their chance of receiving an attractive attorneys' fees award from the Court.

There is no evidence of any inappropriate conduct by Mr. Friedman's co-counsel. Nor—regardless of what Mr. Friedman did—is there any basis to infer that they chose to acquiesce in somehow compromising the Class's interests notwithstanding their clear incentives, and their legal obligation, to do otherwise. The declaration submitted by Ken Feinberg reinforces this point. As mediator, he facilitated and oversaw the entire settlement negotiation process, and nothing in his description of that process supports a claim that Class Counsel failed to advocate vigorously in support of the Class's interests.

In short, Mr. Friedman will need to live with the consequences of his conduct. But there is no basis for the Agreement to become collateral damage under Rule 23. The merits of the Agreement remain the same as before and should be approved for all the reasons that the Court has heard in the prior briefing and argument.

Conclusion

For the reasons stated above and the reasons set forth in Amex's prior submissions and argument, Defendants respectfully requests that the Court grant final approval of the Settlement.

Dated: June 1, 2015
New York, New York

Respectfully submitted,

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