UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

In re AMERICAN EXPRESS ANTI-STEERING RULES ANTITRUST LITIGATION This Document Relates To: ALL CLASS ACTIONS	:	11-md-2221(NGG)(RER)

SUPPLEMENTAL MEMORANDUM OF LAW IN OPPOSITION TO MOTION FOR FINAL APPROVAL OF SETTLEMENT

The 7-Eleven Objectors[1] respectfully submit this supplemental brief in response to the Court's April 30, 2015 Order providing the opportunity to comment on the impact of the Court's February 19, 2015 decision ("Decision") and April 30, 2015 decision and order entering a permanent injunction ("Injunction") in *United States v. American Express Co.*, 10-cv-4496(NGG)(RER), upon the pending motion for final approval of the Proposed Settlement.[2]

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[1] The 7-Eleven Objectors are 7-Eleven, Inc.; Academy, Ltd. d/b/a Academy Sports + Outdoors; Aldo US Inc. d/b/a Aldo and Call It Spring; Amazon.com, Inc.; American Eagle Outfitters, Inc.; Ashley Furniture Industries, Inc.; Barnes & Noble, Inc.; Barnes & Noble College Booksellers, LLC; Beall's, Inc.; Best Buy Stores, L.P.; Boscov's, Inc.; Brookshire Grocery Company; Buc-ee's Ltd.; The Buckle, Inc.; Costco Wholesale Corporation; Euromarket Designs, Inc. d/b/a Crate & Barrel and CB2, Meadowbrook, L.L.C. d/b/a The Land of Nod; Dillard's, Inc.; Drury Hotels Company, LLC; Express, LLC; Foot Locker, Inc.; The Gap Inc.; HMSHost Corporation; IKEA North America Services, LLC; Lowe's Companies, Inc.; Marathon Petroleum Company LP; Martin's Super Markets, Inc.; Michaels Stores, Inc.; Mills Motor, Inc., Mills Auto Enterprises, Inc., Willmar Motors, LLC, Mills Auto Center, Inc., Fleet and Farm of Alexandria, Inc., Fleet Wholesale Supply of Fergus Falls, Inc., Fleet and Farm of Green Bay, Inc., Fleet and Farm of Menomonie, Inc., Mills Fleet Farm, Inc., Fleet and Farm of Manitowoc, Inc., Fleet and Farm of Plymouth, Inc., Fleet and Farm Supply Company of West Bend, Inc., Fleet and Farm of Waupaca, Inc., Mills E-Commerce Enterprises, Inc., Brainerd Lively Auto, LLC; National Association of Convenience Stores (NACS); National Grocers Association (NGA); National Restaurant Association (NRA); Pacific Sunwear of California, Inc.; Panda Restaurant Group, Inc.; Panera, LLC; PetSmart, Inc.; RaceTrac Petroleum, Inc.; Recreational Equipment, Inc. (REI); Republic Services, Inc.; Retail Industry Leaders Association (RILA); Roundy's Supermarkets, Inc.; Sears Holding Corporation; Speedway LLC; Starbucks Corporation; Stein Mart, Inc.; Wal-Mart Stores, Inc.; The Wet Seal, Inc., and YUM! Brands, Inc.

[2] Pursuant to this Court's Order of May 14, 2015, and Judge Orenstein's Order of May 26, 2015, 05-md-1720(MKB)(JO) ECF No. 6484, Objectors intend to make an omnibus motion before

PRELIMINARY STATEMENT

The Proposed Settlement has drawn opposition from a wide swath of the retail economy – from Wal-Mart to Amazon to Starbucks to 7-Eleven to Target to Macy's, to Home Depot and the entire supermarket and drugstore industries. The 7-Eleven Objector group alone includes leading merchants from every merchant sector, plus trade associations such as RILA, NACS, and NGA that in turn represent thousands of merchants. These sophisticated absent class members oppose the mandatory settlement of their claims not only because they were inadequately represented by Class Counsel and a few small merchant representatives, but because the settlement threatens to make matters worse in the highly concentrated payments market by effectively barring differential surcharging across payment card brands. This long-lasting ban – potentially permanent – would at the same time require merchants to release future damages and all manner of injunctive claims against American Express.

As we indicated would be the case at the fairness hearing, a DOJ victory solidifies the already strong conclusion that the settlement should be rejected. *See* 9/17/14 Tr. at 76. The Court's comprehensive decision regarding American Express's non-discrimination provisions ("NDPs") powerfully confirms this conclusion for four distinct, but interrelated, reasons.

First, the Court's ruling that the NDPs impermissibly impede horizontal inter-brand competition "by disrupting the price-setting mechanism ordinarily present in competitive markets," Decision at 98, a fortiori, can and should be applied to restrictions on differential surcharging. In fact, if "differential[] surcharging" is indeed "a particularly strong form of steering," as the Court correctly acknowledged, Decision at 124-25, restrictions on that practice

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Judge Reyes for access to disputed Friedman/Ravelo documents on June 5, and will thereafter make a submission to this Court within 14 days after either receiving the documents or being denied access, concerning the impact of those materials on consideration of the Proposed Settlement.

would cause the same, if not more serious, harm to competition as the NDPs. Yet, the Proposed Settlement threatens to bar differential surcharging – through the implementation of a virtually worthless parity surcharging regime – indefinitely. Such a result cannot be squared with the Court's decision regarding the NDPs, not to mention sound antitrust policy. That this blatantly anticompetitive settlement is being put forward to resolve an antitrust case makes it all the more egregious.

Second, in addition to exposing the anticompetitive nature of parity surcharging, the Court's decision highlights its limited value. Because general purpose credit cards and debit cards are in different markets, the substitution between them that might be generated by parity surcharging of credit cards would be, at best, very small. As a result, the proponents of this settlement cannot justify it by suggesting that its benefits outweigh its obvious anticompetitive effects. In sum, as the Court's decision shows, the Proposed Settlement is likely to provide little to no benefit while harming competition by prohibiting, perhaps forever, "a particularly strong form of steering." Decision at 124-25.

Third, the Court's decision exposes why litigation risk cannot justify the proposed class settlement. While the decision in *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013) ("*Italian Colors*") poses considerable risk to a case seeking class-wide relief against American Express, it has no bearing on the antitrust merits of *individual* merchants' claims against American Express's prohibition of differential surcharging. In fact, as noted above, the Court's decision regarding the NDPs highlights the considerable strength of merchant claims against American Express's prohibition against differential surcharging, particularly since virtually all of the elements of such claims have been preclusively determined against American Express in the government case. The 7-Eleven Objectors are sophisticated merchants who can

bring their own claims against American Express, and they should not be forced into a mandatory class they want no part of. A settlement that bars merchants from challenging this rule, potentially forever, cannot possibly be justified.

Fourth, given the similarity of surcharging and discounting in some instances, a regime of parity surcharging could undermine the efficacy of the Court's remedy that promises to open the door to differential steering with respect to discounting. Parity surcharging could undermine the remedy by confusing merchants as to when they can use differential pricing because the pricing is a discount and when they cannot because the price is a surcharge. That confusion could chill merchant willingness to implement certain forms of differential discounting for fear of violating American Express's parity surcharging rule. While it is impossible to predict how significant that possibility might be as steering evolves going forward, given the settlement's blatant deficiencies and the obvious strength of merchant claims against prohibitions on differential surcharging, we submit that even a small risk that parity surcharging could undermine the Court's remedy should not be tolerated.

For these reasons, and the reasons set forth in our previous submissions, ECF Nos. 430, 524, we respectfully request that the Court deny the motion for final approval.

ARGUMENT

A. The Decision Focuses on the Importance of Differential Pricing, Which the Proposed Settlement Would Bar

The Decision properly concluded that American Express's NDPs blocked horizontal inter-brand competition "by disrupting the price-setting mechanism ordinarily present in competitive markets . . . ." Decision at 98. The Court held that the NDPs "suppress its network competitors' incentive to offer lower prices . . . vitiating an important source of downward pressure on Defendants' merchant pricing, and resulting in higher profit-maximizing prices

across the network services market." Decision at 102. The Court recognized that "[s]teering is a lynchpin to inter-network competition on the basis of price. Without the ability to induce merchants to shift share in response to pricing differentials, a credit card network like Discover cannot increase sales or gain market share by offering merchants a more attractive price than its competitors." Decision at 102. The Court also found that the NDPs imposed higher prices on merchants and consumers, and blocked low-cost business models and other innovations from competitors like Discover. Decision at 4, 98, 107, 111-16.

These conclusions apply with equal force to differential surcharging. As the Court noted, "differential[] surcharging" is "a particularly strong form of steering." Decision at 124-25. It follows that restrictions on differential steering by surcharging cause the same, if not stronger, harm to competition as the NDPs.

Calling the settlement's failure to allow differential surcharging "not perfect," Mem. in Supp. of Final Approval, ECF No. 362 at 3, settlement proponents seek to elide the fact that the settlement not only bars differential surcharging, it imposes a virtually worthless parity surcharging regime – indefinitely. As the Decision consistently observed, the network services market is "highly concentrated and distorted by a history of antitrust violations." Decision at 4. Anti-steering rules such as the NDPs have meant that "each of the credit card networks is largely insulated from the downward pricing pressure ordinarily present in competitive markets." Decision at 102.

A prohibition on differential surcharging cannot be squared with the Court's decision regarding the NDPs, not to mention sound antitrust policy. A settlement that effectively synchronizes the rules of the dominant networks to further diminish interbrand competition should not be permitted, least of all to settle an antitrust case on a mandatory basis.

B. The Court's Market Definition Conclusion Further Weakens the Proposed Settlement

Not only does the Decision exemplify how parity surcharging is anticompetitive, it shows that parity surcharging would have limited value for merchants.

While plaintiffs have pointed repeatedly to the difference between credit card and regulated debit card prices, in practice few merchants will try to use surcharging to steer consumers from credit to debit. As the Court concluded, "product substitution at the point of sale is limited by the core functional differences between debit and GPCC cards," Decision at 56, and "[m]erchants recognize that these qualitative differences influence customer payment behavior, and that the resulting spending patterns limit their ability to switch away from GPCC acceptance." Decision at 58. Moreover, the fact that credit card rates are clustered at high levels is an effect of the market distortions recognized by the Decision – anti-steering rules that insulate all of the dominant networks from price competition have been the norm in the industry for decades.

The proponents cannot justify this settlement by suggesting that its benefits outweigh its obvious anticompetitive effects. As the Court's decision shows, the Proposed Settlement is likely to provide little to no benefit, because credit cards and debit cards are in separate markets. In fact, that credit cards and debit cards are in different markets reinforces the conclusion that the substitution generated by parity surcharging is likely to be very small, if not non-existent. As a result, few merchants are likely to implement the practice and its impact will be de minimus.

Plaintiffs cannot salvage this deficient construct by contending, as they did at the fairness hearing, that parity surcharging will generate network competition to rebate the surcharge on cardholder statements. *See, e.g.*, 9/17/14 Tr. at 18. As an initial matter, such competition would only occur if merchants are likely to implement parity surcharging. Given the limited

substitution between credit and debit, that conclusion is untenable. But more fundamentally, plaintiffs' argument entirely sidesteps the fact that parity surcharging will bar competition through differentiation where it matters most – at the point of sale – where consumer payment patterns are far and away most likely to be influenced by merchant actions. For that reason, American Express's anti-steering rules have always restricted merchants' ability to differentiate at the point of sale. *See* Decision at 23 (noting NDPs were "[f]ormulated to control the manner in which merchants treat Amex cardholders at the point of sale"). As the Decision recognized, "[a]s a number of American Express executives testified, a cardholder's experience at the point of sale when using an Amex card is a critical point of contact between American Express and the cardholder," and "the consumer's decision to pull an American Express card from his wallet at the point of sale represents a critical 'moment of truth' for the company." Decision at 24. For this reason, we are not surprised that American Express is willing to give merchants the entirely useless ability to hang signs in the rafters or in the doorways about rebates on cardholder statements, because the Proposed Settlement gives American Express what it really wants – protection from differential surcharging at the point of sale.

C. The Decision and Injunction Further Strengthen Merchant Claims Against American Express

The Decision – a comprehensive and well-reasoned opinion following a lengthy trial that will be subject to deferential review on appeal – demonstrates why the litigation risk cited by Plaintiffs is misstated. There is little question that the Supreme Court's decision in *Italian Colors* makes class-wide relief difficult if not impossible. But that decision has no bearing on the antitrust merits of *individual* merchant claims that may be brought against American Express. These individual claims may seek to press future damages claims as a result of the liability determined in the Decision, and they may also press injunctive claims against American

Express's prohibition against differential surcharging – both market-wide or as applied to individual merchants.[3]

The Decision regarding the NDPs highlights the considerable strength of such merchant claims against American Express's prohibition against differential surcharging. Indeed, virtually all of the elements of such claims have been determined against American Express in the government case. *See, e.g.*, *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 332-33 (1979); 15 U.S.C. § 16(a) (providing final judgment in a Government case may constitute prima facie proof of a violation in a subsequent treble-damages case). Sophisticated merchants like the 7-Eleven Objectors can bring their own claims against American Express, and should not be forced into a mandatory class. A settlement that bars merchants from challenging the rule against differential surcharging, potentially forever, cannot possibly be justified.

D. Confusion Between Differential Discounting and Parity Surcharging Could Weaken the Injunction

As the 7-Eleven Objectors noted in comments permitted by the Court in the remedy phase in the government case, 10-cv-4496 ECF No. 631, surcharging and discounting can be similar in some instances. Parity surcharging under the settlement would require precisely the same surcharge across all credit and charge cards, whereas at the heart of the Decision and

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[3] If an individual merchant shows that American Express has harmed competition by prohibiting surcharging, the merchant may argue that that relief must "range broadly through practices connected with acts actually found to be illegal," *United States v. U.S. Gypsum Co.*, 340 U.S. 76, 89 (1950), and may "restrain acts which are of the same type or class as unlawful acts which the court has found to have been committed or whose commission in the future, unless enjoined, may fairly be anticipated from the defendant's conduct in the past." *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 132 (1969) (quoting *NLRB v. Express Publ'g Co.*, 312 U.S. 426, 435 (1941)); *see e.g.*, *Cal. v. Am. Stores Co.*, 495 U.S. 271, 281-82 (1990) (noting Section 16 of the Clayton Act "states no restrictions or exceptions to the forms of injunctive relief a private plaintiff may seek, or that a court may order," and finding divestiture remedy available in private action).

Injunction is the goal of allowing differential pricing and other forms of steering across payment networks for the first time.

Parity surcharging imposed by the settlement could therefore undermine the Injunction by confusing merchants as to when they can use differential pricing because the pricing is a discount and when they cannot because the price is a surcharge. *See, e.g.*, *Expressions Hair Design v. Schneiderman*, 975 F. Supp. 2d 430, 436 (S.D.N.Y. 2013) (noting that "[i]n terms of their immediate economic consequences, surcharges and discounts are merely different labels for the same thing – a price difference between" different forms of payment), *appeal pending*, No. 13-4533 (argued Mar. 5, 2015).

Any such confusion could chill merchant willingness to implement certain forms of differential discounting protected by the Injunction for fear of running afoul of American Express's new parity surcharging rule. It is impossible to predict how steering will evolve, especially across new payment technologies. However, any risk of confusion could harm nascent steering efforts as they evolve. Even a small risk of confusion is unacceptable in light of the settlement's blatant deficiencies, weighed against strong merchant claims against differential surcharging. Any risk that parity surcharging could complicate or undermine the Court's remedy should not be tolerated.

CONCLUSION

For the reasons stated above and in the 7-Eleven Objectors' previous submissions, the Court should deny the motion for final approval of the Proposed Settlement.

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