UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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IN RE: AMERICAN EXPRESS ANTI-STEERING RULES ANTITRUST LITIGATION — 11-MD-02221 (NGG) (RER)

This Document Relates To: CONSOLIDATED CLASS ACTION — ECF ACTION

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

Plaintiff,

- against - — 13-CV-07355 (NGG) (RER) — ECF ACTION

AMERICAN EXPRESS COMPANY et al.,

Defendants.

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CLASS PLAINTIFFS' MEMORANDUM IN RESPONSE TO QUESTION NUMBER 1 POSED BY THE COURT IN ITS ORDER DATED APRIL 30, 2015

June 1, 2015

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Class Plaintiffs respectfully submit this Memorandum in response to the following question posed by the Court in its Order dated April 30, 2015: "(1) How, if at all, do the Decision/Findings of Fact and Conclusions of Law and Permanent Injunction entered in No. 10-CV-4496 (NGG) (RER) (E.D.N.Y.) (619 and 638 in 10-cv-4496-NGG-RER) affect the court's review of the proposed class settlement in this MDL?"

INTRODUCTION

In prior briefs, including our Reply Brief dated July 11, 2014 (Dkt. No. 500-1) and our brief in response to the report of Professor Hemphill ("Class Response," Dkt. No. 525-1), we showed that parity surcharging, standing alone, represents extremely meaningful relief for the members of the Class. We submitted overwhelming evidence that parity surcharging in Australia is widespread and plainly profitable for merchants. We completely disproved the notion that parity surcharging must have grown out of differential surcharging, or that it is most popular in less competitive industries or in specific channels. Class Response, Dkt. No. 525-1 at 4-6, 10-12. And we showed that parity surcharging will drive a great deal of volume to debit – a conclusion that is not at all in tension with the Court's finding that debit and credit reside today (when there is no surcharging) in separate relevant product markets.

Nonetheless, certain objectors criticized the proposed settlement on the asserted grounds that parity surcharging – even if it will drive traffic to debit – will do little to stimulate competition *inside* of the credit and charge card industry. But now, following *U.S. v. American Express*, that critique has been fully drained of whatever validity it may have had. As shown below, the combination of the Permanent Injunction and the surcharging relief at the core of the class settlement (the "Class Relief") comprise a steering tool of unique potency – one that is poised to spur competition in the market for credit card acceptance services on an unprecedented scale.

1. The Permanent Injunction Magnifies The Utility Of The Class Relief—And Vice Versa.

The Permanent Injunction greatly enhances, and is greatly enhanced by, the Class Relief. With the Permanent Injunction in place, merchants can use the Class Relief to not only reduce their payment costs in the ways we have detailed previously – e.g., by driving transactions to debit or recouping fees – but also to generate unprecedented competition *among credit card networks*.

Under the two sets of relief, taken together, merchants and card networks can advertise to consumers: "if you use a credit card at XYZ Store, there is a 3% surcharge – but if you use Discover Card, the surcharge is on us; we'll take that charge right off your monthly statement." At the Fairness Hearing on September 17, 2004, we illustrated this concept with a slide:

(Fairness Hearing Court Ex. 1, slide 3 (copy attached)).

As we explained at the Fairness Hearing, the combined relief will provide numerous competitive options for merchants and credit card networks. A card network might absorb most or all of the expense of the surcharge, in order to attract cardholders; in essence, it would be cutting its effective rates to gain share. Or a merchant might absorb (e.g., by rebating to the network) most or all of the surcharge, to be able to offer consumers a "surcharge-free" option while recouping all of its fees on the remaining three networks. And networks could bid for the "surcharge-free" slot – or one of multiple surcharge-free slots. Alternatively, networks could make a standing offer, across an industry or a size tier, to provide merchants cash or rate cuts for joining that network's "The Surcharge Is On Us" campaign. Or merchants could agree to rebate all surcharges incurred on any network that meets the merchant's demand for a low rate. With the Permanent Injunction augmenting the Class Relief, "a great deal of competition *inside* the credit card industry [is] going to be fomented by this relief that we're calling parity surcharging." (9/17/15 Tr. at 203). [1]

There is no question that the Settlement Agreement allows for this form of surcharging. Very pointedly, the Agreement only prevents a discount or rebate that offsets a surcharge where that discount or rebate is offered "*at the point of sale*." Settlement Agreement ¶ 8.b provides that the amount of a surcharge on an Amex card must be the same as on any other credit card "after accounting for any discounts or rebates offered at the point of sale." (DE 306-2). There is simply

[1] This concept was discussed in some depth at the Fairness Hearing. The Court asked "so this could result in [the merchant] going back to other [networks]; Visa and MasterCard could embrace the same idea?" And Class Counsel responded: "Yes. Yes, let the bidding begin: 'We'll pay half your surcharge, we'll pay three quarters, we'll pay the whole thing'… [L]et's say Discover is sitting around saying, you know what, we don't have deep enough penetration in airlines. AmEx is eating our lunch on airlines. . . Let's do a card that says whenever you incur a surcharge on an airline, it's on us. The possibilities are endless, it's competition. It's competition. We should be welcoming it." 9/17/14 Tr. at 27. See generally, *id*. at 18-19, 24-27, 202-05 and Court Ex. 1, slides 3-6 (re-attached hereto).

no dispute that, under this provision and following the Permanent Injunction, merchants may advertise surcharge-offsetting discounts in any and all media, at the store entrance or even strung from the rafters – anywhere but "at the point of sale." Accordingly, at the September 17, 2014 Fairness Hearing, after explaining that this surcharge-based steering tool was permitted under the Settlement Agreement, Class Counsel stated "I'm pretty confident that American Express isn't going to disagree." (Tr. 26-7). And Amex has not disagreed.

The potency of this tool is plain. Thus, the Court observed it could well imagine Amex responding by making "a revision in the merchant agreement" because "American Express might find something like this to be in effect a form of steering . . . on the part of a merchant which accepts both Discover and American Express." Tr. 25-26. And the Court rightly noted that our argument assumed a DOJ victory, while "the government might not win their case." (Tr. at 203).

But now the Government *has* won its case. And while this form of "surcharge-based steering" (i.e., parity surcharging with a brand-based offsetting discount or rebate) may represent a steering practice that American Express would shut down if it could, it has no such option. Under the Permanent Injunction, it is a *permissible* form of steering, and under the Settlement Agreement it is a *permissible* form of surcharging. As Class Counsel explained, "[t]his doesn't violate anything and there isn't anything American Express can do to make it violate anything." Tr. at 26-7. Now that the Permanent Injunction gives merchants precisely the tools that we anticipated, it is clear that the Class Relief opens up perfectly viable – and vibrant – new arenas for inter-brand competition.

And just as the Permanent Injunction enhances the utility of the Class Relief, so too does the Class Relief magnify the potential of the Permanent Injunction to achieve procompetitive effects. The Permanent Injunction is designed to permit not just brand-based discounting,

preference campaigns and the other prompting techniques discussed in the decision, but also steering efforts not yet imagined. See Order of Permanent Injunction at ¶ III.A. The 7-Eleven and Target Objector groups have made this point forcefully, emphasizing that U.S. merchants are primed to "devise novel ways of steering." See Merchants' Response to Proposed Order, *U.S. v. Amex* Dkt. No. 631 at 10. We quite agree.

The most potent and procompetitive "novel way[] of steering" that the Permanent Injunction will enable – until someone develops an even more powerful tool – is the surcharge-based steering we are describing here. We already know that surcharging is an effective tool. No party or objector disputes that an extremely high percentage of Amex-accepting merchants in Australia surcharge, according to data relied on by the RBA. (See Class Response, Dkt. No. 525-1, at 8). And as the Individual Merchant Plaintiffs tirelessly point out, Australian merchants effectively use the *threat* of surcharging to win concessions in rate negotiations. (IMP Obj. Br., Dkt. 399-1 at 2, 27-8; see also 7-Eleven Obj. Br., Dkt. No. 430, at 4.) If the Class Relief is granted, U.S. merchants will have precisely that competitive option.

2. The Settlement Is Fair, Reasonable And Adequate.

The Settlement Agreement fulfills the promise of the historic settlement in MDL 1720, allowing millions of merchants for the first time ever to use surcharging to constrain their card acceptance costs on the Visa and MasterCard networks as well as on American Express. The Settlement is fair, reasonable and adequate by any measure.

To be sure, the new competitive options created by the Class Relief together with the Permanent Injunction are not identical to the full-blown differential surcharging rights sought by the IMPs and certain other objectors. But the question before the Court is not whether the Class Relief would give merchants everything they could win at trial. The question before this Court is

whether the settlement is fair, reasonable and adequate. The new tools made available by the Class Relief – including parity surcharging on its own and surcharge-based steering – will be available to all Amex-accepting merchants (subject to resolution of the constitutional challenges to the state surcharge bans currently pending in the federal appellate courts).

By contrast, if the Settlement were rejected, each merchant would be relegated to an individual arbitration where it may only seek relief as to itself. Only a tiny fraction of merchants could conceivably be expected to arbitrate a full-blown, one-on-one injunctive case against Amex seeking for themselves unfettered differential surcharge rights. Given the complexity of such an arbitration – compounded in the injunctive context, where contingent fee representation is problematic – rejection of this Settlement Agreement would surely leave over 99% of Amex's 3.4 million merchants out in the cold.

And it is no answer to say that this Court's decisions in *U.S. v. Amex* will ease the arbitral path for claimants. Neither the February 2015 decision on the merits (which did not address surcharging) nor the April 30 remedies decision (which expressly excludes surcharging) will have any preclusive effect on the legality of surcharging restrictions or on the scope of appropriate injunctive relief. To win the right to differentially surcharge, each merchant claimant would still have to convince the arbitrator in its case that the rules against differential surcharging are on balance anticompetitive and illegal, and that the equities warrant an order allowing the merchant to differentially surcharge Amex transactions. Given the impassioned arguments Amex is sure to make regarding the effects of differential surcharging on its business – *see* Class Response, Dkt. No. 525-1 at 18 – this will be no walk in the park. And of course, the arbitrations themselves will be shrouded in confidentiality – as will the inevitable settlement of the IMPs' court case – thus ensuring there will be no positive spill-over effects for the broader marketplace.

The objectors do not dispute any of this. But their argument has been that differential surcharging is so far superior to parity surcharging that the Court should overlook the fact that differential surcharge could only ever be available to a small handful of very large merchants. That argument was flawed when it was first made, and it has just gotten immeasurably worse. The criticism of the parity surcharge settlement was that – even if it does allow merchants to recoup payment costs and drive traffic to debit – it does not foster competition *inside* of a narrowly-defined credit card market and that, in any event, surcharging is unlikely to take hold if merchants cannot offer a surcharge-free credit card option to their customers. That was certainly Professor Hemphill's critique, endorsed by the objectors in their responses to his Report.[2]

But now, taking the Class Relief together with the Permanent Injunction, the merchant *can* contract with credit card networks in a fashion that causes the networks to compete. All four networks – very much including Amex, which has substantial prowess in contracting with merchants – can compete on this dimension. So can new market entrants, who could build an entire entry strategy around surcharge-based steering. And of course, surcharge-based steering allows the merchant to offer its customers a surcharge-free credit card option – indeed, that is the whole point of saying "when you use Discover Card, the surcharge is on us." In sum, the advent of the Permanent Injunction vitiates the criticisms of the Class Relief lodged by objectors.

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[2] As we showed in response to Prof. Hemphill's report, a number of his key assumptions – which he borrowed from the 7-Eleven Objectors' expert Prof. Hausman-- are in fact disproven by Australian evidence. Among other things, we showed that in entire massive industries, including the hotly competitive hotel and car rental sectors, parity surcharging is essentially universal. See Court Ex. 1, Slides 7-8 (attached hereto); Reply Br., Dkt. No. 525-1, at 4-6. Contrary to Prof. Hausman's speculation, we showed that merchants in these industries have always surcharged on a parity basis -- i.e., they did not begin as differential surchargers – and that they employ the same surcharging practices in their online, in-person and other channels. Class Response, Dkt. No. 531 at 10-12.

3. The Competitive Option Afforded By The Combined Relief Is Familiar In The Marketplace And Easy To Use.

While Objectors are surely correct that U.S merchants are poised to "devise novel ways of steering" in the wake of the Permanent Injunction, the core message at issue here – "we will pay your surcharge if you use X brand" – is not itself novel. T-Mobile, for example, famously advertises "We'll pay your family's early termination fees" if you switch to T-Mobile. See 9/17/14 Court Ex. 1 (attached hereto) at Slide 5. And closer to home, dozens of banks, brokerages and other financial institutions advertise that, if the customer incurs an ATM surcharge using the institution's branded ATM card at any third-party bank, the institution will absorb (or rebate) the surcharge. Thus, Charles Schwab advertises: "**No ATM Fees**. Receive unlimited ATM reimbursements." See *id.*, Slide 6.

These messages are simple and unmistakable. And so is the message that "we'll take the surcharge right off your monthly statement."

4. The Permanent Injunction Vindicates Class Counsel's Strategy And Underscores The Adequacy Of Their Representation.

Objectors roundly criticized Class Counsel for having abdicated to DOJ the challenge to Amex's rules against steering (as distinct from surcharging), arguing that this supposed failing holds implications for the court's assessment of the adequacy of representation. The Permanent Injunction underscores that this criticism is woefully misguided.

The importance of anti-steering rule relief has never been lost on Class Counsel, who initiated the anti-steering rules case years before anyone else joined the fray. Class Counsel actively sought the intervention of DOJ (see Opening Br., Dkt. 363-1 at 12) and then worked hand-in-glove with the IMPs and DOJ for years to compile a massive record on the anti-steering rules

issues. However, once we were able to procure Amex's agreement to the surcharging terms contained in the Settlement Agreement, on the condition (among others) that we leave the steering issue to DOJ, we readily determined that the deal best served the interests of the Class. We understood that: (1) if DOJ won its case, as we expected, then it would obtain for all merchants steering rights, which would augment the surcharging rights that we obtained in the Settlement Agreement; and (2) if DOJ lost, then it is reasonable to expect we would have lost as well, had we not settled. Thus, Class Counsel explained at the Fairness Hearing, "if the government isn't successful, then we just cut the deal of the century." Tr. 205.

The strategy was sound at its inception and has been vindicated by the Government case. The Permanent Injunction provides the steering rights that the Class has always sought, and for which Class Counsel has long worked. And taken together with the surcharging relief obtained in the Settlement Agreement, it provides merchants unprecedented negotiating tools and enables merchants to commence surcharging while still offering one or more surcharge-free credit card options, as discussed above.

In relevant respect, the adequacy of representation inquiry asks whether class counsel has provided zealous, competent representation throughout the action. We submit that competence and zeal are understatements. Nor is there any misalignment of interests. All merchants' interests – and *especially* those of the large merchants objecting here[3] – are well served by gaining the negotiating tools that the Settlement Agreement provides, and by augmenting the Permanent Injunction with a universal right to impose parity surcharges on credit card transactions.

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[3] As we have shown, objectors have interests at stake here other than those with which Rule 23(e) is properly concerned. See Reply Br., Dkt. No. 500-1, at 2-4. The 7-Eleven/Target Objectors will go to any length to stop the MDL 1720 settlement, which imperils their legislative agenda, *id*. at 3 n. 3, and the IMPs understandably want to retain the differential surcharge threat to maximize their damages settlement (as opposed to seeking marketplace reform, as the Class does).

CONCLUSION

Class Plaintiffs respectfully submit that this Court's decisions in *United States v. American Express*, and specifically the Permanent Injunction, leave no doubt that the proposed class settlement should be approved.

Dated: June 1, 2015

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