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)

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SUPPLEMENTAL BRIEF OF HOME DEPOT U.S.A., INC. OBJECTING TO AMERICAN EXPRESS CLASS ACTION SETTLEMENT

By Order of April 30, 2015, the Court invited briefing on how its decision in the Department of Justice enforcement action affects review of the proposed class settlement. The answer is simple: the DOJ's victory establishes—more clearly than ever—that this Court should reject this or any other settlement that would shield American Express from competition. That is exactly what this settlement would do. It would confer long-term immunity upon various AMEX rules that restrain cost-of-acceptance competition among the credit card companies—competition that, as the Court has found, is sorely lacking.

Among other waivers, the settlement would waive any future challenge to the AMEX rule that prohibit merchants from applying different surcharges to different card brands that reflect their actual cost of acceptance. Yet the DOJ proved that AMEX's anti-steering provisions violate antitrust law, and as this Court has recognized, "permitting merchants to differentially surcharge among the various credit card networks" is "a particularly strong form of steering." Case No. 1:10-cv-4496, Dkt. # 619 ("DOJ Decision") at 124-25. If AMEX cannot lawfully prohibit merchants from steering by applying different discounts to different credit cards, surely it cannot lawfully prohibit them from steering by applying different surcharges to different cards. Nonetheless, this settlement would waive the rights of millions of merchants to challenge AMEX's prohibition on differential surcharge, along with other AMEX rules that restrain

competition. And it would do so over the objections of merchants who represent exponentially greater AMEX transaction volume than the class plaintiffs and so have a far greater stake in such a waiver.

Ultimately, the DOJ's win shows that the class plaintiffs settled for too little and gave up too much. They obtained only the right for merchants to impose highly regulated surcharges that must be uniform across all credit card brands, regardless of differences in a merchant's cost of acceptance. As explained in Home Depot's prior objection, that restricted right of uniform surcharge will not inspire interbrand competition among the credit card companies, is illegal in major states, and is practically unworkable in all of them. *See* Dkt # 410, pp. 8-10, 34-37.

In exchange for this insignificant concession, the class plaintiffs agreed to waive any challenges to all of AMEX's other merchant restrictions for at least ten years and for such longer period as the major credit card companies choose to maintain these restrictions in approximately their current form. Yet the DOJ's win shows that the restrictions protected by the proposed settlement are highly vulnerable to antitrust challenge. Rather than signing away merchants' rights, the class plaintiffs should be vindicating them, by challenging AMEX's prohibition on differential surcharging, its "Honor All Cards" rule and other restrictions that, like the anti-steering rules successfully challenged by the DOJ, constrain competition that could lower the costs of card acceptance.

ARGUMENT AND CITATION OF AUTHORITY

I. Having Ruled that AMEX's Anti-Steering Rules Violate Antitrust Law, the Court Should Not Immunize Similar Rules From Antitrust Challenge.

AMEX's prohibition on steering-by-differential-surcharge violates antitrust law for the same reason as its other anti-steering rules. Anti-steering rules, or "NDPs" as the Court abbreviated them, "disrupt the normal price-setting mechanism by reinforcing an asymmetry of

information between the two sides of the payment card platform." DOJ Decision at 101. Specifically:

> Amex's rules ensure that the set of customers responsible for driving demand for network services (cardholders) cannot be influenced in their payment choice by the set of customers on the other side of the platform, who are informed of and responsible for paying the swipe fees associated with that decision (merchants). In other words, with the NDPs in place, customers do not internalize the full cost of their payment choice or account for the costs of different forms of payment when deciding which form to use, because without merchant steering, the cost to the customer is the same regardless.

Id.

The same dynamic occurs when merchants cannot surcharge credit card purchases in an amount that reflects their true costs of accepting a particular card. If the surcharge must be identical across all credit card brands (as required by the proposed class settlement), then "customers do not internalize the full cost of their payment choice or account for the costs of different forms of payment when deciding which form to use, because … the cost to the customer is the same regardless." *Id.* That is why the Court observed that "permitting merchants to *differentially* surcharge among the various credit card networks" is "a particularly strong form of steering." *Id.* at 124-25 (emphasis added).

To be sure, the DOJ did not elect to challenge AMEX's anti-surcharge rule. However, merchants should not be forced to surrender their rights to attack this rule in future cases (or in this class action) on the same grounds that the DOJ successfully attacked other anti-steering rules. "Steering is a lynchpin to inter-network competition on the basis of price." *Id.* at 102. And, as this Court recognized, price competition "is frustrated to the point of near irrelevance in the network services market as a result of American Express's [anti-steering rules]." *Id.* at 100. So the last thing the Court should do is allow AMEX to prohibit "a particularly strong form of

steering" by conferring immunity from any private antitrust challenge for a decade or more. *Id.* at 124-25. Yet that is what this settlement would do.

Perhaps AMEX or the class plaintiffs will say that differential surcharging is an ineffective or undesirable way for merchants to induce cost-of-acceptance competition among the credit card companies. However, as this Court repeatedly emphasized, it is not for AMEX or even "for the court to draw lines between 'good' competition and 'bad' competition in the network services market." *Id.* at 105. "[T]he law does not permit American Express to decide on behalf of the entire market which legitimate forms of interbrand competition should be available or which should not." *Id.* at 136. Merchants should be free to decide for themselves whether to employ differential surcharge in order to lower their costs of card acceptance. And, as the Court found, "[e]ven if a [particular] merchant were not inclined to engage in steering, its freedom to do so in the future would enhance its bargaining position relative to American Express and its competitor networks, placing additional downward competitive pressure on rates." *Id.* at 119.

To disapprove the settlement, this Court need not rule that AMEX's rule against differential surcharge violates antitrust law. It need only recognize that, by approving this settlement, it would effectively be deciding that question in favor of AMEX and against millions of merchants, who would be powerless to bring an antitrust challenge to that rule for at least ten years and perhaps longer, depending on self-serving choices by the major credit card brands. As the Court knows, this is a dysfunctional market where, because of "Amex's anti-steering rules, merchants cannot inject price competition into the network services industry by encouraging their customers to use their lowest cost supplier, as they can in other aspects of their businesses."

Id. at 103. There is too much at stake here to impose this settlement, with its broad assortment of waivers, on all AMEX-accepting merchants at the behest of only a few.

II. The DOJ's Success Shows that the Class Plaintiffs Got Too Little and Gave Up Too Much.

After extensive discovery and a seven-week trial, the DOJ proved several things that would be critical in any merchant challenge to AMEX's remaining rules:

- **Market Power**: "American Express possesses sufficient market power in the network services market to harm competition, as evidenced by its significant market share, the market's highly concentrated nature and high barriers to entry, and the insistence of Defendants' cardholder base on using their American Express cards …." DOJ Decision at 6.

- **Maintenance of Market Power Through Anti-Steering Rules:** Competition "is frustrated to the point of near irrelevance in the network services market as a result of American Express's NDPs. … American Express's merchant restraints harm interbrand competition." *Id.* at 100-01.

- **Use of Market Power to Raise Prices:** "American Express's ability to impose significant price increases during its Value Recapture initiatives between 2005 and 2010 without any meaningful merchant attrition is compelling evidence of Defendants' power in the network service market. … [T]hese restraints [on steering] have resulted in higher all-in merchant prices across the network services market, providing additional proof of their actual anticompetitive effect." *Id.* at 67, 111

Unless the Court imposes the proposed no-opt out settlement extinguishing their claims, merchants will be entitled to use these findings persuasively and preclusively to challenge various AMEX rules not challenged by the DOJ. By statute, Congress encourages such private, follow-on actions, by providing that "[a] final judgment or decree heretofore or hereafter rendered in any civil or criminal proceeding brought by or on behalf of the United States under the antitrust laws to the effect that a defendant has violated said laws shall be prima facie evidence against such defendant in any action or proceeding brought by any other party against such defendant under said laws …." 15 U.S.C. § 16(a). Moreover, this statute explicitly does not "impose any limitation on the application of collateral estoppel." *Id.* And, under federal

collateral estoppel rules, the findings of this Court in the DOJ case are *preclusive* upon AMEX in subsequent actions by merchants, although they were not parties to that DOJ case. *See, e.g., Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 332-33 (1979) (findings in SEC enforcement action against corporate defendants held preclusive in separate lawsuits by shareholders).[1]

Accordingly, the DOJ victory places merchants in a powerful position to challenge the AMEX rules that would be preserved and protected under this settlement, including the prohibition on differential surcharge, the Honor All Cards rule and so forth. So it makes less sense than ever to force millions of merchants to waive those challenges for a decade or more, simply to obtain a right of uniform surcharge that (1) doesn't allow a merchant to differentiate between credit card brands; (2) is unlawful in some states, including some very large ones; (3) is burdened by impractical constraints and (4) could, as we now know, very likely be achieved through continued litigation in this class action or in subsequent merchant suits or arbitrations, based largely on issues that DOJ has already won.[2]

In urging final approval of this settlement, the class plaintiffs urged that the class faced risk based on "Amex's arguments that it lacks market power and that its rules relating to surcharging are pro-competitive," as well as its arguments based on the "two-sided" nature of the market. Dkt. # 362 at 23. But this Court has already rejected those arguments on their merits;

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[1] Under "non-mutual offensive collateral estoppel" a party is bound by adverse findings made in prior litigation, even though the party invoking those findings was not a party to the prior litigation. The Supreme Court approved that form of collateral estoppel in *Parklane Hosiery*, and the courts of this circuit have applied it in antitrust and other cases. *See, e.g., Cent. Hudson Gas & Elec. Corp. v. Empresa Naviera Santa S.A.*, 56 F.3d 359, 368-69 (2d Cir. 1995); *United States v. Int'l Bhd. of Teamsters, Chauffeurs, Warehousemen & Helpers of Am., AFL--CIO*, 905 F.2d 610, 621 (2d Cir. 1990); *GAF Corp. v. Eastman Kodak Co.*, 519 F. Supp. 1203, 1211-16 (S.D.N.Y. 1981) (antitrust case).

[2] Home Depot's earlier brief in opposition to the settlement explained the lack of value of the highly restricted option of uniform surcharge made available under the Settlement Agreement. *See* Dkt. #410, pp. 8-10, 34-37.

indeed, this Court has already determined that these arguments do not even raise sufficiently serious questions to warrant a stay pending appeal. Case No. 1:10-cv-4496, Dkt. # 663 ("Order Denying Stay Pending Appeal") at 5-9. For the same reasons, these arguments do not raise sufficiently serious questions to justify the waiver-heavy bargain embodied in the proposed settlement.

Contrary to what class plaintiffs have suggested in past filings, the DOJ victory does not mitigate the harm of this settlement in a way that warrants approval. True, the Settlement Agreement provides that class members get the benefit of any decree entered by the Court in the DOJ case, notwithstanding the release provisions in that agreement. Dkt. #306-2 ("Settlement Agreement") ¶ 35. It could hardly do otherwise. But the DOJ did not attack all of the rules preserved by the Settlement Agreement, including the rules prohibiting differential surcharge—or *any* form of surcharge that deviates from the laborious restrictions imposed by the Settlement Agreement. *See id.* ¶¶ 8(b), 26(b), 27(b) (all of which prohibit any surcharge except that explicitly permitted by the settlement). If approved, this Settlement Agreement would protect those rules from private antitrust challenge for a decade or longer.

As another key example, DOJ did not attack the Honor All Cards rule, which imposes on merchants an all-cards-or-no-cards decision as to AMEX. In the future, AMEX could use that explicit tying rule to impose an (even higher) cost card, trusting that its cardholders' "insistence" will preclude most merchants from taking the no-cards option. *See, e.g.*, DOJ Decision at 6 (finding that "insistence … prevents most merchants from dropping acceptance of American Express when faced with price increases or similar conduct"). Yet this settlement would preclude merchants from challenging AMEX's Honor All Cards rule. *See* Settlement Agreement ¶¶ 26(c), 26(d), 27(c), 27(d). Indeed, merchants could not challenge that tying rule for at least

another decade, no matter what new cards AMEX chose to issue or what they cost to accept, since the proposed release extends to "[t]he *future effect* in the United States of the continued imposition of or adherence to any rule or provision identified [in the releases], any rule or provision as modified by this Class Settlement Agreement, and any rule or provision that is substantially similar." *Id.* ¶¶ 26(f), 27(e) (emphasis added).

And this future waiver goes well beyond forced acceptance of traditional credit cards. The Settlement Agreement broadly defines "Credit Card" to include any networked service of any description – whether existing now or developed in the future – that enables the purchase of goods or services on credit. *Id.* ¶ 1(bb). So the explicit tying agreement entrenched by this settlement would apply to "mobile wallets" or virtually any other sort of future payment-on-credit technology that AMEX might develop. That could require Home Depot to install new and costly point-of-sale infrastructure in each of its 2,200 stores in order to accept whatever payment technologies AMEX later develops. And, again, the settlement would deny Home Depot and other merchants any legal recourse. All of this, simply to obtain a highly restricted right of uniform surcharge that, in the opinion of the Court's independent expert, will be of "highly uncertain" effect, with "a substantial probability that its effect will be small or zero." Report of Professor C. Scott Hemphill (Aug. 11, 2014), Dkt # 519 at 42.[3]

[3] On top of Professor Hemphill's report, this Court has now found that "core functional differences" limit substitution between credit and debit cards, including the fact that credit cards allow deferred payment, carry array of ancillary benefits and work best for business travelers. DOJ Decision at 56-59. Yet the supposed benefit of imposing a uniform surcharge on credit cards depends on customers substituting debit cards as a form of payment. This further undermines any prospect that the benefits of the settlement outweigh the risks and costs.

III. The DOJ Victory Further Establishes that the Prospective Antitrust Releases in the Settlement Violate Public Policy.

In its initial settlement objection, Home Depot showed that public policy prohibits the release of future antitrust claims, because antitrust violations harm the *public* interest, not merely the interests of private parties to a settlement. Dkt. # 410, pp. 30-31. That is true here: the Court has recognized that AMEX's anti-steering rules have imposed higher prices, not only on merchants, but on individual consumers. DOJ Decision at 4, 98, 111-14. That is why "the public interest favors enjoining Amex's unlawful practices now." Order Denying Stay Pending Appeal at 17.

In the settlement briefing, class plaintiffs and AMEX urged that public policy should not forbid prospective releases of antitrust claims where the legality of the released conduct is unclear (and will remain unclear because settlement will halt litigation on the merits). If that rejoinder ever had any persuasive force, it didn't survive this Court's decision in favor of the DOJ. It is very hard to understand how the prohibition on steering-by-differential-surcharge that is protected by this Settlement Agreement could be lawful when AMEX's prohibition on steering-by-differential-discounting is not. This Court has held that AMEX cannot lawfully prohibit merchants from applying different discounts to purchases made with different card brands, in order to steer volume to lower cost cards. Surely AMEX cannot lawfully prohibit merchants from applying different additional charges to purchases made with different card brands to achieve the same pro-competitive purpose. Depriving millions of merchants of their right to challenge that prohibition under antitrust law violates public policy.

CONCLUSION

The Court's decision in favor of the DOJ establishes that some or all of the AMEX rules protected by this settlement most likely violate antitrust law and could be successfully

challenged through continued class litigation or actions by individual merchants. Yet the settlement proponents would have all merchants release their rights to challenge or seek future damages based on those rules, in exchange for a highly restricted right of uniform surcharge that does not spur inter-brand price competition between the credit card companies and is illegal in major states. AMEX is the clear winner in that bargain.

This would be a bad settlement and contrary to public policy even if merchants had the right to say no. To force that bargain on merchants, without allowing them to opt out, violates not only Rule 23, but due process. As the Court recognized, the merchants who objected to any stay of the Permanent Injunction in the DOJ case—the same merchants who object to this settlement—"have significant experience with Amex's use of the NDPs to stifle competition and preserve or impose higher fees." Order Denying Stay Pending Appeal at 17 n.11. If some other merchants want to surrender the protections of antitrust law, that is perhaps their right. But the Court should not—acting at the behest of a handful of merchants with a miniscule AMEX transaction volume—deprive millions of merchants of their rights to challenge AMEX's differential surcharge prohibition and other anti-competitive provisions of AMEX's merchant agreement.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 1st day of June, 2015, I electronically filed the foregoing SUPPLEMENTAL BRIEF OF HOME DEPOT U.S.A., INC. OBJECTING TO AMERICAN EXPRESS CLASS ACTION SETTLEMENT with the Clerk of Court using the CM/ECF system which will send notification of such filing to counsel of record.

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