UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

In re PAYMENT CARD INTERCHANGE FEE AND MERCHANT DISCOUNT ANTITRUST LITIGATION	MDL No. 1720(JG)(JO) Civil No. 05-5075(JG)(JO)
This Document Relates To: ALL ACTIONS.	**INDIVIDUAL PLAINTIFFS' MEMORANDUM IN SUPPORT OF THE SETTLEMENT REFORMS**

Members of the proposed 23(b)(2) Class, Ahold U.S.A., Inc.; Albertsons LLC; Albertson's, Inc.; BI-LO, LLC; Delhaize America, Inc.; Eckerd Corporation; The Great Atlantic & Pacific Tea Company; H.E. Butt Grocery Company; Hy-Vee, Inc.; The Kroger Co.; Maxi Drug, Inc. (and doing business as Brooks Pharmacy); Meijer, Inc.; Meijer Stores Limited Partnership; Pathmark Stores, Inc.; QVC, Inc.; Raley's; Rite Aid Corporation; Safeway Inc., SuperValu Inc.; and Walgreen Co. submit this memorandum in support of the Rules Reforms contained in the proposed Class Settlement.

I. The Current Situation

There have been a number of developments in the payment card industry that have been directed toward reducing merchant fees and introducing or simulating competition in the network services market. The proposed settlement in MDL 1720 is just one piece of this mosaic. Taken in context, the MDL 1720 Class Settlement is a critical and irreplaceable piece in the march toward reform in the card payments industry. Here is the context:

The payment card system in the United States evolved over several decades in a manner that became increasingly and overwhelmingly anticompetitive in the market of providing network services to merchants. As the system developed, the three major brands, Visa, MasterCard and American Express, employed a set of similar rules and regulations that effectively prevented

horizontal competition between them on the pricing of card services and terms of card acceptance agreements with merchants. These merchant restraints by each company have historically supported the effectiveness of the restraints by the other "competitive brands."

If all of these merchant restraints were completely removed with one bold unequivocal stroke of a pen, it would still take a significant period of time for the marketplace to react decisively to this development. Even though this would be a major positive development releasing competitive forces in the market, any responsible merchant would need time to employ these new tools in a positive manner.

Of course, the industry is not being reformed completely with one bold stroke. It is evolving piecemeal in a manner that is both understandable and predictable considering the amount of time the restraints were in place and the limited reach of each agent of change for these reforms.

Whether the agent is the Durbin Amendment, the Treasury Regulations, the Department of Justice Consent Decrees with the Visa and MasterCard, the Class Settlement in *Wal-Mart*, or the proposed Class settlement with Visa and MasterCard in MDL 1720, there is only a portion of the problem reached by each and a significant portion of the problem that is outside the reach of each of these processes. The lingering effects of the prior regime, the uncertainty of the proposed settlement caused by a coordinated and cynically misleading attack on the Class Settlement in *MDL 1720*, and the continued presence of the American Express merchant restraints, coupled with the technological challenges of implementing the reforms once the smoke clears, make a slow roll out of the Rules Reforms by merchants a virtual certainty.

Under the circumstances, it is disingenuous of the critics of the Rules Reforms achieved by the Class in MDL 1720 to point to the conservative and restrained reaction of the merchant community to the changes in the Rules regime over the past couple of years as an indication of the potential effectiveness and value of the reforms.

These reforms will, over time and with increasing pace, place effective downward pressure on merchant fees. Along with other reforms, including the restructuring of Visa and MasterCard, the Rules changes help, to the extent available in the litigation, to introduce competitive market forces in the market for merchant payment card business.

II. The Class Settlement is a Critical Development

We address in this memorandum the proposed b(2) injunctive Class. The merits of the b(3) damage Class is more appropriately addressed by others. The undersigned b(2) Class members have opted out of the b(3) Class and settled their damage claims in mediation with Professor Green and this Court.

The *MDL 1720* Class Settlement, including events directly related to the course of the litigation and the terms of the b(2) Class Settlement, has finally presented merchants with real reform. The Network IPOs, the legislative and regulatory changes, and the Department of Justice Consent Decrees, are the direct result of and constitute an important part, of the reforms obtained by this litigation.

Visa and MasterCard are no longer bank-controlled entities, but independent companies each looking for merchant payment card volume.[1] Merchants are now free for the first time to expose the hidden bank fees to their customers and use that information in a variety of creative ways to influence their customers' choice of payment methods or to negotiate with Visa and/or MasterCard with a credible option to discourage higher swipe fees.

The questions for the Court in evaluating the Class Settlement are whether the negotiated reforms are the best appropriate solution to the Class antitrust litigation or is there too much that could be accomplished in the litigation that is being left undone by the settlement? To add to the

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[1] We realize that saying this is not so is a favorite rallying cry of those who criticize the Class settlement. But saying it is not so does not change the facts confirmed by the discovery record and market events.

confusion, our clients, who have spent seven years and tens of millions of dollars litigating the case against Visa, MasterCard and American Express, strongly support the Class Settlement reforms, while other prominent merchants have publicly condemned the settlement and reject the reforms.

It appears to be a daunting task to figure out who to believe about the merits of the Class Settlement. Although the answer is complex on one level, it is fairly simple on another level to sort out the rhetoric from fact and analyze the Class Settlement as the resolution of an antitrust case rather than some long shot wish list divorced from law, economics, and reality. The answer is that after 7 years of litigation, 18 months of Court-supervised mediation, and countless hours evaluating the potential reforms with some of the nation's top economists, whose analysis focused on the contours of the antitrust litigation, merchants who support the Class Settlement want to reap the benefits of the reforms in a settled environment. The companies who support the Class settlement understand the limits of the law of competition and what an obstacle to innovation this seven year old antitrust case has become. They want reform now – not five (or more) years from now. The vocal critics of the Class Settlement seem to be focused on terms not included in the settlement and which, upon close review, are clearly beyond the reach of the litigation.

During these past seven years, our clients, the Class Plaintiffs and the Department of Justice Antitrust Division thoroughly and independently examined the law and economics of the payment card industry. Our clients challenged the Payment System's Rules and the Class had a broader attack on the payment card system. The Department of Justice Antitrust Division, studying the fully developed record from the private litigation, chose to challenge Visa's and MasterCard's Rules which interfere with the pricing mechanism at the point of sale. Each of these groups started from a different place and perspective and with different approaches, but each ended up in the same spot. The reason is inescapable. Despite all of the rhetoric and mythology, it is the Networks' Anti-Steering Price Rules which make the otherwise efficient and output-enhancing payment card system anticompetitive for merchants. Indeed, many merchants believe that the Department of

Justice acted too timidly when it concluded that permitting product-level discounting of debit and credit cards was sufficient to remove Visa's and MasterCard's anticompetitive practices. Regardless of the remedy sought, all of these groups eventually concluded that it is the pricing mechanism at the point of sale and not the settling of default rates that is the antitrust culprit.

The critics of the settlement seem to be focusing on a list of legislative objectives which they were unable to obtain from Congress, while conveniently ignoring the long history of evaluation and investigation, and the complete rejection, of their theories by the Department of Justice Antitrust Division. The Antitrust Division rejected the critics' theories based on a thorough analysis of the private litigation record and an informed understanding of the law of competition.

The settlement critics seem to have no concern for the fact that without the Class Settlement reforms, help for them, if any, is likely many years away. The critics also have no apparent plan for proceeding further in the litigation. Even with many more years of litigation, this antitrust case under the Court's supervision will almost certainly not provide the outcome which the critics seek. The Class Settlement represents the single greatest advancement of a merchant's ability to resist high credit card fees in industry history, and merchants should seize the opportunities that it provides rather than chase illusory and fanciful goals that have not or will not materialize from private antitrust litigation.

Every merchant surely wants lower merchant service fees. But this Court does not legislate and it is not a price regulator. The law, however, endows this Court with certain powers to protect competition. The Class Settlement gives merchants tools which they can use at the point of sale to stimulate Network price competition for merchants' payment card volume if they choose to use them. And perhaps that is among the points here. The Class Settlement gives merchants the ability to give their customers choices about payment means and price which they never had before. Offering their customers those choices enable merchants to control/lower their card acceptance costs. But under the Class Settlement, merchants will have to decide whether to

exercise their rights and take steps to promote Network price competition for their card volume. No lower fees by legislative or regulatory fiat. Rather, lower fees and more price choices for their customers if merchants implement the Reforms. The Class Settlement gives merchants tools to do something provided by the laws of competition if they choose to use them. The opportunity and the choice is theirs.

If merchants fail to embrace the opportunity extended by the law of competition through the Class Settlement, then unless Congress decides to act quickly, the current situation will endure for many more years. Swipe fees will continue to rise as merchant groups continue to complain, lobby and discuss non-existent legal theories.

Anyone who understands the law of competition and takes a clear-eyed look at the card payment industry and its evolution will understand that after seventeen (17) years of litigation, a Congressional investigation, and two detailed and thorough investigations by the Department of Justice, the Class Settlement is the breakthrough that sophisticated merchants have been waiting for and presses the top end of the relief available under the law of competition. A lot of the confusion in the merchant community stems from a complete misunderstanding of the limits of an antitrust lawsuit and the continued perpetuation of some industry mythology that confuses many merchants and provides a fertile haven for many undisclosed agenda.

III. Settlement Critics' Mythology

The Class Settlement arises out of litigation based on the law of competition. The law of competition provides opportunity – not gifts. Most of the criticism of the Class settlement comes from either lobbyists used to asking for gifts from Congress or merchants who have continuously complained for years about the Default Interchange Rule, while doing nothing to challenge the practice in Court. These critics seem oblivious to the unprecedented review and investigation of the payment industry or the complete absence of finding by a court or governing agency which supports their theory. More surprisingly, these entities appear to ignore the fact that while urging

Congress to regulate credit card fees, they and other merchant groups told Congress that the antitrust laws provided no effective remedy. Now they demand a remedy in this case that Congress declined to provide.

There are a number of illusory concepts at the core of settlement critics' mythology about the payments industry which are continuously and harmfully repeated by industry activist critics. The problem is that undue belief in industry mythology leads merchants to miss opportunities to change the payment card industry while pursuing myths that are always purported to be within reach but are never realized. An objective analysis exposes these illusions.

Here are the three most damaging myths in the payment industry that continue to get in the way of real solutions:

1. **Myth:** The law of competition is concerned about the fairness of the current payment system to merchants, and the solution under the law should be that which merchants prefer rather than what law and economics dictate.

Fact: A number of vocal merchants seem to believe that the antitrust laws are focused on fairness for merchants, instead of economic efficiency and consumer welfare. Many of the critics talk as if the antitrust litigation in *MDL 1720* is a private dispute between the merchants and the Visa/MasterCard Networks. In fact, the litigation involves the public economic policy of the United States and a diverse number of effected parties other than merchants including consumers, small banks and credit unions, large banks, single-entity corporations, Visa and MasterCard, competitor Payment Card Companies, and the good offices of the United States District Court. An attack on the setting of default interchange rates involves all of these stakeholders. The law of competition is focused on economic efficiency and *consumer* welfare – not *merchant* fairness.

The setting of interchange fees by Visa or MasterCard, either before or after their respective IPOs, is analyzed under the Rule of Reason. *See Law v. NCAA*, 134 F.3d 1010, 1018-19 (10th Cir. 1998). The Rule of Reason focuses on whether the anticompetitive effects of a

challenged restraint outweigh its pro-competitive effects. Under the Rule of Reason, the [plaintiff] bears the initial burden ... of demonstrating that each restraint has substantial adverse effects on competition such as an increase in price or a decrease in quality ... [O]nce that initial burden is met, defendants bear the burden of coming forward with evidence of the pro-competitive justification(s) for the agreements. If that burden is met, then the [plaintiff] must prove either that the restraints are not reasonably necessary to achieve the pro-competitive objections, or that the restraint objectives can be achieved in a substantially less exclusionary manner."

2. **Myth:** The setting of default interchange rates by Visa or MasterCard is anticompetitive and the law of competition makes it illegal.

Fact: The merchant-centric battle cry of the critics of the Class settlement – that Visa's and MasterCard's post-IPO setting of default interchange is *per se* anticompetitive – simply fails to satisfy even the most rudimentary economic analysis of anticompetitive practices. No court or governing antitrust regulatory body has found the default interchange rule to be anticompetitive before or after the IPO, despite an extensive history of litigation and Government investigation. Beginning in 1979, when *NaBanco* challenged in Federal Court the setting of default interchange rates as anticompetitive, every Court and U.S. Government agency that addressed the issue failed to find the setting of default interchange rates to be anticompetitive. No private plaintiff has been able to muster the evidence to prove otherwise. There is an extensive history of antitrust scrutiny that has failed to find default interchange rate setting to be anticompetitive.

(a) *NaBanco v. Visa U.S.A.* *NaBanco* is an antiquated case that is useful only in understanding the evolution of the challenges to the Visa (and MasterCard) systems. The District Court found: "The interchange fee is pro-competitive in nature ... IRF promotes the efficiency and competitiveness of Visa...." The U.S. Court of Appeals found that the District Court balanced the pro-competitive and anticompetitive purposes and effects of default interchange rates and properly decided the alleged restraint (setting the IRF) did not substantially impede competition. There was

an abundance of evidence submitted from which the District Court plausibly and logically could conclude that the default interchange rate was, on balance, pro-competitive because it was necessary to achieve stability and thus ensure the one element vital to the survival of the Visa system – universality of acceptance. Substantial plausible evidence also disclosed that the default interchange rate acted as an internal control mechanism that yielded pro-competitive efficiencies that its members could not create acting alone – and helped create a product that its members could not produce singly.

(b) In 1995, a group of merchants filed a class action antitrust lawsuit challenging the Visa/MasterCard Honor All Cards Rule and the charging of anticompetitive, artificially escalated interchange fees. *In re Visa Check/MasterMoney Antitrust Litigation*. After seven years of litigation, the Class settled the case by requiring the Networks to amend their Honor All Cards Rule to apply separately to credit and debit card products, *i.e.*, delinking the merchants' mandatory acceptance of credit cards *and* debit cards. Although the settlement occurred after this Court determined that Visa and MasterCard had market power, the setting of interchange by a "consortium of competitors" was left untouched. The settlement contained debit card rate reduction that was immediately consumed by credit card rate increases. This should have been a signal to merchants that the change in the Honor All Cards Rule did nothing to change the Networks' dynamic that was causing ever-increasing interchange fees. Wal-Mart, the de facto leader today of those who embrace the myth of the anticompetitive nature of default interchange rates, spear-headed this earlier litigation and yet made no serious attempt to challenge the practices about which it now complains while releasing all claims based on those theories. To date, Wal-Mart has contributed nothing to any subsequent litigation except to repeat its empty rhetoric regarding default interchange rates.

(c) In 2001, the United States Department of Justice challenged the structure of Visa and MasterCard in an attempt to stimulate competition in the General Purpose Payment Card

Market and the General Purpose Credit Card Network Services Market. After analyzing the Card Networks while both were still associations of banks, the Department of Justice chose to attack the exclusivity rules that prohibited Visa/MasterCard banks from issuing American Express and Discover cards. This attack did open up competition among the card companies and American Express on the *issuing* side, but it only exacerbated the ever-escalating merchant fee problem. Significantly, this litigation occurred while *In re Visa Check/MasterMoney Antitrust Litigation* was pending and while the card companies were still a "consortium of competitors." Yet the Department of Justice Antitrust Division – whose job it was to enforce the law of competition in the United States – did not challenge the setting of interchange rates, the Honor All Cards Rule, or any other Visa or MasterCard rule.

(d) In 2005, two sets of private antitrust lawsuits were filed against Visa and MasterCard. A group of 20 prominent retail merchant chains filed lawsuits against Visa and MasterCard challenging the merchant restraints in the Visa and MasterCard operating rules. The cases focused on the Rules that protected Visa and MasterCard from interbrand competition on the merchant side of the market. After several months of pre-litigation investigation, and the assistance of some of America's top economic and consumer advocates, these merchants concluded that the law of competition should prohibit certain of the Visa/MasterCard Rules that allowed the Networks to charge hidden fees that are assessed to consumers while prohibiting merchants from communicating the existence and impact of those fees to consumers.

A separate set of lawsuits filed as Class Actions attacked the Visa and MasterCard systems as structural conspirators whose setting of default interchange rates was anticompetitive and should be enjoined. Because the Class Actions were brought on behalf of all merchants, the experienced Class attorneys brought broad somewhat broader allegations, including claims challenging the setting of default interchange rates.

Both sets of lawsuits were coordinated before this Court in *MDL 1720*. Significantly, as a result of the litigation challenges to the Networks' corporate structure in *Visa/MasterCard*, the banks divested themselves of control of Visa and MasterCard – major developments that resulted from these cases. These combined cases were litigated from 2005 until the conclusion of arguments on dispositive motions before this Court on November 2, 2011. This Court, which has been presiding over the private antitrust challenges to Visa and MasterCard for the last seventeen years, is unquestionably the most knowledgeable Court in the federal system regarding the Visa/MasterCard Networks and the law of competition. The *Visa/MasterCard* case alone generated more than 400 depositions, including 24 expert depositions, and more than 80 million pages of documents during approximately 7 years of litigation. *Visa Check/MasterMoney* previously produced another 400 depositions, including 21 expert depositions, and more than 5 million pages of discovery. Collectively, these two cases created a discovery record regarding the Visa and MasterCard systems of more than 800 depositions, including 45 expert depositions, and more than 85 million pages.

Against the backdrop of the enormous discovery record from *Visa/MasterCard* and *Visa Check/MasterCard*, and the literally hundreds of thousands of attorney hours focused on the Networks from those two different cases, the Department of Justice opened an investigation in 2008 of Visa's, MasterCard's and American Express's operating rules. The investigation examined the ever-increasing merchant swipe fees. The Antitrust Division obtained the extensive discovery record from the private antitrust cases through Civil Investigation Demands. For 24 months, the Department of Justice, with its economic staff and experienced antitrust attorneys, conducted an exhaustive investigation into the level of merchant discount fees and whether there was a solution under the antitrust laws to the perceived competition problem. They interviewed merchants, Networks and other stakeholders, and studied the testimony and documents from the private antitrust cases. As part of the investigation, attorneys and experts for the Class Plaintiffs and the

Individual Plaintiffs made presentations to the Department of Justice regarding the focus of their investigation and encouraged the Department to challenge the business practices of Visa, MasterCard and American Express. The Class attorneys urged the Antitrust Division to challenge Visa's and MasterCard's setting of default interchange rates. But after all of that work, the Department of Justice declined to do so. Everyone else who has looked at the issue eventually comes to the same conclusion – under the Rule of Reason, the setting of the default interchange rate is critical to the Networks' efficiencies and prevents the ineffective need for thousands of banks and millions of merchants to reach agreement on the fees to accept each bank's payment cards. This single characteristic, according to all knowledgeable experts, outweighs any indirect anticompetitive effects of the Networks' setting of the default interchange rate, particularly post-IPO. The Department of Justice's staff chose to challenge the merchant restraints that prevented merchants from disclosing hidden fees to cardholders and steering cardholders to less expensive forms of payment.

(e) On October 4, 2010, the Department of Justice filed lawsuits against Visa, MasterCard and American Express. In response to these Complaints, both Visa and MasterCard entered into Consent Decrees which provided that merchants can discount credit card products and debit card products to encourage their use. This Consent Decree represented an express endorsement of the Class settlement theory, but was less extensive than the relief obtained by the Class in the *Visa/MasterCard* settlement.

(f) During the period 2006-2010, the United States Congress investigated the payment card industry. Merchant trade associations told Congress that the antitrust laws did not provide adequate remedies to solve their problems and they needed Congress to regulate credit card and debit card fees. After several months of hearings and deliberations, the U.S. Congress passed the Durbin Amendment which authorized the Federal Reserve Board to regulate debit card rates and allowed merchants to discount credit cards and debit cards. This Congressional action is

very rudimentary compared to the much more nuanced and sophisticated remedies provided in the Class settlement.

3. **Myth:** American Express, as a three-party system, is able to charge rates higher than Visa and MasterCard while escaping antitrust liability.

Fact: The Rules-based case settled by the Class has the same underlying theory as the case to be made against American Express. The Class Settlement, and ironically critics' opposition to it, further highlights the problem posed by American Express. The American Express merchant restraints, like those of Visa and MasterCard, interfere with the pricing mechanism at the merchants' point of sale and creates a horizontal restraint on the market for the provision of network merchant payment card services which imbues all three Networks with anticompetitive market power. The focus on Visa and MasterCard in the manner argued by the settlement critics completely ignores the tremendous threat of American Express to the introduction of price competition in the market for the provision of network merchant payment card services. These critics acknowledge American Express's market power by pointing out that American Express's merchant restraints limit the utility of the Class Settlement Rules Reforms, but they fail to focus on the fact that the problem about which they complain is *American Express's* doing, not the Visa/MasterCard Class Settlement. If merchants were allowed to use the price mechanism at the point of sale to steer away from Visa and MasterCard, but were still unable to differentially steer from higher priced American Express, then the American Express problem becomes more acute. A merchant's nightmare scenario is for the current iteration of American Express with its merchant restraints and fee structure to be the only major network *insulated* from price competition at the point of sale!

As noted earlier, it is fanciful to think that the Visa, MasterCard and American Express merchant restraints can be solved all at the same time. The Class case against Visa and MasterCard has come first, and their restraints are effectively incorporated into the American

Express restraints. The Class Settlement reforms the Visa and MasterCard Rules, leaving it to merchants through lawsuits now pending to address the American Express problem. For all of their bluster about the Visa/MasterCard Class Settlement, these critics have no answer to the American Express problem other than to solve it precisely in the sequence and manner which the Class Settlement now makes possible – namely, reform the Visa/MasterCard merchant restraints, isolate and expose the American Express non-discrimination rule as the anticompetitive merchant restraint that it is without the cover of the Visa/MasterCard Rules, and then use the laws of competition to cause American Express to reform its merchant restraints as well.

IV. The Terms of the b(2) Settlement

Against this extensive litigation and Government record, the Class Settlement has been formulated. The *Visa/MasterCard* Settlement accomplishes a number of structural reforms that are important to merchants' ability to lower Network fees, including interchange. In addition to the reorganization of Visa and MasterCard as a direct result of this litigation, the Settlement Agreement is responsible for the following important accomplishments:

1. Locks in the reforms in the Durbin Amendment even if Congress repeals the legislation.

2. Locks in the reforms in the Department of Justice Consent Decree even if they are rescinded as a result of political changes.

3. Removes Visa's and MasterCard's Rules requiring a merchant to accept their payment cards at all of its banners or trade names if it accepts either Network's payment cards at any banner or trade name. This will allow, for example, a merchant to develop or expand a low-price, low-cost banner that operates as part of a company's enterprise.

4. Modifies Visa's and MasterCard's surcharge Rules to *allow* merchants to surcharge at the Network level (*i.e.*, Visa, MasterCard, American Express, Discover) subject to acceptance cost and limits imposed by other Network cards accepted by a merchant.

5. Modifies Visa's and MasterCard's surcharge Rules to *allow* merchants to surcharge at the brand level (*i.e.*, different kinds of cards such as consumer card, commercial card, reward card, etc.) subject to acceptance cost and limits imposed by other Network cards accepted by a merchant.

6. Merchants will be able to surcharge or discount credit cards regardless of the device used to deliver the payment device. Thus, the Networks cannot effectively blunt the settlement reforms by adopting a Rule that prohibits discounting or surcharging if a credit card is presented, for instance, in a mobile telephone rather than in a plastic card. There is no functional difference between a credit card in a mobile device or a piece of plastic. Each has the same account number and credit function, and is used to authorize, clear and settle credit card transactions.

7. Isolates the anticompetitive character of the American Express no-discrimination rule. American Express had been sheltered by the anticompetitive Visa and MasterCard no-discount, no-discrimination and no-surcharge Rules which American Express incorporates through its no-discrimination Rule. The reform of Visa's and MasterCard's Rules strip away American Express's cover and expose its no-discrimination Rule to be the anticompetitive restraint that it is.

8. The facts discovered through the *Visa/MasterCard* case provided Congress, the Federal Reserve Board and the Justice Department with invaluable information for their deliberations and which likely would not have been available to them but for the adversarial legal process.

9. Currently and throughout the seven year pendency of this litigation, merchants have effectively surcharged all of their customers for credit card fees that result from credit card transactions regardless of the customer's form of payment. With the Rule changes now implemented by the proposed Class Settlement Agreement, merchants can for the first time pull back the veil on these hidden card fees and communicate their existence, embedded costs, and impact on consumer prices to their customers. The new price communication provided under the

settlement will put downward pressure on credit card swipe fees and generally reduce prices over time.

V. The Settlement is Pro-Consumer

The settlement, properly understood, is pro-consumer. Focus group studies with consumers reveal that consumers overwhelmingly are offended by hidden card fees and clearly grasp the cross-subsidy issue regarding cash and debit card users.

1. The reforms (finally) allow a merchant to be transparent with its customers about its costs of accepting payment cards. A merchant can show or tell a customer what it cost the merchant to accept a particular payment card.

2. The reforms allow a merchant to provide a consumer with a choice about the price he/she wants to pay for goods or services. A consumer who values his/her rewards over a lower ticket price can use a high-cost rewards credit card and pay the merchant's cost of accepting the card. A consumer who values a lower ticket price over rewards can pay with a lower cost payment means and pay less.

3. Consumers who pay with cash, check or debit cards (or even a low-cost credit card) no longer will be subsidizing the prices of goods or services paid by customers who pay with a credit card (or a high-priced credit card).

4. Merchants can (finally) use the ability to favor or disfavor one Network or another at the point of sale through discounting or surcharging to incent Visa and MasterCard to moderate or lower their swipe fees in exchange for not being disfavored or being favored by the merchant. We know from comparable experience in Australia that when merchants demonstrate the credible ability and willingness to use price signals to steer customers to one Network's card over another, the disfavored Network will usually lower or moderate swipe fees to avoid being disfavored.

5. Merchants can (finally) recoup payment card acceptance costs through surcharging or lower their prices through discounting. Either way, merchants can realize substantial cost

savings which they can pass on to customers in the form of lower prices or reinvest in their businesses to provide more value to their customers.

VI. The Class Settlement Completes the Reform of Visa/MasterCard

The result in *Visa/MasterCard* reflects more than 15 years of effort by merchants to reform the payments industry, and achieves reforms that neither Congress nor the Department of Justice was able to achieve.

1. The *Wal-Mart* case broke the tie between credit and debit cards of Visa and MasterCard. (1996-2003)

2. The Durbin Amendment (2010) removed the restrictions imposed by Networks on discounting credit and debit cards at the *Network* level – *i.e.*, no longer could a Network prohibit a merchant from discounting a Visa, MasterCard, American Express, Discover, etc. credit or debit card – where the difference in average Network level acceptance costs is relatively small. But it did not allow for discounting at the product level – *i.e.*, card type (consumer card, commercial card, rewards card, etc.) – where there are substantial differences in acceptance costs, and it did not disturb Network rules prohibiting surcharging.

3. The Justice Department extended the Durbin Amendment reforms in a Consent Decree with Visa and MasterCard (2011) under which those Networks agreed to remove their merchant prohibitions on product-level discounting. The Justice Department Consent Decree did not address surcharging. American Express refused to make the same changes agreed to by Visa and MasterCard, and thus the Department of Justice filed an antitrust suit against American Express which is pending. (Private merchants also have sued American Express.)

4. As a result of MDL 1720, Visa and MasterCard are no longer controlled by banks.

5. The *Visa/MasterCard* settlement (2005-2012) provides the reforms missing from the Durbin Amendment and the DOJ Consent Decree plus other reforms.

VII. The Settlement Procedure and Negotiations Were Unprecedented

The depth, length and intensity of the mediation process in *Visa/MasterCard* are virtually unprecedented in antitrust litigation. The settlement reflects the considered input of two of the most experienced mediators in the United States, and very experienced antitrust lawyers on all sides.

The critics of the settlement simply ignore a number of relevant factors regarding the complexity, expense and likely duration of the litigation, the stage of the proceedings, the amount of discovery completed, and the risks of maintaining the Class Action through trial. This Court should not ignore these factors.

VIII. The Settlement Should be Found Fair and Reasonable

This Court has considerable experience and knowledge regarding this industry and is familiar with the difficult and contentious negotiations that have yielded the significant reforms. The organized attack on the settlement appears to confuse the orderly process of a United States District Court with the mayhem of legislative lobbying. The critics appear to believe that shrill criticism can be as effective in Court as it can be in Congress or the media. While all interested parties will, unquestionably, get a full and fair hearing before this Court, the evaluation of the structural reforms in the *Visa/MasterCard* settlement requires an understanding and appreciation of the limits of the federal court system and antitrust law and a knowledge base to sort out reality from fanciful but unfounded dreams.

1. This case is an antitrust case – nothing more and nothing less. This means that the relief attainable is only that which a federal court can order under the remedies available to it in an antitrust case. The critics of the settlement want a gift rather than relief within the power of a federal court to order.

2. Regulating interchange rates is not the business of the federal courts. A federal court is not a price regulator, and it wields a blunt instrument in ordering reform. It can remove

anticompetitive restraints, but it is not in the business of deciding on the price that a network can charge for its services. The reforms in the settlement enable competition to regulate swipe fee rates rather than regulators doing so. Regulation is the business of the Federal Reserve Board as charged by Congress. Competition is the business of the courts.

3. The *Visa/MasterCard* settlement is not responsible for the eleven State statutes dealing with surcharging. Visa and MasterCard have been required to change their Rules in all fifty states. The interpretation and application of those state statutes is uncertain and in some cases problematic. In addition, those state statutes may be subject to challenge under the First Amendment to the United States Constitution. These issues are separate from a challenge to a Network's system-wide restraint. Although the settlement will enable merchants to surcharge credit cards, it does not address the eleven State statutes dealing with surcharging. The existence and scope of those State laws is facially within the province of the State legislatures. That said, there is a serious question whether those State statutes prohibit what the critics claim they prohibit,[2] or mean what the critics claim they mean. *See, e.g.*, MDL 1720, Tr. 41-46, 49-52 (Nov. 2, 2011). Just as Visa and MasterCard cannot rely on those statutes to keep their restraints in

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[2] *Expressions Hair Design et al. v. Eric T. Schneiderman, in his official capacity as Attorney General of the State of New York*, Case No. 13-cv-3775 (S.D.N.Y.), New York Attorney General Memorandum of Law at 19, 25, Dkt. 27 (filed July 12, 2013) ("Rather, a seller violates § 518 [the New York surcharge statute] only if it charges consumers more for using a credit card without displaying that credit card price at least as prominently as the cash price – an interpretation of the statute that accords with its plain meaning, the meaning of the federal precursor on which it is based, the legislative history, the statute's policy objectives, the case law, established canons of construction, and the attorney general's consistent view for more than 25 years. ... [S]ellers are free to impose dual pricing under the statute, regardless of the label they use to characterize it. Moreover, requiring sellers to prominently disclose the credit card price <u>exposes</u> credit card companies to competition by allowing consumers to make an informed decision whether the higher credit card price is worth paying at an early moment in the transactions when they can feasibly switch to cash – by, for example, stopping at an ATM or choosing a competitor with a lower credit card fee.") (emphasis in original).

place in those eleven States, merchants cannot hold Visa and MasterCard responsible for the actions of those eleven State legislatures.

IX. Conclusion

Visa and MasterCard are no longer "structural conspiracies" with their bank members. Post-IPOs, interchange rates remained artificially high because of the Networks' anti-steering rules and not the Networks' structures.

1. At the start of the *Visa/MasterCard* case, the two Networks *were* structural conspiracies as recognized by the courts. However, after the lawsuits started, MasterCard, and then Visa, went public and converted to single entities no longer controlled by the banks.

2. The reason that interchange rates remained artificially high after the IPOs is because Visa's and MasterCard's No-Discount/Discrimination and No-Surcharge Rules insulated the Networks from price competition for merchants' credit card business.

3. The lawsuits challenged as anticompetitive Visa's and MasterCard's Anti-Steering Rules, including the No-Discount/Discrimination Rule, the No-Surcharge Rule, the All Outlets Rule, and the Honor All Cards Rule, along with the Networks' default interchange rule.

4. The Anti-Steering Rules are part of an integrated system of Rules and there is an inter-play between and among them.

5. By removing the No-Discount/Discrimination Rule, substantially modifying the No-Surcharge Rule, and eliminating the All Outlets Rule, a merchant can now effectively set prices for the acceptance of high-cost Visa or MasterCard payment cards by surcharging them and recover acceptance costs, thus eliminating the need or incentive for a merchant not to accept those cards. As such, removing the Honor All Cards rule provides no additional competitive benefits for merchants. Viewed another way, the negotiated reforms will effectively enable a merchant to decline to accept all Visa or MasterCard credit or debit cards by surcharging a credit card a merchant does not want to accept or discounting a competing card that the merchant prefers to

accept. In that way, a merchant can effectively not "honor all cards." Similarly, the Networks' ability to use price competition to avoid being disfavored by merchants at the point of sale is a counterbalance to the default interchange rate.

6. Whether the Networks' Honor All Cards and default interchange rules are lawful is evaluated under the "Rule of Reason," in which the fact finder balances the pro- and anti-competitive qualities of the challenged restraint. With the reforms in the *Visa/MasterCard* settlement, the Networks can retain the pro-competitive benefits of consumers knowing their payment cards will be accepted, while the merchants are able to counter the high cost of certain Network cards or card types.

Based on the foregoing analysis, the undersigned urges on behalf of the b(2) Class Members Ahold U.S.A., Inc.; Albertsons LLC; Albertson's, Inc.; BI-LO, LLC; Delhaize America, Inc.; Eckerd Corporation; The Great Atlantic & Pacific Tea Company; H.E. Butt Grocery Company; Hy-Vee, Inc.; The Kroger Co.; Maxi Drug, Inc. (and doing business as Brooks Pharmacy); Meijer, Inc.; Meijer Stores Limited Partnership; Pathmark Stores, Inc.; QVC, Inc.; Raley's; Rite Aid Corporation; Safeway Inc., SuperValu Inc.; and Walgreen Co. that the Court find the Rules Reforms fair and adequate.

Dated: August 16, 2013

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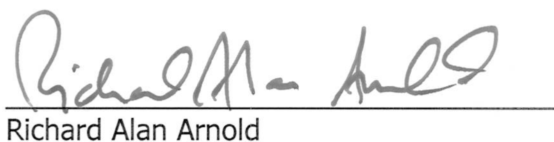
CERTIFICATE OF SERVICE

I hereby certify that the foregoing document was served on all counsel of record via ECF on August 16, 2013.



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