

## SETTLEMENT WITHOUT CONSENT: ASSESSING THE CREDIT CARD MERCHANT FEE CLASS ACTION

Steven Semeraro\*

*The multi-district class action In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation has pitted the merchants that accept credit cards against the two largest card networks, Visa and MasterCard, and the thousands of banks issuing their cards. The merchants charged the banks with fixing the prices that businesses pay to accept cards.*

*Last year, the parties' attorneys announced a \$7 billion settlement, the largest ever. But in exchange, all class members were required to accept (1) an injunction that did not alter the contested pricing practices and (2) a breathtakingly broad release. The settlement prohibited class members from opting out, deeming the injunctive relief class mandatory under Federal Rule of Civil Procedure 23(b)(2).*

*Despite objections from over half the named plaintiffs and many other merchant class members, the District Court approved the settlement. Home Depot summed up the objectors' view, arguing that the settlement "fails to address in any meaningful way the anticompetitive practices that are the subject of this litigation" and leaves "Visa and MasterCard . . . free to keep setting . . . fees exactly as they do now, free from any liability . . . ."*

*Although Fed. R. Civ. P. 23 recognizes mandatory classes when a court enjoins conduct that necessarily impacts the entire class, the settlement here does not have that quality. Its principle feature—granting merchants the ability to surcharge credit card transactions—could be extended to some class members, but not others. Indeed, the settlement*

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\* Professor of Law, Thomas Jefferson School of Law and antitrust and competition law expert for the Legal Research Network's Ethics & Compliance Alliance.

*explicitly recognized this possibility, allowing Visa and MasterCard to negotiate bilateral agreements with individual merchants that prohibit surcharging.*

*The court justified its decision on the ground that the merchants could not expect to do any better. They had a slim chance of winning the case and, even if they did, the court could not grant a more effective remedy than the right to surcharge.*

*The court was wrong on all counts. Antitrust law requires price competition, and nothing about current credit card markets should exempt the largest banks from that requirement. And although commentators' views on surcharging differ, they agree that the settlement as written does not grant merchants the flexibility necessary to create acceptance fee competition. Finally, if the merchants prevailed, the court could impose significantly more effective relief than the settlement provides. The credit card systems could operate as they do now with one exception. Merchants today must accept all cards issued on a network. The proposed relief would instead empower a merchant to refuse to accept the cards of a large card-issuing bank if that bank refused to offer the merchant an acceptance fee below the networks' default interchange rate. This approach would force card issuers that are big enough to support their own system to bear the risk that a merchant would drop its cards while continuing to accept those issued by its competitors.*

*Forcing a mandatory settlement without consent in these circumstances finds no support in Rule 23 and violates the fundamental public policy guaranteeing injured parties a day in court.*

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## I. INTRODUCTION

The multi-district class action *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*<sup>1</sup> has pitted merchants that accept credit cards against the two largest card networks, Visa and MasterCard, and the thousands of banks issuing their cards. In 2005, the merchants sued, alleging that the defendants' conspired to fix the prices that merchants paid to accept cards. In 2012, the parties' attorneys announced a \$7 billion settlement.<sup>2</sup> But in exchange, all class members were *required* to accept (1) an injunction that did not alter the contested pricing practices and (2) a breathtakingly broad release. By deeming the injunctive relief class mandatory under Federal Rule of Civil Procedure 23b(2), the settlement prohibited class members from opting out.<sup>3</sup>

<sup>1</sup> Second Consolidated Amended Class Action Complaint at 7, *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720) [hereinafter "Second Amended Complaint"] (Merchants pay fees to accept credit cards that are divided between the merchant's own bank and the bank that issued the card. The "interchange fee" is the portion that the merchant pays to the card-issuing bank).

<sup>2</sup> *In re Payment Card Interchange Fee & Merch. Discount Antitrust Litigation*, 986 F.Supp. 2d 207, 213 (E.D.N.Y. 2013) [hereinafter "Merch. Disc. Antitrust Litig."].

<sup>3</sup> *Id.* at 217, 236. Class members were permitted to opt out of the damages portion of the case, but they would nonetheless be bound by the injunctive order and the release.

Although half of the named plaintiffs and over 1000 additional class members refused to consent to the settlement, Eastern District of New York Judge John Gleeson found it fair, adequate, and reasonable.<sup>4</sup> Unless an appellate court intervenes, the millions of merchants accepting credit cards will be prohibited in perpetuity—many without consent—from challenging Visa and MasterCard’s pricing practices no matter how anticompetitive they may be.<sup>5</sup>

The merchants opposing the settlement have pulled no punches. It “fails to address in any meaningful way,” one argued, “the anticompetitive practices that are the subject of this litigation.”<sup>6</sup> And “as a practical matter,” it leaves “Visa and MasterCard . . . free to keep setting . . . fees exactly as they do now, free from any liability . . . .”<sup>7</sup>

Although Rule 23 of the Federal Rules of Civil Procedure recognizes that a settlement may bind class members without consent when the court enjoins conduct that necessarily impacts the entire class,<sup>8</sup> the settlement here

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<sup>4</sup> *Id.* at 241; *see* Fed. R. Civ. P. 23(e)(2) (requiring the district court to determine that a class action settlement is fair, adequate, and reasonable before the parties may implement it).

<sup>5</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 236 (E.D.N.Y. 2013). The case is currently on appeal to the Second Circuit. The attorneys do not anticipate a decision before summer 2015, and subsequent Supreme Court review is certainly possible.

<sup>6</sup> The Home Depot’s Objection to Preliminary Approval of Proposed Class Settlement at 1, *In re* Payment Card Interchange Fee & Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720) [hereinafter Home Depot Brief].

<sup>7</sup> *Id.* at 2.

<sup>8</sup> Neither the language of Rule 23, nor the advisory committee’s notes, appear to have considered the specific question whether a class member could be bound to a settlement without consent. The relevant portions of the Rule and the notes accompanying the 1966 amendments, however, are consistent with the interpretation that consent is not essential when the relief necessarily binds the entire class. Fed. R. Civ. P. 23(b)(2) permits a class action where “the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole.” Rule 23(c)(2) explains that in a b(2) class action the class members

does not have that quality. Its principle feature—granting merchants the ability to surcharge credit card transactions—could be extended to some class members, but not others. Indeed, the settlement explicitly recognized this possibility, allowing Visa and MasterCard to negotiate bilateral agreements prohibiting surcharging with individual merchants.<sup>9</sup>

The court justified its decision to bind millions of merchants without their consent on three grounds:

- (1) the class had little chance of prevailing on the merits;<sup>10</sup>
- (2) conveying merchants the right to surcharge, as the settlement purported to do, substantially improved competitive conditions in the card-acceptance-fee market;<sup>11</sup> and
- (3) even if the class prevailed in the litigation, the court could not fashion more effective relief.<sup>12</sup>

The court was wrong on all counts. The underlying case boils down to a simple question: whether banks that issue Visa and MasterCard credit cards must compete with each other on the prices that they charge merchants. Although the banks aggressively seek to attract cardholders, Visa and

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do not have to be notified and Rule (c)(3) requires the court with respect to any in a b(2) class action to “include and describe those whom the court finds to be class members.” The Advisory Committee Notes to the 1966 Amendments further explain that a b(2) class “is based on grounds which have general application to the class.”

<sup>9</sup> Class Settlement Agreement at 52 (Visa), 63 (Mastercard), *In re* Payment Card Interchange Fee & Merch. Discount Antitrust Litig., 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720) [hereinafter “Settlement”].

<sup>10</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 218 (concluding “that the proposed settlement secures both a significant damage award and meaningful injunctive relief for a class of merchants that would face a substantial likelihood of securing no relief at all if this case were to proceed”).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 227 (quoting the court’s appointed expert witness as concluding “the expected returns to continued litigation are highly uncertain, and . . . plaintiffs[] face a substantial probability of securing little or no relief at the conclusion of trial”).

MasterCard set default merchant fees that virtually all banks simply accept. The antitrust laws should require banks to compete for merchants just as they do for cardholders, and the merchants should thus prevail.<sup>13</sup>

Second, the impact of surcharging on market conditions is far from clear. Although some commentators agree with Judge Gleeson that surcharging could exert downward pressure on card acceptance fees, even they question whether the settlement as written grants merchants the flexibility necessary to surcharge effectively.<sup>14</sup> And other commentators have concluded that the practice would threaten the efficiency of the card system and could raise consumer prices.<sup>15</sup>

Finally, if the merchants prevailed, the court could impose significantly more effective relief than the settlement provides. A relatively simple injunctive order would stimulate the bank-to-bank competition on merchant fees that the class seeks. The credit card systems could operate as they do now with one exception—any merchant could insist that one or more of the four largest card-issuing banks offer it a bilateral card acceptance fee at a rate below the networks' default interchange rates. This approach would force a card issuer that is big enough to support its own system to compete head-to-head, bearing the risk that a merchant would drop its cards while continuing to accept those issued by its competitors. All network-level functions and the card-issuing businesses of the smaller banks would be unaffected. And this competition among the largest issuers would likely be sufficient to drive card-acceptance fees to competitive levels.<sup>16</sup>

Part II reviews the history of credit card system merchant acceptance fees. Part III summarizes the allegations in the merchants' class complaint, and Part IV sets out the proposed settlement's injunctive relief provisions. Part V

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<sup>13</sup> See *infra* Part VI.

<sup>14</sup> See *infra* Part VII.

<sup>15</sup> *Id.*

<sup>16</sup> See *infra* Part VIII.



presents the court's reasons for rejecting the merchants' objections and approving the settlement. Parts VI through VIII show that the court's reasoning is faulty. The merchants are likely to prevail on the merits. Surcharging, particularly in the form permitted by the settlement, is not a panacea that will drive down merchant fees. And the court could impose more effective relief. Finally, Part IX reviews the settlement's release and concludes that it neither satisfies Rule 23 nor comports with bedrock public policy principles.

## II. COMPETITION AND MERCHANT CARD ACCEPTANCE FEES

This Part explains how merchants pay to accept credit cards and the market conditions that led them to sue the card networks.

### A. The Components of Merchant Card Acceptance Fees

In a typical credit card transaction, a customer makes a purchase with a card, obligating the consumer to pay the full purchase price to the card-issuing bank.<sup>17</sup> That bank promptly pays the merchant's bank the purchase price less the card issuer's cut, known as the interchange fee.<sup>18</sup> The merchant's bank then deposits into the merchant's account

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<sup>17</sup> Cardholders who run a balance, of course, pay interest, and many credit cards now provide "rewards" to cardholders, which are essentially a rebate of some portion of the merchant fee to the cardholder. *See In re Payment Card Interchange and Merch. Disc. Fee Antitrust Litig.*, No. 05-1720, 2006 WL 6848702, at \*2 (E.D.N.Y. Aug. 7, 2006); *Capital One Financial Corp. v. C.I.R.*, Tax Ct. Rep. (CCH) Dec. 57,945 at 4111, 4118 (T.C. 2009) (providing a detailed explanation of the flow of funds in a credit card transaction).

<sup>18</sup> The interchange fee compensates the cardholder's bank ostensibly for the value of card issuance to the merchant. For example, the merchant receives prompt payment for the purchase, while the card-issuing bank generally does not receive payment from the cardholder for a month or more. *See In re Payment Card Interchange and Merch. Disc. Fee Antitrust Litig.*, No. 05-1720, 2006 WL 6848702, at \*2 (E.D.N.Y. Aug. 7, 2006); *Capital One Financial Corp. v. C.I.R.*, Tax Ct. Rep. (CCH) Dec. 57,945 at 4111, 4118 (T.C. 2009).

the funds received from the card issuer less the merchant's bank's cut.<sup>19</sup> The total amount retained by both banks together is called the *merchant discount*.<sup>20</sup> And typically, the card-issuing bank receives about three quarters of it.<sup>21</sup>

## B. Merchant Concern With Card Acceptance Fees

Merchants do not object to the fee that they pay to their own bank. Scale economies and intense competition have dramatically reduced this portion of the merchant discount.<sup>22</sup> As one commentator explained, undifferentiated product offerings have led to “brutal competition between [banks providing card acceptance services] and . . . the exercise of leverage by major merchants” has lowered this portion of the merchant discount.<sup>23</sup>

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<sup>19</sup> Merch. Disc. Fee Antitrust Litig., 2006 WL 6848702, at \*2; Capital One Financial Corp. v. C.I.R., Tax Ct. Rep. (CCH) Dec. 57,945 at 4111, 4119 (T.C. 2009).

<sup>20</sup> Merch. Disc. Fee Antitrust Litig., 2006 WL 6848702, at \*2; Capital One Financial Corp. v. C.I.R., Tax Ct. Rep. (CCH) Dec. 57,945 at 4111, 4119 (T.C. 2009).

<sup>21</sup> James M. Lyon, *The Interchange Fee Debate: Issues and Economics*, THE REGION, June 2006, at 10.

<sup>22</sup> DAVID S. EVANS & RICHARD SCHMALENSEE, PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING 230 (2005) (showing that the top 10 acquirers account for 78% of the volume). David A. Balto, *The Problem of Interchange Fees: Costs Without Benefits*, 4 EUR. COMM. L. REV. 215, 218–19 (2000) (describing how changes in the industry reduced costs).

<sup>23</sup> Howard H. Chang, *Payment Card Industry Primer*, 2 PAYMENT CARD ECON. REV. 29, 46 (2004) (quoting Charles Marc Abbey, *National Merchants Revisited*, CREDIT CARD MGMT., Dec. 27, 2002); see also Jean-Charles Rochet & Jean Tirole, *Cooperation Among Competitors: Some Economics of Payment Card Associations*, 33 RAND J. ECON. 549, 552 (2002) (“The acquiring side involves little product differentiation as well as low search costs and is widely viewed as highly competitive.”). The portion of the merchant discount retained by merchant banks has thus fallen. See EVANS & SCHMALENSEE, *supra* note 22, at 261 (explaining that “[c]ompetition, scale economies, and rapid reductions in data processing and telecommunications costs have come together to reduce the net merchant discount—the difference between the total merchant discount and the interchange fee, which goes to issuers—that merchants pay acquirers for their services”); Balto, *supra* note 22, at 218–19 (describing

The fee that merchants pay to the card-issuing banks forms the core of their complaint.<sup>24</sup> In contrast to the highly competitive merchant banks, card-issuers do not compete for merchant acceptance.<sup>25</sup> Visa and MasterCard set default rates that each issuing bank accepts.<sup>26</sup> The card networks' rules prohibit merchants from refusing to accept—or discriminating against—a particular bank's cards through their systems' rules, which merchants must accept as a condition of taking credit cards.<sup>27</sup> The so-called *honor-all-cards* rules prohibit a merchant, for example, from refusing to accept Citibank cards while continuing to accept all other Visa cards.<sup>28</sup> Although no rule prohibits issuing banks from striking individual interchange fee deals with retailers, because a merchant may not force a bank to compete by threatening to stop accepting, or surcharging, its cards, each issuer can maximize its own profit by accepting the collectively-set default interchange fee.<sup>29</sup>

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how changes in the industry reduced costs); Lyon, *supra* note 21 at 9 (“[T]he rise in interchange fees over time has fueled a growing conflict between retailers and card issuers.”).

<sup>24</sup> *In re* Payment Card Interchange Fee & Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 214 (E.D.N.Y. 2013).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> See *Visa U.S.A., Inc. v. First Data Corp.*, No. C 02-01786 JSW, 2006 WL 1310448, at \*3 (N.D. Cal. May 12, 2006) (quoting First Data's economic expert as testifying that the “ban on network processing and the anticompetitive aspects of the Honor-All-Cards rule . . . , particularly in tandem, have a significant potential to limit interchange competition among Visa issuers”).

### C. The History of Merchant Concern With Interchange Fees

From the early 1970s through the mid-1990s, merchants did not object to the collective setting of interchange fees. Although some complained about American Express' fees,<sup>30</sup> which were set unilaterally, most card accepting businesses were apparently content with the jointly set Visa and MasterCard fees.<sup>31</sup> Presumably, card use was sufficiently limited during this period that a merchant could simply refuse to accept credit cards altogether if the fees were too high. And the Visa and MasterCard systems kept fees in check as part of a competitive strategy built around having a merchant network larger than American Express'.<sup>32</sup>

In the mid-1990s, card acceptance fees became controversial for two reasons. First, interchange fees began to climb despite declining transaction-processing costs.<sup>33</sup> Merchants complained that a technologically advanced banking system with significant scale economies and diminishing fraud losses should not be increasing what were already the world's highest interchange fees.<sup>34</sup>

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<sup>30</sup> EVANS & SCHMALENSEE, *supra* note 22, at 185–87.

<sup>31</sup> In the early 1980s, a federal circuit court rejected a private antitrust case filed by an acquirer challenging the interchange fee. *Nat'l Bancard Corp. v. Visa U.S.A. (NaBanco)*, 779 F.2d 592, 592–93 (11th Cir. 1986). After *Nabanco*, careful analysis of interchange fees “for the most part . . . languished in obscurity until around the turn of this century.” DAVID S. EVANS, *INTERCHANGE FEES: THE ECONOMICS AND REGULATION OF WHAT MERCHANTS PAY FOR CARDS* 3 (2011).

<sup>32</sup> Anyone over the age of twenty surely remembers the ubiquitous line on Visa ads: “And they don’t take American Express.” *See, e.g.*, Richard W. Stevenson, *Visa Aims at American Express*, N.Y. TIMES, Feb. 10, 1988, at D23.

<sup>33</sup> In the late 1990s, a class of merchants attacked Visa’s and MasterCard’s debit card interchange fees on the ground that acceptance of these cards was illegally tied to credit cards. A settlement favorable to merchants was reached. However, the case did not directly address the collective setting of credit card interchange fees. *Wal-Mart v. Visa U.S.A.*, 396 F.3d 96, 100–01 (2d Cir. 2005).

<sup>34</sup> *See generally* Second Amended Complaint, *supra* note (1); Lyon, *supra* note 21, at 11, 38; Missy Baxter, *Interchange Wars: Merchants Tug*

Second, card acceptance became ubiquitous, spreading to merchants that had smaller profit margins and less to gain by accepting credit cards.<sup>35</sup> And card use exploded. In 1986, 55 percent of households held credit cards, and by 2006 the number stood at 77 percent with the average household holding multiple cards.<sup>36</sup> Transaction volume also increased steadily.<sup>37</sup> Between 1986 and 2000, the percentage of consumer expenditures in the United States on payment cards grew from 3 percent to 25 percent.<sup>38</sup> Now, two thirds of

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*Networks for Change*, ATM MARKETPLACE (Feb. 10, 2006) <http://www.atmmarketplace.com/articles/interchange-wars-merchants-tug-networks-for-change/>, archived at <http://perma.cc/GXT7-5Q76> (quoting plaintiff's counsel as saying that "[t]he United States has one of the highest interchange fees on the globe, which is surprising, considering that our banking system is more technologically advanced than systems in most other countries").

<sup>35</sup> For example, supermarkets have much smaller profit margins than the types of merchants that had previously accepted cards—travel and entertainment and retail merchants—and they have much less to gain from card acceptance because consumers rarely need to rely on credit for subsistence purchases. See generally D.B. De Loach & A.D. O'Rourke, *Use of Credit Cards in Grocery Stores*, California Agricultural Experiment Station Bulletin 843, 20–21 (1969), available at <http://archive.org/stream/useofbankcreditc0843delo#page/n19/mode/1up>, archived at <http://perma.cc/8G8K-6DFL> (explaining that "[t]he most frequently offered reason for [banks not seeking to operate credit card plans in grocery stores in the early days of the card systems] was that the net margin of most grocers is insufficient for them to afford to offer credit services," and consumers and grocers had grown accustomed to a cash and carry model).

<sup>36</sup> See Second Amended Complaint, *supra* note (1), at 42; EVANS & SCHMALENSEE, *supra* note 22, at 95; Fed. Res. Bd., *The Profitability of Credit Card Operations of Depository Institutions*, at 4 (June 1999), available at <http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/1999/default.htm>, archived at <http://perma.cc/23CE-U3Z7>.

<sup>37</sup> EVANS & SCHMALENSEE, *supra* note 22, at 84–85, (noting the steady rise in percentage of transactions from about two percent to twenty-five percent change); *Id.* at 233 (noting double annual transaction volume increases from the early 1970s through the 1990s).

<sup>38</sup> EVANS, *supra* note 31, at 3–4. And the growth in other countries was even more dramatic. *Id.*

all in-person sales are made with payment cards, about half of those with credit cards.<sup>39</sup>

As technology has improved and transaction volume soared, one might have expected per transaction costs, and thus card acceptance fees, to fall.<sup>40</sup> Between 1995 and 2005, however, the interchange fee paid to issuing banks rose more than 25 percent.<sup>41</sup>

The obvious competitive response to these developments would have been for merchants to threaten to stop accepting credit cards. But that did not happen largely because of competitive conditions in retail markets. No single merchant could have credibly threatened to stop accepting credit cards.<sup>42</sup> Such a unilateral decision would have driven the

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<sup>39</sup> Catherine New, *Cash Dying As Credit Card Payment Predicted to Grow in Volume: Report*, HUFFINGTON POST (June 7, 2012, 12:07 PM), [http://www.huffingtonpost.com/2012/06/07/credit-card-payments-growth\\_n\\_1575417.html](http://www.huffingtonpost.com/2012/06/07/credit-card-payments-growth_n_1575417.html), archived at <http://perma.cc/LP3N-W8JS>.

<sup>40</sup> Cf. William F. Baxter, *Bank Interchange of Transactional Paper: Legal and Economic Perspectives*, 26 J.L. & ECON. 541, 562 (1983) (explaining how societal and industrial changes, most importantly the rise in clearinghouses, led to shifts in the cost structure of check transactions). Advances in fraud detection provide an illustrative example. In the early decades of card issuance, fraud losses were extremely difficult to control. Modern authorization and fraud detection techniques have been very successful in reducing those losses. Balto, *supra* note 22, at 218 (“Electronic transactions and authorizations means that the card issuing bank knows almost instantly whether or not a transaction is valid.”); *id.* at 221 (describing how changes in the industry reduced costs).

<sup>41</sup> Lyon, *supra* note 21, at 11 (explaining that interchange “fees for credit cards have risen on five occasions since 1994, most recently in April 2005”). Although merchant discount rates fell from about 2.7% to 2.0% from 1982 through 1994, merchant discounts then rose to 2.3% by 2001, see EVANS & SCHMALENSSEE, *supra* note 22, at 126, despite continued streamlining of the acquiring business, Balto, *supra* note 22, at 216 (describing interchange fee wars in the late 1990s, which unlike typical price wars, involved an increase in fees).

<sup>42</sup> If merchants could lawfully collaborate, they might be able to make a credible threat, but a group boycott of this type would almost certainly violate Section 1 of the Sherman Act. Although most concerted refusals to deal are now evaluated under the Rule of Reason, naked boycotts by groups of competitors against a supplier remain per se illegal. See

merchant's customers to competitors who continued to accept cards.<sup>43</sup> Merchants thus felt compelled to take at least Visa and MasterCard, the two largest brands.<sup>44</sup> As the CEO of an internet-based card-accepting merchant bemoaned, "[r]etailers are beholden to credit card companies. We've moved so far to an e-commerce model that if I don't accept credit cards, I'm out of business."<sup>45</sup>

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HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE § 5.4a, at 220–21 (3d ed. 2005).

<sup>43</sup> See *United States v. Visa U.S.A.*, 163 F. Supp. 2d 322, 341 (S.D.N.Y. 2001) (describing merchants' inability to stop accepting Visa and MasterCard payment cards despite increases in interchange fees), *aff'd* 344 F.3d 229 (2d Cir. 2003).

<sup>44</sup> Second Amended Complaint, *supra* note (1) (alleging that "[e]ven in the face of frequent and significant increases in Interchange Fees, Merchants have no choice but to continue to accept Visa's and MasterCard's dominant Credit Cards"). The merchants' motion for summary judgment quoted merchants of varying sizes making this point:

Michael Schumann, the co-owner of a three-location retail-furniture business, testified that while he would like to stop accepting payment cards, "that's not a viable option for me, because if I didn't accept Visa and MasterCard, I'd be out of business." . . . Similarly, Susan De Vries, the director of financial services of Walgreens, one of the nation's largest retailers, testified that in the "business we're in today, we cannot not [sic] accept credit cards or debit cards as a form of payment." . . . The Defendants realize that merchants are powerless to stop accepting their cards. According to a senior MasterCard executive, even Wal-Mart, the world's largest retailer, could not discontinue accepting MasterCard (let alone Visa) because "there are too many Wal-Mart consumers carrying the card" such that "it would have been very detrimental to their customer service."

Class Plaintiffs' Memorandum of Law in Support of their Motion for Summary Judgment at 47–48, *In re Payment Card Interchange and Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720) [hereinafter "Plaintiffs' SJ Motion"].

<sup>45</sup> See Martin H. Bosworth, *Credit Card Companies Rocked by New Merchant Law Suits*, CONSUMERS AFFAIRS, Sept. 27, 2005, <http://waytoohigh.wordpress.com/2005/09/27/credit-card-companies-rocked-by-new-merchant-lawsuits-consumer-affairs> (last visited Jan. 8, 2015), archived at <http://perma.cc/6WT2-H3HL>.

Rather than drop credit cards and risk losing customers, merchants attempted to negotiate lower fees. Although merchant banks competed vigorously, they had no authority over the collectively set interchange fee paid to card-issuing banks. And Visa and MasterCard, who did, generally treated interchange as non-negotiable.<sup>46</sup> This situation likely led to a sense of vulnerability among merchants that exacerbated their concerns about fee levels.

Appreciating that the banks' power arose from their collective offer—either the merchants accepted all banks' cards or none—the merchants sued, alleging that the fees they paid card issuers were higher than they would be in a competitive market because those banks do not compete for merchants to accept their cards.<sup>47</sup>

### III. THE MERCHANTS' CASE AGAINST THE INTERCHANGE FEE

The merchants alleged that the defendants fixed the interchange fee through a two-step process. First, Visa and MasterCard each set a default interchange rate that all banks could accept. Second, the networks adopted a set of nearly identical rules, known as the honor-all-cards rules, insulating the card-issuing banks from competition on merchant acceptance fees. The rules achieved this goal by prohibiting merchants from dropping one issuer's cards while continuing to accept those issued by other banks within the network. The default rate thus became the fixed rate that virtually all card-issuing banks charged. The merchants further claimed that the Visa and MasterCard rules prohibiting them from steering their customers toward lower-cost payment mechanisms blocked the only possible alternative means to spur acceptance fee competition.

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<sup>46</sup> Exceptions were sometimes made for the largest merchants, such as Wal-Mart. Lyon, *supra* note 21, at 10.

<sup>47</sup> First Consolidated Amended Class Action Complaint, 44, *In re* Payment Card Interchange Fee & Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720).



### A. Default Interchange and the Honor-All-Cards Rules

The merchants alleged that Visa, MasterCard, and their respective member banks exploited the networks' market power to fix interchange fees at supra-competitive levels.<sup>48</sup> Although the Visa and MasterCard networks, which set the interchange fee, are independent business entities, the merchants alleged that each network's honor-all-cards rules—which prohibit merchants from refusing to accept a particular bank's credit cards—effectively made the card-issuing banks partners in the fee-setting process.<sup>49</sup> In their

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<sup>48</sup> Second Amended Complaint, *supra* note (1), at 52–53 (alleging that networks set interchange fees based on perception of merchant elasticity of demand rather than costs or other competitive factors). See Sealed Memorandum and Order, *In re* Payment Card Interchange Fee & Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207 (E.D.N.Y. 2013) No. 05-MD-1720.

<sup>49</sup> See Second Amended Complaint, *supra* note (1)44, at 49–50 (alleging that the banks either directly controlled interchange fees or served as conduits ensuring that Visa and MasterCard did not compete); *id.* at 68 (banks prohibiting Visa and MasterCard from competing on interchange fees); *id.* at 64–65 (even after Visa's and MasterCard's IPOs, the banks still collectively agreed on interchange fees).

In their brief objecting to the proposed settlement, ten of the named plaintiffs summarized the merchants' complaint as follows:

This case challenges three distinct, but interrelated, anticompetitive practices. First, plaintiffs challenge Visa's and MasterCard's Honor All Cards rules, which require merchants to accept all Visa/MasterCard credit cards or all Visa/MasterCard debit cards regardless of issuer. Second, plaintiffs challenge Visa's and MasterCard's default-interchange rules, contending that those rules, when coupled with the Honor All Issuer rules, force merchants to pay 276 competitive interchange fees on all Visa and MasterCard transactions, credit or debit.

Objecting Plaintiffs' Opposition to Class Plaintiffs' Motion for Preliminary Approval of Proposed Class Settlement at 5, *In re* Payment Card Interchange Fee & Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720) [hereinafter "Merchant Objections"]. See also Objections of Target Corporation, Macy's, Inc., J.C. Penney Corporation, Inc., The GAP, Inc., Limited Brands, Inc., Dillard's, Inc., Big Lots Stores, Inc., Ascena Retail Group, Inc., The Neiman Marcus Group,

motion for summary judgment, the merchants explained that “[b]ecause default interchange fees provide a guaranteed source of revenue for issuing banks on every transaction, the issuer does not have an incentive to accept any lesser amount from the merchant.”<sup>50</sup> Although the networks’ rules permit banks to deviate from the default fee, those rules also prevent “merchants from favoring one issuer’s card over another’s.”<sup>51</sup> As a result, a merchant cannot spur competition among banks by threatening to refuse one bank’s cards while continuing to accept others and, “[b]ilateral interchange agreements between merchants and issuers are [thus] . . . virtually non-existent, in the Visa and MasterCard systems.”<sup>52</sup>

In their lawsuit, the merchants thus sought to force individual banks to compete for merchants to accept their cards, just as they compete for cardholders to use their cards. Doing so, the merchants alleged, would produce card-acceptance-fee competition and fairer fee levels.<sup>53</sup>

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Inc., Abercrombie & Fitch, Co., Saks incorporated, Chico’s Fas, Inc., Bob Evans Farms, Inc., CKE Restaurants, Inc., Papa John’s International, Inc., National Retail Federation, American Booksellers Association, and National Association of College Stores To Preliminary Approval of The Definitive Settlement Agreement, *In re* Payment Card Interchange Fee & Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720).

In 2003, the Second Circuit upheld a district court finding that the card networks possess market power over merchants. *United States v. Visa U.S.A.*, 344 F.3d 229, 239–40 (2d Cir. 2003) (holding that “Visa U.S.A. and MasterCard, jointly and separately, have power within the market for network services” in part because “despite recent increases in both networks’ interchange fees, no merchant had discontinued acceptance of their cards”).

<sup>50</sup> Plaintiffs’ SJ Motion, *supra* note 44, at 34.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> Second Amended Complaint, *supra* note (1), at 51 (bilateral agreements technologically possible); *id.* at 68–69 (default interchange and honor all cards rule work in tandem); *id.* at 69 (merchants cannot reject a card when they believe its cost outweighs its benefit because of honor-all-cards rule).

## B. Visa and MasterCard's Anti-Customer-Steering Rules

The merchants also complained about rules prohibiting them from steering their customers toward less expensive payment mechanisms.<sup>54</sup> At the time the case was filed,<sup>55</sup> Visa and MasterCard had rules prohibiting merchants from:

- (1) offering discounts or other benefits to encourage the use of a cheaper payment mechanism;
- (2) surcharging any credit card transaction;<sup>56</sup>
- (3) setting minimum and maximum purchase levels for credit card use; and
- (4) choosing to route a transaction over the least expensive processing network.<sup>57</sup>

The merchants alleged that these rules reinforced the anticompetitive impact of default interchange and the honor-all-cards rules.<sup>58</sup>

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<sup>54</sup> *Id.* at 55.

<sup>55</sup> In 2011, while the litigation was pending, the Department of Justice, Antitrust Division, filed a case attacking the rules prohibiting the offering of discounts for using less expensive payment mechanisms. Visa and MasterCard entered a consent decree purporting to permit discounts that discriminate against all cards, but not those of particular issuers. But that decree has not altered market dynamics because American Express continues to litigate the case and it prohibits discriminatory discounts. *See infra* note 66.

In addition, the Dodd-Frank Act included a provision empowering merchants to set minimum purchase requirements for the acceptance of credit cards not to exceed \$10. 15 U.S.C. § 1693o-2(b)(3)(A)(i).

<sup>56</sup> Second Amended Complaint, *supra* note (1), at 55.

<sup>57</sup> Merchant Objections, *supra* note 49, at 5 (explaining that the “plaintiffs challenge various anti-steering restraints, including the no-surcharge rules, no minimum/maximum-purchase rules, no-discrimination rules, no-bypass, no-multi-issuer, and all outlets rules”); Second Amended Complaint, *supra* note (1), at 55–57 (referring generally to “the Anti-Steering Restraints”).

<sup>58</sup> Second Amended Complaint, *supra* note (1), at 55.

#### IV. THE SETTLEMENT

After seven years of litigation, the class' and the defendants' counsel agreed to settle. Under the terms of the settlement, Visa and MasterCard would (1) pay the merchants approximately \$7.25 billion and (2) relax their rules prohibiting merchants from steering their customers toward less expensive payment mechanisms. The settlement, however, did not alter the default interchange system or honor-all-cards rules. Nor did it empower merchants to steer their customers' payment choices by routing a particular issuer's cards over a less expensive network or by discriminating against particular card issuers.

When the parties announced the proposed deal in summer 2012, they described it as the largest private antitrust settlement in history.<sup>59</sup> This Part describes the settlement's overall structure and the provisions relating to surcharging, the principal injunctive relief from which no class member could opt out.

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<sup>59</sup> Robb Mandelbaum, *Visa and MasterCard Settle Lawsuit, but Merchants Aren't Celebrating*, N.Y. TIMES, Aug. 9, 2012, at B6. The damages awarded were twice as large as those in the debit card litigation that the same parties settled before the same judge about a decade before. See Adam J. Levitin, *An Analysis of the Proposed Interchange Fee Settlement* (Georgetown Law and Economics Research Paper No. 12-033, Georgetown Public Law Research Paper No. 12-125), GEORGETOWN LAW FACULTY PUBLICATIONS 1, 5 (2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2133361](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2133361), archived at <http://perma.cc/YD9D-4EPZ>.

## A. Overview of the Settlement

The parties created two separate classes, one for damages and the other for injunctive relief.<sup>60</sup> The damages portion, a

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<sup>60</sup> See FED. R. CIV. P 23(a)–(b) defining classes as follows:

- (a) Prerequisites. One or more members of a class may sue or be sued as representative parties on behalf of all members only if:
  - (1) the class is so numerous that joinder of all members is impracticable;
  - (2) there are questions of law or fact common to the class;
  - (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and
  - (4) the representative parties will fairly and adequately protect the interests of the class.
- (b) Types of Class Actions. A class action may be maintained if Rule 23(a) is satisfied and if:
  - (1) prosecuting separate actions by or against individual class members would create a risk of:
    - (A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or
    - (B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;
  - (2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or
  - (3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:
    - (A) the class members' interests in individually controlling the prosecution or defense of separate actions;

typical Rule 23b(3) opt-out class, included all merchants that accepted cards from January 1, 2004<sup>61</sup> until the late-2012 preliminary approval of the settlement.<sup>62</sup> The injunctive relief class, however, was designated a non-opt out, mandatory Rule 23b(2) class.<sup>63</sup> It included any merchant

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- (B) the extent and nature of any litigation concerning the controversy already begun by or against class members;
  - (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and
  - (D) the likely difficulties in managing a class action.

<sup>61</sup> This was the date on which the court determined that the preclusive effect of the settlement in the debit card litigation ended. Second Amended Complaint, *supra* note (1), at 37.

<sup>62</sup> Definitive Class Settlement Agreement 18, *In re* Payment Card Interchange Fee & Merch.-Disc. Antitrust Litig., 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720) [hereinafter Settlement]. A small group of plaintiffs set forth in the settlement would not participate in the damages portion of the case, presumably because they had already reached individual settlements with the defendants. These plaintiffs were deemed “Individual Plaintiffs” in the settlement and they included: Ahold U.S.A., Inc.; Albertson’s Inc.; BI-LO, LLC; Bruno’s Supermarkets, Inc.; 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.; Publix Supermarkets, Inc.; QVC, Inc.; Raley’s; Rite Aid Corporation; Safeway, Inc.; SupervaluInc.; Wakefern Food Corporation; and Walgreen Co. These individual settlements were not disclosed. *See also In re* Payment Card Interchange Fee & Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 212 n.2 (E.D.N.Y. 2013) (defining “Individual Plaintiffs”).

<sup>63</sup> Paragraph 2 of the settlement provided as follows:

The Class Plaintiffs will seek, and the Defendants will not oppose, the Court’s certification of two settlement classes for settlement purposes only, defined as follows.

- (a) A “Rule 23(b)(3) Settlement Class” under Federal Rules of Civil Procedure 23(a) and (b)(3), from which exclusions shall be permitted, consisting of all persons, businesses, and other entities that have accepted Visa-Branded Cards and/or MasterCard-Branded Cards in the United States at any time from January 1, 2004 to

that accepted cards from the date of preliminary approval of the settlement into perpetuity, including merchants that (1) opted out of the damages class and (2) had not yet even begun accepting cards when the court approved the settlement.<sup>64</sup> On its face, the settlement would bind even merchants that began doing business after the 2021 expiration of the injunctive relief provisions.

### B. Injunctive Relief—Permitting Certain Forms of Surcharging

The injunctive relief imposed by the settlement is notable in that it ignored the concerns at the heart of the complaint: (1) the collective setting of a default interchange fee; and (2) the rules prohibiting merchants from rejecting the cards of, surcharging the card transactions of, or otherwise discriminating against a particular card-issuing bank.<sup>65</sup> The settlement did enjoin the defendants from prohibiting certain forms of surcharging card transactions.<sup>66</sup> Even there,

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the Settlement Preliminary Approval Date, except that this Class does not include the named Defendants, their directors, officers, or members of their families, financial institutions that have issued Visa- or MasterCard-Branded Cards or acquired Visa- or MasterCard-Branded Card transactions at any time from January 1, 2004 to the Settlement Preliminary Approval Date, or the United States government.

(b) A “Rule 23(b)(2) Settlement Class” under Federal Rules of Civil Procedure 23(a) and (b)(2), from which exclusions shall not be permitted, consisting of all persons, businesses, and other entities that as of the Settlement Preliminary Approval Date or in the future accept any Visa-Branded Cards and/or MasterCard-Branded Cards in the United States[.]

Settlement, *supra* note 9, at 18.

<sup>64</sup> *Id.* at 18.

<sup>65</sup> *Id.* at 48.

<sup>66</sup> *Id.* at 41 (brand level surcharging); *id.* at 48 (product level surcharging). The settlement also superfluously enjoined the defendants from changing two government-imposed requirements. First, a federal statute guaranteeing merchants the right to impose minimum purchase

requirements up to §10,15 U.S.C. § 1693o-2(b)(3)(A)(i), was duplicated by the settlement. Settlement, *supra* note 9, at 50–51 (Visa); *id.* at 64 (MasterCard). Second, a Department of Justice consent decree prohibited Visa and MasterCard from enforcing rules that blocked merchants from offering discounts to encourage their customers to use less expensive payment mechanisms. The consent decree entered by Visa and MasterCard in the government prosecution required the networks to permit merchants to (1) communicate their actual cost of accepting a particular means of payment and (2) offer inducements to their customers by offering a discount, free product, or enhanced service “if the Customer uses a particular Brand or Type of General Purpose Card, a particular Form of Payment, or a Brand or Type of General Purpose Card or a Form of Payment other than the General Purpose Card the Customer initially presents.” Final Judgment as to MasterCard International Inc. and Visa Inc. at 6–7, *United States v. Am. Express Co.*, 2011 WL 2974094 (E.D.N.Y. July 20, 2011) (No. 10-CV-4496). The judgment explicitly did not prohibit Visa and MasterCard from “adopting, maintaining, and enforcing Rules that prohibit Merchants from encouraging Customers to pay for goods or services using one of its General Purpose Cards issued by one particular Issuing Bank rather than by another of its General Purpose Cards issued by any other Issuing Bank.” *Id.* The settlement simply duplicated the consent decree’s requirements. Settlement, *supra* note 9, at 39 (Visa); *id.* at 53 (MasterCard). Visa and MasterCard also agreed to permit merchants to decide whether to accept cards and surcharge separately for outlets with different forms of branding. *Id.* at 40 (Visa); *id.* at 53 (MasterCard). No existing rule prohibited this practice.

In addition, the defendants agreed to bargain over interchange fees in good faith with groups of merchants to the extent that the antitrust laws permitted it. *Id.* at 50–51 (Visa); *id.* at 63–64 (MasterCard). Nothing prohibited these negotiations in the past. In approving the settlement, however, the court pointed out that both Visa and MasterCard had a history of refusing to negotiate with groups of merchants. *See In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207, 234–35 (E.D.N.Y. 2013). Nothing in the settlement required Visa or MasterCard to enter individual or group interchange agreements with merchants in lieu of their default interchange rates. If the court enforcing the settlement found that a defendant did not negotiate in good faith, however, the offending defendant would have to pay the merchants’ attorneys’ fees incurred in prosecuting the case for breach of the settlement agreement. Settlement, *supra* note 9, at 50. The value of this part of the relief was further limited by the potential antitrust liability if merchants entered an agreement with their competitors that affected their prices. *Competitive Impact Statement* at 3, *United States v. Oklahoma State Chiropractic Indep. Physicians Ass’n*, No. 13-CV-00021, 2013 BL 139537 (N.D. Okla. Jan. 10, 2013) (entering consent decree blocking



however, the settlement is notable for what it did not do. It permitted Visa and MasterCard to continue to prohibit merchants from surcharging a particular card issuer as a means to force that bank to lower its acceptance fees.<sup>67</sup>

The settlement nominally allowed a merchant to surcharge either (1) all credit cards within a brand; or (2) particular credit card products from all brands.<sup>68</sup> But this right was significantly limited. A merchant could not surcharge at all if it accepted, but did not surcharge, a more expensive card brand.<sup>69</sup> So, for example, if American Express charged a higher card acceptance fee than Visa, which is often the case, the merchant could not surcharge Visa cards unless it also surcharged American Express cards.

The settlement also (1) explicitly acknowledged that it did not purport to limit the applicability of state laws prohibiting surcharging<sup>70</sup> and (2) tacitly permitted the defendants to oppose efforts to repeal state no-surcharge statutes.<sup>71</sup> Indeed, nothing prohibited the defendants from lobbying additional states to adopt similar ones. Moreover, merchants with any operations in states prohibiting surcharging would be prohibited from surcharging anywhere because the settlement required merchants to adopt uniform card acceptance policies across all similarly branded outlets.<sup>72</sup>

If a merchant could overcome these obstacles, the settlement limited any surcharge to: (1) the merchant's own

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chiropractors “negotiating contracts” on a group basis that “increased prices for chiropractic services in Oklahoma”).

With respect to each of these rule-based injunctive provisions, including the right to surcharge, the settlement provided for a July 20, 2021 sunset. That was the same date on which the DOJ consent decree will expire. At that time, the defendants would become free to reinstate any rule not otherwise prohibited by then-applicable law. Settlement, *supra* note 9, at 51 (Visa); *id.* at 64 (MasterCard).

<sup>67</sup> Settlement, *supra* note 9, at 48 (Visa); *id.* at 62 (MasterCard).

<sup>68</sup> *Id.* at 41–49 (Visa); *id.* at 54–63 (MasterCard).

<sup>69</sup> *Id.* at 41–45.

<sup>70</sup> *Id.* at 52 (Visa); *id.* at 66 (MasterCard).

<sup>71</sup> *Id.* (failing to restrict the ability of the card networks to oppose efforts to change state law).

<sup>72</sup> Settlement, *supra* note 9, at 40 (Visa); *id.* at 53–54 (MasterCard).

average card acceptance fee rate;<sup>73</sup> (2) the defendants' system-wide rates;<sup>74</sup> or (3) the fee the merchant paid for the right to accept the particular card product being surcharged less the statutorily imposed interchange fee for debit cards.<sup>75</sup>

In addition to these fee limits, the settlement required a merchant desiring to surcharge credit card transactions to (1) provide the defendants 30-day notice of its intent; and (2) disclose the practice at the points of entry to the store or website, the point of sale, and on the receipt.<sup>76</sup>

Finally, the settlement also prohibited a merchant from surcharging a particular card product from a particular brand, for example, MasterCard reward cards.<sup>77</sup> And critically, the defendants retained the right to individually negotiate agreements with merchants that would prohibit surcharging.<sup>78</sup>

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<sup>73</sup> *Id.* at 41, 54.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.* at 41 (Visa); *id.* at 54 (MasterCard).

<sup>76</sup> *Id.* at 41, 54 (prohibiting the merchant from surcharging based on both brand and product type).

<sup>77</sup> *Id.* at 41 (Visa); *id.* (MasterCard).

<sup>78</sup> *Id.*

## V. MERCHANT OBJECTIONS AND COURT APPROVAL

In mid-October 2012, the parties officially filed the then-proposed settlement with the court. Ten of the nineteen named plaintiffs<sup>79</sup> and additional merchants accounting for nineteen percent of total transaction volume refused to consent.<sup>80</sup>

The identities of the objectors tell an even more vivid story than the numbers. Those opposing the settlement included merchant associations,<sup>81</sup> and a virtual who's who of large and powerful retailers.<sup>82</sup> Nevertheless, the Court approved the settlement in its entirety.<sup>83</sup>

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<sup>79</sup> Christie Smyth, *Visa, MasterCard Merchant Fee Settlement Sent to Judge*, BUS. WK. (Oct. 19, 2012), <http://www.bloomberg.com/news/articles/2012-10-19/visa-mastercard-merchant-fee-settlement-sent-to-judge> (last visited Jan. 7, 2015), archived at <http://perma.cc/H792-L8SJ>. Counsel for the parties first notified the merchants of the settlement through a memorandum of understanding in July 2012. *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207, 217 (E.D.N.Y. 2013).

<sup>80</sup> *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d at 223.

<sup>81</sup> These were: National Association of Convenience Stores; National Association of Truck Stop Operators; National Community Pharmacists Association; National Cooperative Grocers Association; National Grocers Association; and the National Restaurant Association. Merchant Objections, *supra* note 49, at 1 n.1. Additional named plaintiffs opposing the settlement were Coborn's Incorporated; D'Agostino Supermarkets, Inc.; Jetro Holdings, Inc. and Jetro Cash & Carry Enterprises, LLC; Affiliated Foods Midwest Cooperative, Inc. *Id.*

<sup>82</sup> *Id.* at 1 n.2 (objecting large retailers include Wal-Mart Stores, Inc., Target Corporation, 7-Eleven, Abercrombie & Fitch Co., AutoZone, Best Buy, Big Lots Stores, Costco, Crate & Barrel, Cumberland Farms, Dick's Sporting Goods, Dillard's, Inc., Dollar General, Expedia, Giant Eagle, IKEA, J.C. Penney Corporation, Inc., Limited Brands, Inc., Lowe's, Macy's, Inc., Michaels, Papa John's International, Inc., Petco, REI (Recreational Equipment, Inc.), Saks Incorporated, Sports Authority, Starbucks, The Gap, Inc., The Neiman Marcus Group, Inc., and Wendy's). Many small merchants opposed the settlement as well. *Id.*; Brief as Amicus Curiae of the National Federation of Independent Business Small Business Legal Center, *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720) [hereinafter Small Business Brief].

This Part summarizes the merchants' objections to the settlement's injunctive relief provisions<sup>84</sup> as well as the

The court downplayed the number of objectors, reasoning that only 0.05% of the 12-million-member class objected, and 90% of the objectors "filled out boilerplate forms downloaded from websites that disseminated false and misleading information for the precise purpose of drumming up objections and opt-outs." Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 223.

<sup>83</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 213. The court appointed an expert to assist in the analysis of the settlement. *Id.* at 218 (explaining that the court, relying on Fed. R. Evid. 706, appointed New York University School of Law Professor and economics Ph.D. Allan O. Sykes to serve an expert witness).

<sup>84</sup> The objectors also challenged the settlement's damages provisions. Upon preliminary approval of the settlement, the card networks agreed to pay \$6.05 billion, two-thirds from Visa and one-third from MasterCard, into a settlement fund. Settlement, *supra* note 9, at 21. In addition, they agreed to cut their applicable interchange fees by 10 basis points for eight months. Rather than actually reducing the fees, however, Visa and MasterCard agreed to withhold 10 basis points from collected fees that would otherwise have been paid to card issuers. *Id.* at 22–23. These contributions would be all-inclusive, meaning that class counsel would deduct their attorneys' and experts' fees as well as the administrative costs of the settlement fund before the monies could be distributed to the merchants. *Id.* at 23–24. Curiously, nothing in the settlement prohibited Visa or MasterCard from increasing their fees immediately by ten basis points, thus wholly eliminating the benefit of the fee reduction provision. *Id.* at 52 (Visa), 66 (MasterCard). Visa and MasterCard have a history of increasing interchange fees after settling litigation involving those fees. See Plaintiffs' Motion for SJ, *supra* note 44 (pointing out that after settlement the merchants' debit card litigation "the present average effective interchange fees on both credit and debit cards have continued to increase inexorably"); Levitin, *supra* note 59, at 6 (referring to "the history of debit interchange fee increases that occurred after the 2003 Wal-Mart settlement in the previous round of interchange litigation"). The objectors also argued that the seemingly high \$7.25 billion figure amounted to only three months of interchange fee revenue to the issuing banks. Merchant Objections, *supra* note 49, at 9.

The court concluded that damages amounting to 2.5 percent of the fees paid during the relevant period were reasonable given the uncertain harm suffered. Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 229. Proving a "but for" world without default interchange and the honor-all-cards rules would be virtually impossible, the court concluded, and credit card markets differ from debit card markets where a regulatory benchmark

court's analysis rejecting each concern.<sup>85</sup> It shows that the court rested its approval on three suspect assumptions:

- (1) the low likelihood that the merchants would not prevail on the merits of the case;
- (2) the efficacy of the surcharge provisions in the settlement to foster competition on card acceptance fees; and
- (3) the court's own inability to impose more effective relief.

This Part identifies obvious flaws in the court's analysis. Parts VI–VIII provide more in-depth analysis of each assumption.

#### A. The Settlement's Injunctive Relief Provisions Do Not Address the Core Anticompetitive Conduct Challenged in the Complaint

The objecting merchants argued that the settlement failed to respond to their core concerns, leaving default interchange and the honor-all-cards rules unaltered.<sup>86</sup>

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exists. *Id.* at 228; Memorandum from Professor Alan O. Sykes to Hon. John Gleeson, 22–25 (Aug. 28, 2013), *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720) [hereinafter Sykes Rep.] (explaining the difficulty of assessing damages given uncertainty about what the market would have looked like absent the defendants' rules); Daniel M. Tracer, Note, *Overcharge But Don't Overestimate: Calculating Damages for Antitrust Injuries in Two-Sided Markets*, 33 *CARDOZO L. REV.* 807, 831–38 (2011). Reduced interchange fees would also likely reduce the value of credit cards to cardholders as issuers cut back on reward programs, a factor that would have to be taken into account. *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d at 228. Finally, the court reasoned that a jury would be unlikely to side with the merchants because consumers already paid higher prices for goods and services because of high interchange fees and would in the future pay higher bank fees if the merchants won the case. *Id.* “Jurors,” the court concluded, “have great common sense” and would view themselves, rather than the merchants, as the ultimate victims. *Id.*

<sup>85</sup> Some factors relevant to the court's decision on the fairness and adequacy of the settlement were not in dispute. *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 221, 224 (adequate discovery completed); *id.* at 229 (defendants could withstand a larger judgment).

<sup>86</sup> Merchant Objections, *supra* note 49, at 5 n.3, 6.

Although the court acknowledged that these rules formed the heart of the merchants' case,<sup>87</sup> Judge Gleeson concluded, for both practical and legal reasons, that the relief in this case could not change either one.<sup>88</sup> On the practical side, he questioned whether he could impose effective relief that would directly lower the merchant's fee burden.<sup>89</sup> Visa and MasterCard, for example, could simply impose a higher fee on merchant banks to make up for any reduction in the interchange fee.<sup>90</sup>

This practical concern curiously ignored the settled rule that an antitrust decree should go "beyond a simple proscription against the precise conduct previously pursued" to guard against the same harm from occurring in the future.<sup>91</sup> As Justice Stevens explained for the Court, "it is not necessary that all of the untraveled roads to [an anticompetitive result] be left open and that only the worn one be closed."<sup>92</sup>

Perhaps Judge Gleeson took this overly circumspect approach to his own authority because of his proclaimed certainty both that (1) the merchants could not win the case and (2) the settlement's surcharging provisions would reduce card acceptance fees. With respect to the merits, he described the "most significant defect in the objectors' collective presentation" as their "abject failure to acknowledge the perils of *not* settling . . ."<sup>93</sup> The objectors

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<sup>87</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 214–15.

<sup>88</sup> *Id.* at 224 (explaining that "the Court should balance the benefits afforded the Class, including the *immediacy* and *certainty* of a recovery, against the risks of litigation" (quoting *In re Top Tankers, Inc. Sec. Litig.*, 2008 WL 2944620, at \*4 (S.D.N.Y. July 31, 2008))).

<sup>89</sup> *Id.* at 218–19.

<sup>90</sup> *Id.*

<sup>91</sup> Nat'l Soc'y of Prof'l Eng'rs v. U.S., 435 U.S. 679, 697–98 (1978) (holding that once a defendant is found guilty of violating the antitrust laws, "the District Court [i]s empowered to fashion appropriate restraints on the [defendant's] future activities both to avoid a recurrence of the violation *and to eliminate its consequences*") (emphasis added).

<sup>92</sup> *Id.* at 698–99 (quoting *Int'l Salt Co. v. U.S.*, 332 U.S. 392, 400 (1947)).

<sup>93</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 224.

wrongly assumed, Judge Gleeson asserted, “that a complete victory on the merits is a foregone conclusion.”<sup>94</sup> But the honor-all-cards rules and default interchange, he explained, “undeniably have significant precompetitive effects” and thus would “quite easily” withstand rule-of-reason scrutiny.<sup>95</sup> To support this conclusion, he repeatedly cited to the Department of Justice’s decision, after a presumably thorough investigation, not to challenge either honor-all-cards or default interchange.<sup>96</sup>

### B. The Settlement’s Injunctive Relief Provisions Do Not Ensure that Interchange Fees Will Be Set Competitively

The objectors argued that the settlement’s limited right to surcharge would not undo the competitive harm. Few merchants, they argued, would benefit from the opportunity because ten states, accounting for 42% of all retail transactions, prohibited surcharging.<sup>97</sup> And the settlement effectively extended the scope of those laws by requiring a merchant to surcharge all transactions.<sup>98</sup> Any merchant with multi-state operations in at least one state that prohibited surcharging would thus be barred from the practice.<sup>99</sup>

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<sup>94</sup> *Id.*

<sup>95</sup> *Id.* at 219.

<sup>96</sup> *Id.* at 219, 235.

<sup>97</sup> Merchant Objections, *supra* note 49, at 8 n.10 (“The ten states that prohibit surcharging are California, Colorado, Connecticut, Florida, Kansas, Maine, Massachusetts, New York, Oklahoma and Texas.”). See *Merchant Surcharging: Understanding Payment Card Changes*, VISA, <http://usa.visa.com/personal/get-help/checkout-fees.jsp>, archived at <http://perma.cc/89WB-CV7X> (listing “States Where No Surcharge Laws Protect Consumers” and providing information about each statute); Michelle Crouch, *Credit Card Surcharges? No Way, Poll Says*, FOX BUSINESS (Aug. 20, 2012), <http://www.foxbusiness.com/personal-finance/2012/08/16/credit-card-surcharges-no-way-poll-says/> (last visited Mar. 7, 2015) (citing Morgan Stanley July 2012 research report).

<sup>98</sup> Settlement, *supra* note 9, 40, 63.

<sup>99</sup> Merchant Objections, *supra* note 49, at 2, 8. The supporting plaintiffs responded to this concern by arguing that Visa and MasterCard’s consent decrees in the government prosecution relating to discrimination

In addition, even in states without prohibitions, the objectors argued, no merchant could surcharge if it accepted American Express. The settlement does not permit surcharging if (1) the merchant accepted a card brand with more expensive merchant fees, which American Express often has and (2) the merchant does not surcharge that brand. Although American Express does not prohibit surcharging, it requires non-discrimination among all cards, including debit cards.<sup>100</sup> For a merchant to surcharge consistently with American Express' rules, it would therefore have to either exempt AmEx cards or apply the surcharge to debit as well as credit cards. But the settlement prohibited both of those options.<sup>101</sup> And, of course, merchants would not want to surcharge less expensive debit cards.<sup>102</sup> They might not even want to surcharge American Express cards, which may bring a different, more attractive customer set to the merchant.<sup>103</sup>

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against cards would enable merchants to get around the surcharging uniformity requirement because that decree permits multiple price point discounts. The objectors responded that the ability to discount under the decree is still bound up with the government's on-going litigation against American Express and that, in all events, the consent decree applies only to discounting for *not using a credit card*. It does not permit surcharging customers who do use a credit card, *id.* at 7–8 & nn. 11–12, a distinction that the Department of Justice made quite clear. *See* Resp. of Pl. United States to Public Comments on the Proposed Final J. at 26 n.14, U.S. v. Am. Express Co., (E.D.N.Y. June 14, 2011) (internal citations omitted).

<sup>100</sup> Merchant Objections, *supra* note 49, at 7 n.8 (linking to American Express rules).

<sup>101</sup> Settlement, *supra* note 9, at 41 (Visa), *id.* 64 (MasterCard) (not extending surcharging right to debit cards and prohibiting exempting American Express cards if that company's fees are higher).

<sup>102</sup> Merchant Objections, *supra* note 49, at 2, 7.

<sup>103</sup> Promotional material that American Express presented to merchants contends that the brand “help[s] our Merchants increase their revenue, by attracting and retaining their most valuable customers and prospects” and highlights that:

[t]he average annual personal income of an American Express Card member is significantly higher than that of non-Cardmembers. Their monthly spend on plastic is more,



To emphasize the inadequacy of the settlement's surcharging provisions, the objectors showed that not one of the nine named plaintiffs supporting the settlement could surcharge because (1) all but one operated in a state with no-surcharge laws and (2) every one accepted American Express cards.<sup>104</sup> The centerpiece of the settlement's injunctive relief thus failed to benefit even the named plaintiffs.<sup>105</sup>

Judge Gleeson acknowledged these limitations but claimed to be powerless to overcome them.<sup>106</sup> Bemoaning that he could not "enjoin nonparties or preempt state laws," he concluded that "there could not be [a solution] in this case."<sup>107</sup> But he ignored obvious, implementable solutions. He could have enjoined the defendants from prohibiting merchants from (1) surcharging in some states but not others and (2) enacting schemes that surcharged one card network but not a more expensive one.<sup>108</sup>

Judge Gleeson also expressed a high degree of confidence that surcharging, despite the limitations in the settlement, would reduce merchant card acceptance fees.<sup>109</sup> Describing state no-surcharge laws as "not only anti-consumer, [but

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and the majority of them are enrolled in a Rewards program, so they're loyal to using their card.

See *Merchant Services: Why American Express*, AM. EXPRESS, <http://www.americanexpress.com/au/content/merchant/pdf/why-amex/Why-American-Express.pdf> (last visited Mar. 1, 2015), archived at <http://perma.cc/YHC5-WT4N>.

<sup>104</sup> Merchant Objections, *supra* note 49, at 23–24.

<sup>105</sup> *Id.*

<sup>106</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 219, 233 (E.D.N.Y. 2013).

<sup>107</sup> *Id.* at 219, 234.

<sup>108</sup> Writing as if all merchants would want to surcharge American Express cards, Judge Gleeson wholly failed to acknowledge the possibility that a merchant might (1) be willing to pay more to accept American Express because the card provided more value, *see supra* note 103; and thus (2) legitimately desired to surcharge only Visa and MasterCard. After all, the honor-all-cards rule does not protect American Express and many merchants simply refuse to accept it because of its higher cost and lower transaction volume. Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 233.

<sup>109</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 234.

also] arguably irrational . . . ,”<sup>110</sup> he praised the settlement’s surcharging provisions as “an indisputably pro-competitive development that has the potential to alter the very core of the problem this lawsuit was brought to challenge.”<sup>111</sup> Prior to the settlement, the court explained, a merchant was powerless to steer a customer toward a less expensive card by passing on the extra costs; but post-settlement a merchant could make the cost of accepting cards “transparent and avoidable.”<sup>112</sup> He reiterated the case that some commentators have raised against no-surcharge rules—that they hide the true cost of cards from a merchant’s customers and shift costs to poorer consumers who have no credit cards.<sup>113</sup> And he contended that the mere threat of surcharges from those merchants that were able to engage in the practice would force down interchange fees for

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<sup>110</sup> *Id.* at 232. The attorneys for the merchant class who negotiated the settlement have begun to challenge state no-surcharge laws on constitutional grounds, including the First Amendment and the Due Process Clause. They have achieved initial success in a case challenging New York’s no-surcharge statute. *Expressions Hair Design v. Schneiderman*, 975 F. Supp. 2d 430, 447–48 (S.D.N.Y. 2013) (holding that a statute prohibiting merchants from surcharging offends the First Amendment and is void for vagueness).

<sup>111</sup> *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d at 230 (describing the right to surcharge “as a central piece” of the puzzle of making credit card merchant fees competitive and “a critical accomplishment”); *id.* at 218–20 (explaining that “[t]he proposed settlement adds another crucial reform [to the credit card industry]—the lifting of restrictions on network- and product-level surcharging” and constitutes “an important step forward” that would enable merchants “to expose hidden bank fees to their customers”).

<sup>112</sup> *Id.* at 231.

<sup>113</sup> *Id.* (explaining that no-surcharge rules “hurt the very consumers they were ostensibly enacted to protect by propping up high credit card acceptance costs [and t]hey aid and abet a regime in which the poorest consumers subsidize the awards conferred upon premium cardholders because merchants are prohibited from disfavoring those premium cards through surcharging”); see also Adam Levitin, *Priceless? The Competitive Costs of Credit Card Merchant Restraints*, 55 UCLA L. REV. 1321, 1385–88 (2008).

all.<sup>114</sup> “In short,” the court concluded, “the settlement gives merchants an opportunity at the point of sale to stimulate the sort of network price competition that can exert the downward pressure on interchange fees they seek.”<sup>115</sup>

But the court’s appointed expert witness, Professor Alan Sykes, an economist and NYU law professor, was considerably less sanguine about the potential value of surcharging to merchants. He described the potential benefits as “highly uncertain” and potentially “small.”<sup>116</sup> Judge Gleeson also failed to take account of the economic and practical analysis showing that surcharging may harm credit card systems and raise consumer prices.<sup>117</sup> Ironically,

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<sup>114</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 230–31. Repeatedly, the court asserted that these limitations do not “alter the fact that the essence of the injunctive relief obtained by the proposed settlement will permit precompetitive actions by merchants at the point of sale.” *Id.* at 234. It also pointed out that 27 of the top 60 merchants to opt out of the 23b(3) class did not object to the settlement. *Id.* at 223. These merchants included the major airlines that, the court emphasized, had surcharged card transactions in countries where it had been permitted. *Id.* (explaining that 15 of the top 25 convenience stores did not object to the settlement).

<sup>115</sup> *Id.* at 218.

<sup>116</sup> Sykes Rep., *supra* note 84, at 35–43.

<sup>117</sup> Because credit card systems are two-sided markets that must appeal to both cardholders and merchants, efficient pricing must take account of the demand structure on each side of the market. Historical evidence indicates that cardholder demand is more elastic and thus efficient pricing would place more of the cost on merchants than cardholders. Permitting surcharging may undo that efficient pricing by shifting too much of the cost of the system to cardholders. See Steven Semeraro, *Assessing the Costs & Benefits of Credit Card Rewards: A Response to Who Gains and Who Loses from Credit Card Payments?* Theory and Calibrations, 25 LOY. CONSUMER L. REV. 30, 80–83 (2012) [hereinafter Card Rewards]; Steven Semeraro, *The Antitrust Economics (and Law) of Surcharging Credit Card Transactions*, 14 STAN. J.L. BUS. & FIN. 343, 357–74 (2009) [hereinafter Economics of Surcharging]; Joshua S. Gans & Stephen P. King, *Regulating Interchange Fees in Payment Systems* 5, 25 (Melbourne Bus. Sch., Working Paper No. 2001-17, Oct. 2001) (explaining that the no-surcharge rule “can play an important, socially desirable, role in eliminating the ability of merchants to use the choice of payment instrument as a means of practicing price discrimination . . . [that] serves to distort the cost of transacting further away from its cost

he failed to acknowledge that the Antitrust Division had investigated, but failed to challenge, the card networks' no-surcharge rules. He thus never explained how, on the one hand, the Division's failure to challenge default interchange and the honor-all-cards rules confirmed the pro-competitive effects of those practices, but, on the other hand, the antitrust enforcer's failure to challenge surcharging was, according to the court's analysis, apparently a colossal mistake.

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minimising [sic] level"), *available at* [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=286535](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=286535) (last visited Jan. 7, 2015), *archived at* <http://perma.cc/29YP-KX6E>; Zhu Wang, *Market Structure and Credit Card Pricing: What Drives Interchange?* 36–37 (Payments System Research, Federal Reserve Bank of Kansas City Working Paper 06–04) (Dec. 20, 2006) (explaining that no-surcharge rule can be welfare enhancing where it limits surcharging by merchants with market power); Julian Wright, *Optimal Card Payment Systems*, 8 (2002) (explaining that “[w]hen surcharging is allowed, merchants with monopoly power will exploit their power by setting a price to extract surplus from inframarginal cardholders”), *available at* [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=278047](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=278047) (last visited Mar. 7, 2015), *archived at* <http://perma.cc/ER9E-BH85>; Michael L. Katz, Commissioned Report, in 2 *Reform of Credit Card Schemes in Australia* 17 (Reserve Bank of Australia Aug. 2001) (last visited Jan. 7, 2015) (explaining that surcharging can undo the effects of interchange fees).

## VI. THE MERCHANTS' LIKELIHOOD OF SUCCESS ON THE MERITS

As with any class action, assessing the fairness, reasonableness, and adequacy of the settlement requires the court to take account of the likely result that the class could obtain with a victory on the merits, discounting for the delay that further litigation could cause as well as the chance that the class would lose.<sup>118</sup> Judge Gleeson took the position that the merchants were unlikely to win. This Part evaluates his conclusions.

### A. General Factors Unrelated to the Specific Merits of the Merchants' Claims

In upholding the settlement, the court and its appointed expert relied on a number of factors that were unrelated to the merits of the merchants' antitrust claims. This section explains why those factors are unpersuasive.

#### 1. Expert Disagreement and False Statistical Analysis

Professor Sykes' 51-page expert report supporting the settlement did not directly assess the merits of the case.<sup>119</sup> Instead, it relied on two general considerations. First, he concluded that when "experts in this case devoted a great deal of attention" to an issue, the merchants' chances of success must be uncertain.<sup>120</sup> That sophisticated experts are able to contest an issue, however, is hardly predictive of the outcome. Second, Professor Sykes made much of the statistical phenomenon that (1) if the case depended on several independent legal issues, then (2) the merchants' chances of victory would be lower than one might expect.

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<sup>118</sup> See, e.g., *In re Agent Orange Prod. Liab. Litig.*, 597 F. Supp. 740, 749 (E.D.N.Y. 1984) (citing as a reason for finding the settlement fair that the "likely ultimate result [of the litigation would be] no recovery by any plaintiff").

<sup>119</sup> Sykes Rep., *supra* note 84, at 1–2.

<sup>120</sup> *Id.* at 10.

Even if they had a 50/50 chance of winning each of five independent issues, Sykes cautioned, the class' chances of prevailing would be only slightly better than three percent.<sup>121</sup> These calculations, however, depend on the independence of each question. Because the legal issues faced by the merchants are all interrelated, this statistical point is essentially irrelevant.

## 2. Timing of Relief

Both Professor Sykes and the court asserted that the settlement enabled the class to benefit more quickly than would a litigated decree.<sup>122</sup> But that would be true only if, counter-factually, the entire class accepted the settlement. Given that numerous well-financed merchants are attacking the court's approval, the settlement is unlikely to provide relief to the class significantly more quickly than would a trial.<sup>123</sup>

The case was filed over seven years ago, and it came on the heels of prior multi-year class litigation by essentially the same parties before the same judge. More than a year ago, the parties filed over 500 pages of dispositive motions. Presumably, the court could decide the case based on this paper or set it for trial in relatively short order. To be sure, an appeal would be likely. But it would take no longer than the appeal of the court's decision to approve the settlement. From the perspective of timing, the choice between settlement and litigation is a toss up

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<sup>121</sup> *Id.* at 6.

<sup>122</sup> *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207, 222–23 (E.D.N.Y. 2013).

<sup>123</sup> In July 2014, Judge Gleason allowed new challenges to Visa's and MasterCard's interchange fees to proceed. The plaintiffs in these cases included large and well-funded merchants, such as Macy's, Target, and Walmart. See Christie Smythe, *Visa, MasterCard Must Face Target, Macy's Swipe-Fee Case*, BLOOMBERG NEWS (Jul. 18, 2014), <http://www.bloomberg.com/news/articles/2014-07-18/visa-mastercard-must-face-target-macy-s-swipe-fee-case>, archived at <http://perma.cc/F6VL-7MXE>.

### 3. Class Certification

In any class action, the plaintiffs must successfully certify the class before proving the merits of their case. In the debit card litigation a decade ago, Judge Gleeson certified a merchant class challenging Visa and MasterCard network rules relating to merchant acceptance fees, and the Second Circuit upheld his decision.<sup>124</sup> Given that this case is in the same circuit, before the same trial judge, and raises similar issues, the class should again be certified.<sup>125</sup> The court acknowledged as much, explaining that the plaintiffs have “strong arguments.”<sup>126</sup>

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<sup>124</sup> *In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124 (2d Cir. 2001).

<sup>125</sup> The defendants also argued that in settling the 1990s debit card litigation, the merchants released the defendants from liability for conduct relating to rules that were in existence prior to that settlement. *See* Defendants’ Reply Memorandum of Law in Support of their Motion for Summary Judgment as to the Claims in the Second Consolidated Amended Class Action Complaint at 1–9, *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720). Since the default interchange, honor-all-cards, and anti-steering rules were all in place when the same parties settled the prior case, the defendants argued that merchants are now barred from challenging them. *Id.* The merchants countered that the issues raised in this litigation are different and that the release in the prior case cannot properly be interpreted to cover the defendants’ subsequent conduct, including additional increases in default interchange fees. Although both cases involved the honor-all-cards rule broadly defined, the debit card case resolved whether merchants would be required to accept debit cards if they accepted credit cards. In the current litigation, the issue is whether merchants must accept cards from all issuers. *See* Class Plaintiffs’ Memorandum of Law in Opposition to Defendants’ Motion for Summary Judgment, at 7–22, *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720). Neither the court nor its expert paid attention to this argument. And given that the same judge oversaw the prior settlement and is thus as familiar as anyone with the intent of the parties, it seems hard to imagine that he would have allowed the current litigation to continue for seven years if he believed that the parties intended the prior settlement to release the merchants’ current claims.

<sup>126</sup> *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d at 229.

## B. The Likely Outcome of the Litigation

The most significant issue in assessing the settlement's reasonableness is whether the class could prevail on the merits if the case were litigated. This Section addresses a threshold standing issue and then reviews the merchant's rule-of-reason case.

### 1. Are the Merchants Indirect Purchasers?

The defendants argue that the merchants formally deal only with their own banks and are thus indirect payers of the interchange fee to card-issuing banks. Under the federal antitrust laws, only the *direct* purchaser from an antitrust violator may sue to recover an anticompetitive overcharge even if that purchaser passed it on to its customers.<sup>127</sup> An indirect purchaser, by contrast, is generally prohibited from recovering damages.<sup>128</sup> Since indirect purchasers lack standing to sue for antitrust damages, the defendants claim, the merchants' case cannot proceed to the merits.<sup>129</sup>

Although the court acknowledged that the class could overcome this threshold issue, Judge Gleeson nonetheless labeled it "a source of significant uncertainty for the plaintiffs if they sought to litigate their claims."<sup>130</sup> The court cited the Ninth Circuit's recognition of the defense in similar cases as the source of this uncertainty.<sup>131</sup>

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<sup>127</sup> *Hanover Shoe Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481 (1968).

<sup>128</sup> *Ill. Brick v. Illinois*, 431 U.S. 720, 737 (1977).

<sup>129</sup> See Defendants' Reply Memorandum of Law in Support of their Motion for Summary Judgment as to the Claims in the Second Consolidated Amended Class Action Complaint at 9–20, *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 1:05-MD-1720).

<sup>130</sup> *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d at 226.

<sup>131</sup> *In re ATM Fee Antitrust Litig.*, 686 F.3d 741, 750–58 (9th Cir. 2012); see *Kendall v. Visa U.S.A.*, 518 F.3d 1042, 1048–50 (9th Cir. 2008).



But the Ninth Circuit's reasoning would not support dismissing the claim here.<sup>132</sup> The indirect purchaser rule bars claims for damages, but not for injunctive relief.<sup>133</sup> Even if the indirect purchaser rule prevented the merchants from recovering for past overcharges, they could nonetheless continue to undo prospectively the honor-all-cards rules and default interchange. As a result, the merchants' prospective challenge could not be blocked.

Moreover, the merchants should be permitted to maintain their damages claims as well because they directly purchased services from the card system. In a typical market, a purchaser buys a product (for example, bricks in the seminal case establishing the direct-purchaser rule<sup>134</sup>) at a supra-competitive price, and then resells it to its own customers. The defendants allege that merchants' banks directly pay the interchange fee and pass it on to merchants, as a contractor passes along the cost of bricks to its clients. But the defendants paint a distorted picture of the card market. A merchant's bank participates in a joint venture with issuing banks to provide a payment system. Merchants and cardholders purchase the benefits of that system directly from all the banks constituting the card network.<sup>135</sup> One bank does not pass on the services of another in the way that a contractor passes on raw materials.

Judge Gleeson explicitly recognized this distinction in a pre-trial ruling in the 1990s debit card class action. He held

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<sup>132</sup> See Class Plaintiffs' Memorandum of Law in Opposition to Defendants' Motion for Summary Judgment, at 22–42, *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720).

<sup>133</sup> See *Lucas Auto. Eng'g, Inc. v. Bridgestone/Firestone, Inc.*, 140 F.3d 1228, 1235 (9th Cir. 1998) (holding “indirect purchasers are not barred from bringing an antitrust claim for injunctive relief against manufacturers”); see also *McCarthy v. Recordex Serv., Inc.*, 80 F.3d 842, 856 (3d Cir. 1996); *In re Beef Indus. Antitrust Litig.*, 600 F.2d 1148, 1167 (5th Cir. 1979). In *Kendall*, the Ninth Circuit inexplicably ignored its own precedent in rejecting a claim for injunctive relief. See *Kendall*, 518 F.3d at 1051.

<sup>134</sup> *Ill. Brick v. Illinois*, 431 U.S. 720 (1977).

<sup>135</sup> *EVANS & SCHMALENSEE*, *supra* note 22, at 152.

there that the merchants had standing to pursue a claim that the defendants monopolized the debit card market because they “are direct consumers of the defendants’ debit cards services and are directly injured by their allegedly anticompetitive conduct.”<sup>136</sup> The current case is indistinguishable.<sup>137</sup>

## 2. The Merits of the Rule-of-Reason Case

The merchants’ case is compelling, if not entirely unassailable.<sup>138</sup> To succeed, the merchants must show that

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<sup>136</sup> *In re VisaCheck/MasterMoney Antitrust Litig.*, No. 96-CV-5238, 2003 WL 1712568, at \*6 (E.D.N.Y. Apr. 1, 2003).

<sup>137</sup> The merchants may be able to maintain damages claims for two additional reasons. First, card acceptance services are sometimes sold, particularly to large merchants, on a strict interchange-fee-plus basis. *See* EVANS & SCHMALENSSEE, *supra* note 22, at 155 (explaining that “[l]arge merchants typically pay an acquirer fee plus the interchange fee”). Cost-plus contracts, the Supreme Court has recognized, may be an exception to the indirect-purchaser rule. *See* Ill. Brick v. Illinois, 431 U.S. 720, 724 n.2, 736 (1977) (recognizing a potential exception for pre-existing cost plus contracts). Acquiring banks do not pay interchange fees in any meaningful sense. They are simply the conduit through which the merchants pay the card-issuing banks. The Supreme Court rejected this exception in a case involving a public utility that was required by regulation to pass on its costs of acquiring electric power. The Court there reasoned that the delays and uncertainties inherent in the regulatory pricing process would raise the same complicated damages apportionment issues as those that led the Court to adopt the indirect-purchaser rule. *See* Kansas v. Utilicorp United Inc., 497 U.S. 199, 2816–17 (1990). But those regulatory complications do not exist in card acceptance markets.

Second, even if some merchants were barred from seeking damages by the federal indirect purchaser rule, others could pursue damages under state law. Many states have refused to apply the indirect-purchaser rule to limit standing under their state law counterparts to the Sherman Act. *See* Jonathan R. Tomlin & Dale J. Giali, *Federalism and the Indirect Purchaser Mess*, 11 GEO. MASON L. REV. 157, 161–62 (2002) (explaining that thirty-six states and the District of Columbia recognize antitrust claims by indirect purchasers).

<sup>138</sup> In commenting on the settlement, interchange expert Adam Levitin acknowledged that the “merchants might lose if they proceeded with litigation.” Levitin, *supra* note 59, at 23. But he concluded that the

the defendants agreed to restrain trade and have market power in a relevant market.<sup>139</sup> Then, the class must articulate the consumer harm flowing from the defendant's conduct and show that it outweighs the challenged rules' pro-competitive effect.<sup>140</sup> Although the merchants cannot show naked agreements subject to *per se* illegality, the challenged rules restrain competition and thus should violate the rule of reason.

a. Interchange Fees Are the Product of an Agreement

In order to violate § 1 of the Sherman Act, the defendants must have agreed to engage in the challenged conduct.<sup>141</sup> The merchants allege that default interchange and the honor-all-cards rules flow from an agreement among the banks that constitute the Visa and MasterCard networks. Historically, bank representatives sat on the boards of directors for each company and thus directly influenced interchange fee-setting decisions.<sup>142</sup> During the pendency of the litigation, both Visa and MasterCard changed their corporate structures to create publically-owned corporations.<sup>143</sup> And the court cited this change in form as a factor strengthening the defendants' argument that no agreement existed.<sup>144</sup>

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risks are worthwhile because "the gains from the settlement are so small."  
*Id.*

<sup>139</sup> United States v. Visa U.S.A., Inc., 344 F.3d 229, 238 (2d Cir. 2003).

<sup>140</sup> *Id.*

<sup>141</sup> 15 U.S.C. § 1 (2004). Although unilateral claims may be challenged under § 2 of the Sherman Act, 15 U.S.C. § 2, such a claim would require proof that an individual defendant possessed monopoly power. It is unlikely that any single defendant possessed a sufficiently high level of market power to meet this standard.

<sup>142</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 220 (E.D.N.Y. 2013).

<sup>143</sup> *Id.* at 215.

<sup>144</sup> *Id.* at 226.

But even within this new corporate structure, each bank, upon joining a card network, must agree to accept the applicable rules. Essentially, the plaintiffs allege a hub-and-spoke conspiracy with Visa and MasterCard at the hub and each bank forming a spoke.

In a 2008 decision, the Ninth Circuit held that Visa and MasterCard imposed these rules unilaterally. “[M]erely charging, adopting or following the fees set by a Consortium,” the court held, “is insufficient as a matter of law to [violate] Section 1 . . . . [M]embership in an association does not render an association’s members automatically liable for antitrust violations committed by the association.”<sup>145</sup>

The Ninth Circuit’s decision, to the extent it is applicable to the current case, is wrong. Each bank issuing Visa or MasterCard cards, as a practical matter, cedes the power to the network to set the default fee that merchants must pay, knowing that the merchant is prohibited from dropping a single bank because its price is too high. In the Department of Justice prosecution a decade ago, the Second Circuit concluded that Visa and MasterCard rules limiting competition among banks are subject to antitrust scrutiny as agreements under §1 of the Sherman Act.<sup>146</sup> Nothing in that court’s analysis indicated that the Visa and MasterCard corporate structure was relevant to that decision. Although the rules in that case limited competition to issue brands of credit cards other than Visa and MasterCard, the structure of the agreement was the same.

The Second Circuit’s decision, unlike the Ninth’s, follows a long line of U.S. Supreme Court cases applying § 1 to association rules.<sup>147</sup> Perhaps the most similar is the NCAA

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<sup>145</sup> *Kendall v. Visa U.S.A.*, 518 F.3d 1042, 1048 (9th Cir. 2008).

<sup>146</sup> *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 240 (2d Cir. 2003).

<sup>147</sup> *See, e.g.*, *Arizona v. Maricopa County Med. Soc’y*, 457 U.S. 332, 342–43, 348–49 (1982) (reimbursement fee schedule set by physicians’ association analyzed under § 1); *Broadcast Music v. Columbia Broadcasting System*, 441 U.S. 1, 8–9 (1979) (licensing fee set by consortium scrutinized under § 1); *Nat’l Soc. of Prof’l Eng’rs v. United*

college football case, in which the Supreme Court held that an association rule limiting individual schools' ability to televise football games was the product of an agreement among the NCAA member schools.<sup>148</sup> "By participating in an association which prevents member institutions from competing against each other on the basis of price or kind of television rights that can be offered to broadcasters," Justice Stevens wrote for the majority, "the NCAA member institutions have created a horizontal restraint—an agreement among competitors on the way in which they will compete with one another."<sup>149</sup>

Banks joining the Visa and MasterCard system similarly agree on rules governing the way that they will compete with one another. The practical impact of the honor-all-cards rules is that banks will accept default interchange and not compete on the interchange fees that they charge to merchants. Those rules are thus the product of an agreement.

b. Do the Defendants Have Market Power in a Relevant Market?

The merchants allege that Visa, MasterCard, and their largest banks have market power over merchants in the market for credit card acceptance. In the mid-1980s, the Eleventh Circuit held otherwise.<sup>150</sup> The court reasoned that credit cards did not constitute a relevant market, because they always had a reasonable substitute payment method.<sup>151</sup>

Given the expanded use of credit cards over the past twenty-five years and more recent case law, the Eleventh Circuit's decision lacks continuing validity. When the Antitrust Division prosecuted Visa and MasterCard, the

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States, 435 U.S. 679 (1978) (ethical rule adopted by professional society scrutinized under § 1).

<sup>148</sup> NCAA v. Bd. of Regents, 468 U.S. 85 (1984).

<sup>149</sup> *Id.* at 99.

<sup>150</sup> Nat'l Bancard (NaBanco) v. Visa U.S.A., Inc., 779 F.2d 592, 605 (11th Cir. 1986), *aff'g* 596 F. Supp. 1231 (S.D. Fla. 1984).

<sup>151</sup> *Id.* at 1257–58.

Second Circuit held that credit cards constituted a relevant market in which both networks separately possessed market power.<sup>152</sup> The trial court explained its reasoning through an analogy: Even though cars, trains, and buses provide substitute transportation for many destinations also served by airplanes, those alternatives would not be sufficiently close substitutes to stop commercial airlines from profitably raising prices if they were able to collude on airfares.<sup>153</sup> The court found that the same reasoning applies to credit cards, citing “specific conduct indicating the defendant’s power to control prices or exclude competition.”<sup>154</sup>

Although that case did not challenge the interchange fee, the court explicitly relied on the networks’ power over merchant card-acceptance fees, including evidence that merchants never left the system despite increasing fees.<sup>155</sup> The trial judge, Barbara Jones, credited “the testimony of merchants that they cannot refuse to accept Visa and MasterCard even in the face of significant price increases because the cards are such preferred payment methods that customers would choose not to shop at merchants who do not accept them.”<sup>156</sup> The court also found that “both Visa and MasterCard have recently raised interchange rates charged to merchants a number of times, without losing a single merchant customer as a result,” and they discriminate among merchants as a monopolist would, charging higher interchange fees to those most dependent on credit cards.<sup>157</sup>

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<sup>152</sup> *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 340–41 (S.D.N.Y. 2001) (explaining that “even a cursory examination of the relevant characteristics of the network market reveals that whether considered jointly or separately, the defendants have market power), *aff’d*, 344 F.3d 229, 238–40 (2d Cir 2003).

<sup>153</sup> *Visa U.S.A.*, 163 F. Supp. 2d at 338.

<sup>154</sup> *Id.* at 340 (citing *K.M.B. Warehouse Distribs. v. Walker Mfg. Co.*, 61 F.3d 123, 129 (2d Cir. 1995)).

<sup>155</sup> *Id.* at 340.

<sup>156</sup> *Id.*

<sup>157</sup> *Id.* at 341 (“Visa and MasterCard are able to charge substantially different prices for those hundreds of thousands of merchants who must take credit cards at any price because their customers insist on using

In their motion for summary judgment in the current case, the merchants cited evidence showing that after that earlier litigation, interchange fees continued to rise and merchants still did not stop accepting credit cards.<sup>158</sup> This new evidence and the same circuit's prior finding that the defendants had market power in a credit card market based largely on evidence of interchange price increases should combine to lead the court to again find that the defendants have market power in a credit card market.

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those cards.”). The European Commission found similar evidence of discrimination:

It would appear that merchants paying the highest average rates for MasterCard and Visa card acceptance (florists, restaurants, professional services, car rental, hotels) are typically those active in the T&E [Travel & Entertainment] sector, where travelers expect to pay with cards, while merchants paying lower fees are typically to be found in segments with low profit margins (charitable organizations, contracted services, government services, wholesale trade, etc.). An outlier is the fuel sector, which yields high margins but nevertheless pays comparatively low fees for card acceptance.

Eur. Comm'n, Competition DG, Fin. Servs. (Banking and Ins.), Interim Report I: Payment Cards, Sector Inquiry under Article 17 Regulation 1/2003 on Retail Banking at 51 (Apr. 12, 2006), *available at* [http://ec.europa.eu/competition/sectors/financial\\_services/inquiries/interim\\_report\\_1.pdf](http://ec.europa.eu/competition/sectors/financial_services/inquiries/interim_report_1.pdf), *archived at* <http://perma.cc/8ZAF-2V3B>.

In the Justice Department case against Visa and MasterCard, merchants, “including large, prominent, national retail chain stores, such as Target and Saks Fifth Avenue,” testified “that if they were to stop accepting Visa and MasterCard general purpose cards they would lose significant sales.” *Visa U.S.A.*, 163 F. Supp. 2d at 337. The court concluded that “these merchants believe they must accept Visa and MasterCard, even in the face of very large price increases.” *Id.*

<sup>158</sup> Class Plaintiffs' Memorandum of Law In Support of their Motion for Summary Judgment, at 40, *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720).

### c. The Challenged Rules' Competitive Effects

Were the merchants' case to be litigated, the court's decision would (and should) come down to whether, on balance, anticompetitive or pro-competitive effects flow from the default interchange fee and the honor-all-cards rules. In approving the settlement, Judge Gleeson described this central issue as very complicated.<sup>159</sup> But the competitive effects stage of a rule-of-reason case is always difficult, because it essentially turns on a story-telling battle. To win, the plaintiff must provide an anticompetitive narrative that is more compelling than the defendant's pro-competitive version.

#### i. The Anticompetitive Narrative

The networks' default interchange and honor-all-cards rules together enable banks to avoid competing with each other for merchants to accept their cards. A joint venture that prohibits its members from competing with each other does not *ipso facto* violate the antitrust laws.<sup>160</sup> But where the venture, as here, has significant market power, restraining intra-venture competition will have anticompetitive effect. As Judge Jones recognized in the government prosecution of Visa and MasterCard, "merchants—and ultimately consumers—have an interest in the vigor of competition to ensure that interchange pricing points are established competitively."<sup>161</sup>

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<sup>159</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 226–27 (E.D.N.Y. 2013).

<sup>160</sup> Compare *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 214 (D.C. Cir. 1986) (finding no anticompetitive effect when moving company with a small market share prohibited its affiliates from competing with the company), with *Gen. Leaseways v. Nat'l Truck Leasing Assoc.*, 744 F.2d 588, 595–97 (7th Cir. 1984) (finding likely anticompetitive effect where truck leasing company prevented affiliates from competing with each other across territories where competition was limited in local geographic markets).

<sup>161</sup> *Visa U.S.A.*, 163 F. Supp. 2d at 396.



Merchants cannot stimulate competition among the networks because Visa and MasterCard know that a merchant will not refuse to accept their cards *in toto* for fear of alienating its customers. Because network competition is unlikely, bank-to-bank competition is the only real option.<sup>162</sup> Prohibiting class members from compelling individual banks to compete for merchant acceptance thus has a significant anticompetitive impact.

## ii. The Pro-Competitive Narrative

Default interchange and the honor-all-cards rules are vehicles for increasing transaction volume by distributing system costs efficiently between cardholders and merchants.<sup>163</sup> Changing those rules, the networks argue, would confuse and anger card users, reducing credit card use.<sup>164</sup> For example, if a merchant refused to accept, or surcharged, a Citibank Visa card, but not one issued by Chase, consumers would be frustrated with, and thus less likely to use, any credit card.<sup>165</sup> After all, no one likes to have

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<sup>162</sup> The defendants argue that the rules do not restrain competition because banks may negotiate their fees individually with any merchant. See Defendants' Memorandum of Law in Opposition to Class Plaintiffs' Motion for Summary Judgment at 24, *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720); see also Defendants' Reply Memorandum of Law Support of Their Motion for Summary Judgment as to the Claims in the Second Consolidated Amended Class Action Complaint at 20–35, *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720). But the merchants' inability to put competitive pressure on a bank to enter a bilateral deal makes the theoretical option unavailable to virtually all merchants. See *infra* note 193 and accompanying text.

<sup>163</sup> *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207, 226 (E.D.N.Y. 2013) at 226 (claiming default interchange is “procompetitive because [it] enable[s] issuers to improve card features and rewards and reduce card finance charges and other costs”).

<sup>164</sup> *Id.*; Defendants' Memorandum of Law in Opposition to Class Plaintiffs' Motion for Summary Judgment at 25–30, *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d 207 (E.D.N.Y. 2013).

<sup>165</sup> *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d at 227 (explaining that “[t]he assurances that a network’s cards will be accepted wherever

a card denied at the point of sale. And if consumers cut back on their use of credit cards, the economies of scale on which the system depends would suffer. Cards would then become more expensive and everyone involved, including banks, merchants and cardholders, would be worse off.<sup>166</sup>

### iii. Assessing the Competing Narratives

Legal and economic scholars have emphasized the core antitrust principle that competition should regulate market behavior.<sup>167</sup> Merchant acceptance of credit cards is no exception. Economic analysis predicts that interchange fees will be set too high if merchant resistance to fee increases is

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the network's logo is displayed is critical to customers' desire to carry such cards and to merchants' willingness to accept them").

<sup>166</sup> The defendants contend that the challenged rules are pro-competitive. But their arguments are weak. First, they claim that default interchange lowers the merchants' cost of accepting cards because individually negotiated fees would pose significant transaction costs. *Id.* at 226. That would be true only if the sole alternative was individually negotiated fees. Other alternatives exist. *See, e.g., infra* Part VIII. For example, each bank could simply post its own fee schedule that merchants could accept or reject on a bank-by-bank basis.

Next the defendants argue that the default interchange enables reward programs and lower card finance charges, which benefit merchants by increasing consumer demand. *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d at 226. That argument amounts to saying that a victim of theft benefits if the thief gives some of the money back. Unless purchasing power increases more than the extra fee placed on the merchant (which is presumably passed onto the customer) even returning the entire supra-competitive portion of the interchange fee to the cardholder would simply leave purchasing power unchanged.

The court also pointed out that card-issuing banks cover the costs of fraud and non-payment. *Id.* Default interchange and the honor-all-cards rules, however, are not necessary to enable banks to recover sufficient revenue to cover these costs. In a competitive market, participants set their own fees at a level sufficient to cover their costs of doing business. Banks could thus set finance charges and cardholder fees to allow them to recover their costs.

<sup>167</sup> *Nat'l Soc'y of Prof'l Eng'rs*, 435 U.S. at 695 (holding that "[t]he Sherman Act reflects a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services.") (internal citations omitted).

weak (which it is),<sup>168</sup> and banks pass on less interchange revenue to cardholders than they receive (which is likely given the vigor with which issuing banks pursue cardholders).<sup>169</sup> Defendants must therefore counter the anticompetitive narrative flowing from the restraint on bank-to-bank competition for merchant acceptance.<sup>170</sup>

The defendants' pro-competitive argument boils down to a concern that cardholders will be less likely to use credit cards if some issuers' cards are rejected at the point of sale, but not others. Such an argument might have had merit when credit card use was a new and unusual means of payment. Now that cards are ubiquitous, however, the impact of rejecting a particular issuer's cards is likely to have a *de minimis* impact on overall credit card use. After all, most people carry multiple cards and have experienced a rejected card. To be sure, a cardholder might be less likely to use the card of a particular issuer if a merchant rejected it. But that's the point of competition.

(1) Historic Analysis Finding that  
Default Interchange and the Honor-  
All-Cards Rules Have Pro-  
Competitive Effects Outweighing  
Their Anticompetitive Impact

Only one appellate opinion has fully analyzed this narrative battle, and it was decided more than 25 years ago when the market was far different. There, the Eleventh Circuit rejected a merchant bank's challenge to default

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<sup>168</sup> Rochet & Tirole, *supra* note 23, at 558–66.

<sup>169</sup> Julian Wright, *The Determinants of Optimal Interchange Fees in Payment Systems*, 52 J. INDUS. ECON. 1, 12–14 (2004).

<sup>170</sup> The economist Alan Frankel—an expert for the class plaintiffs, but one who had been writing about card economics long before this case—has concluded that the defendants cannot meet this burden. The available evidence, he has emphasized “suggests that interchange fees in the United States are being set too high.” Alan S. Frankel & Allan A. Shampine, *The Economic Effects of Interchange Fees*, ANTITRUST L.J. 627, 672 (2006); *id.* at 632–37, 672 (analyzing the negative effects of default interchange fees on consumers).

interchange because at that time ubiquitous card acceptance would not then have been possible without it.<sup>171</sup> Bilateral negotiations, the court explained, would have imposed crippling costs and could have led individual card-issuing banks to demand fees so high that merchants would have refused to participate in the system.<sup>172</sup> By contrast, the default interchange fee—which at that time was cost-based—distributed the industry’s expenses efficiently between card-issuing banks and those serving merchants.<sup>173</sup> To be sure, more revenue went to card-issuing banks than the merchants’ own banks. But that was justified, the court explained, because the fraud and credit risk borne by issuers made their costs higher than those of the banks that serviced merchant accounts.<sup>174</sup> “[B]y bringing the costs of the system in line with the revenue for each participating . . . bank regardless of the role it plays,” the court concluded that the default interchange fee helped to expand industry output.<sup>175</sup>

## (2) Market Changes Impacting Competitive Effects Analysis

Since the 1980s, much has changed in credit card markets. The merchants thus argue that while the anticompetitive effects of default interchange and the honor-all-cards rules persist, the pro-competitive narrative is no longer viable. The court belittles this *changed circumstances* argument as a non-particularized claim that the market has matured in some unstated way.<sup>176</sup> An amorphous sense of maturation, the court reasoned, could not convert practices that have historically had significant pro-competitive

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<sup>171</sup> Nat’l Bancard (NaBanco) v. Visa U.S.A., Inc., 596 F. Supp. 1231, 1260 (S.D. Fla. 1984).

<sup>172</sup> *Id.* at 1261.

<sup>173</sup> *Id.* at 1260–61.

<sup>174</sup> *Id.* at 1260

<sup>175</sup> *Id.* at 1261.

<sup>176</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 227–28 (citing economic analysis establishing importance of the honor-all-cards rules to the developing systems).

benefits into antitrust violations.<sup>177</sup> And this is particularly true, the court concluded, when the honor-all-cards rules “continue to make [] the networks successful.”<sup>178</sup>

The court’s analysis of the changed circumstances point, however, unfairly mischaracterized the objectors’ arguments. First, neither the court, nor its appointed expert, cited anything in the record or otherwise to support the conclusion that the challenged rules have a *current* pro-competitive effect. Notably, the court’s own expert explicitly acknowledged that these historical effects may no longer exist.<sup>179</sup>

Tellingly, Professor Sykes’ report also articulated the historic pro-competitive justifications for the networks’ no-surcharge rules, which the settlement prohibits despite past pro-competitive effects.<sup>180</sup> Judge Gleeson, however, expressed the utmost certainty that those no-surcharge rules now have significant anticompetitive effect.<sup>181</sup> Neither the court nor Professor Sykes explains why, on the one hand, the past justifications for the no-surcharge rules no longer apply, but the old pro-competitive case for honor-all-cards and default interchange remains somehow viable.

In reality, the historical pro-competitive case has withered across the board. When the Eleventh Circuit conducted its analysis, most banks both issued cards and worked with merchants, and the overall market was much smaller and less concentrated, in part because banks were quite limited in their ability to compete interstate.<sup>182</sup> These factors gave card-issuing banks far different incentives than they have today. Then, expanding the card market to more

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<sup>177</sup> *Id.*

<sup>178</sup> *Id.* at 228.

<sup>179</sup> Sykes Rep., *supra* note 84, at 16 (recognizing that honor-all-cards and default interchange rules may have “served” pro-competitive functions in the past, but may not do so today).

<sup>180</sup> Sykes Rep., *supra* note 84, at 35–36.

<sup>181</sup> *Merch. Disc. Antitrust Litig.*, 987 F. Supp. 2d at 232.

<sup>182</sup> *See Marquette Nat’l Bank v. First Omaha Serv. Corp.*, 439 U.S. 299, 308 (1978) (explaining that banks were not previously permitted to compete for cardholders nationwide).

merchants was critical to its continued success. Today, merchant acceptance is ubiquitous and industry expansion depends primarily on increased card usage. Moreover, the end of interstate banking restrictions<sup>183</sup> has led to a highly concentrated issuing market whose participants care little about the merchant service business.<sup>184</sup>

Similarly, in the 1980s, technological limits made bilateral merchant-issuer agreements cost prohibitive, and inconsistencies in acceptance standards may have hindered consumer willingness to adopt what was then a relatively new payment system. But technology has now improved, and each merchant readily deals with a plethora of interchange fees varying by card and transaction type across numerous card networks.<sup>185</sup> Bilateral agreements, at least between the major card issuers and merchants, would thus surely be feasible. Indeed, the four largest Visa and MasterCard issuers have more transaction volume than Discover,<sup>186</sup> which has bilateral agreements with its merchants.

Moreover, fraud costs have declined and interest rates are at historically low levels, thereby limiting credit losses. At the same time, issuer revenue has grown. All things being equal, lower costs and higher revenue on the issuer side should have led to lower interchange fees.<sup>187</sup> Instead, those fees have moved in the opposite direction, tracking increases in the level of market power that the networks obtained over merchants.

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<sup>183</sup> *See id.* at 310 (holding that the National Bank Act permits credit card-issuing bank to issue cards nationwide pursuant to federal law).

<sup>184</sup> THE NILSON REPORT, Feb. 2012, at 10, *available at* [http://www.nilsonreport.com/publication\\_newsletter\\_archive\\_issue.php?issue=989](http://www.nilsonreport.com/publication_newsletter_archive_issue.php?issue=989), *archived at* <http://perma.cc/P3TV-Z65W> (chart showing fifty largest Visa and MasterCard issuers).

<sup>185</sup> EVANS & SCHMALENSEE, *supra* note 22, at 259.

<sup>186</sup> According to THE NILSON REPORT, *supra* note 184, Chase, Bank of America, Citibank, and CapitalOne are all substantially larger than Discover.

<sup>187</sup> EVANS & SCHMALENSEE, *supra* note 22, at 154–55 (explaining that when issuer revenue increased with the addition of new cardholder fees in the 1980s, economic theory predicted, and the systems in fact experienced, reduced interchange fees).

Although Visa and MasterCard have dominated payment card volume since the 1970s, banks had limited ability, prior to the 1990s, to exploit market power to the detriment of consumers or merchants. Although the interchange fee was set collectively, the associations were open to any bank or other federally insured financial institution. Exploiting market power to increase interchange fees would have spurred new issuing-side entry, eroding the profits of existing issuers and thus lessening any incentive for the banks to use their collective power over the interchange fee for anticompetitive purposes.<sup>188</sup>

Over the last two decades, however, the largest card issuers have consolidated and increased their dominance.<sup>189</sup> Although the systems are still nominally open to new entry, the top issuers operate on a significantly larger scale and have a more favorable cost structure, thus enabling them to exploit excess interchange fee revenue in ways that smaller issuers cannot.<sup>190</sup> In such a market, new entry by card issuers is not the threat that it was twenty years ago.<sup>191</sup>

Another change has arisen on the card acceptance side of the market. Today, it is common knowledge that virtually all retail establishments accept credit cards, including those

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<sup>188</sup> In fact, in the late 1980s, large non-banking corporations did enter the payment card market on a large scale, most notably AT&T, General Motors, and General Electric. See EVANS & SCHMALENSSEE, *supra* note 22, at 78–79.

<sup>189</sup> See Lyon, *supra* note 23 (showing that the top five card issuers now control over 80% of card transaction volume); EVANS & SCHMALENSSEE, *supra* note 22, at 203 (as recently as 1990, the ten largest Visa and MasterCard issuers accounted for only 42% of cards issued).

<sup>190</sup> Of course, there remain enough large issuers that one might expect competition among them to be sufficient. Regulators in other countries, however, have investigated whether or not all excess revenue is competed away and consumer harm is occurring despite apparent competition. Press Release, European Commission, Commission Sends Statement of Objections to MasterCard (Apr. 30, 2006), [http://europa.eu/rapid/press-release\\_MEMO-06-260\\_en.htm](http://europa.eu/rapid/press-release_MEMO-06-260_en.htm), archived at <http://perma.cc/X52Z-7KZ6>.

<sup>191</sup> In contrast to the new entrants that emerged in the 1980s, no significant new player has emerged in Visa and MasterCard issuing in over a decade.

issued by brands such as Discover with fewer cardholders than Visa and MasterCard. Most consumers carry multiple cards from different systems and use their cards for growing percentages of their purchases.<sup>192</sup> As a result, banks have acquired a significant degree of market power vis-à-vis merchants. The point is not just that card transaction volume has increased as a percentage of all payments, but also that consumers have come to expect ubiquity in card acceptance.

### (3) Modern Case for Anticompetitive Effects

Without default interchange and the honor-all-cards rules, banks would have no way to exploit this power over merchants. Banks directly serving card-accepting merchants compete vigorously, and their historic willingness to narrow their own margins in pursuit of volume suggests that they would quickly reduce merchant fees if the networks reduced interchange fees. If issuing banks had to compete head-to-head, there is no reason to believe that they would be any less competitive than the merchant banks have been. But the networks' rules blunt any incentive an issuing bank might have to enter a bilateral agreement with a merchant. For example, Citibank has little incentive to compete by offering Home Depot a lower interchange fee than Chase offers. This is true because the card networks' honor-all-cards rules prohibit Home Depot from punishing Chase for its higher fee. A merchant that wants to favor Citibank to reward it for charging lower fees can neither refuse to accept Chase cards or, even after the settlement, surcharge them without also surcharging Citibank cards.<sup>193</sup>

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<sup>192</sup> EVANS & SCHMALENSSEE, *supra* note 22, at 148

<sup>193</sup> It is worth noting that even while permitting certain forms of surcharging, the settlement would not permit a merchant to punish an issuer for refusing to lower interchange by surcharging that issuer's cards. The settlement permits surcharging only on a network or product basis. *See supra* Part IV.



One cannot conclude with scientific precision whether the pro-competitive value of uniform acceptance of a card brand at all merchants accepting the brand outweighs the value of this basic form of competition. But given modern market conditions, the old pro-competitive narrative certainly seems anachronistic.

## VII. ASSESSING THE VALUE OF SURCHARGING AS AN INJUNCTIVE REMEDY

Separate from his analysis of the merits, Judge Gleeson cited as a reason to approve the settlement the court's inability to award more effective relief even if the merchants prevailed.<sup>194</sup> Part VII will address the court's relief options. This Part explains that surcharging, at least as permitted by the settlement, will not constitute effective relief.

### A. Time Limited Relief

In approving the settlement, the court ignored that the surcharging right was time limited. All of the injunctive provisions expire in 2021, permitting the defendants to reimpose the rules that are modified by the settlement.<sup>195</sup> Perhaps one could argue that if card-acceptance-fee markets were set right, Visa and MasterCard would be unable to return to the restrictive practices of the past once the injunctive order expires. But the proposed injunctive relief does not come close to setting things right.<sup>196</sup>

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<sup>194</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 230 (E.D.N.Y. 2013).

<sup>195</sup> Definitive Class Settlement Agreement at 51 (for Visa); *id.* at 64 (for MasterCard), Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207 (E.D.N.Y. 2013) (No. 05-MD-1720).

<sup>196</sup> The final aspect of the injunctive relief required the defendants to negotiate in good faith with groups of merchants seeking lower interchange fees. But the settlement imposed no sanction if the defendants and requesting merchants fail to reach agreement. In addition, merchants considering this option must worry about potential antitrust liability if they enter an agreement with their competitors that affects their prices. See *United States v. Okla. St. Chiropractic Indep. Physicians Assoc., et al.*, No. 13-CV-21-TCK-TLW, at 3 (N.D. Okla. Jan. 10, 2013), <http://www>.

## B. Assessing the Settlement's Injunctive Relief Provisions

Ignoring the fundamental source of restrained competition—default interchange and the merchants' inability to discriminate among issuers in any fashion because of the honor-all-cards rules—the settlement's drafters essentially put all of their eggs in the surcharging basket.<sup>197</sup> This section reviews the expert analysis and comparative experience in other countries, concluding that surcharging as permitted by the settlement will be ineffective and potentially counter-productive.

### 1. Expert Assessment

Experts have debated whether an optimally structured surcharge could effectively counteract the anticompetitive effects in the merchant card acceptance market.<sup>198</sup> Despite their disagreements, however, those experts would likely agree that the surcharging nominally permitted by the proposed settlement will prove insufficient to significantly impact interchange fees.

Adam Levitin, a surcharging advocate,<sup>199</sup> has argued for federal legislation that would override state anti-surcharging laws and give merchants complete discretion to surcharge credit card transactions.<sup>200</sup> Levitin has nonetheless criticized the settlement's surcharging provisions. He points out that merchants would have to either (1) surcharge all credit cards

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justice.gov/atr/cases/f291200/291221.pdf, archived at <http://perma.cc/PE8W-93G2> (entering consent decree blocking chiropractors "negotiating contracts" on a group basis that "increased prices for chiropractic services in Oklahoma").

<sup>197</sup> See *supra* note 66 (explaining that the other aspects of the settlement held no prospect of increasing merchant acceptance fee competition).

<sup>198</sup> Compare Levitin, *supra* note 113, at 1385, with Steven Semeraro, *The Economic Benefits of Credit Card Merchant Restraints: A Response to Adam Levitin*, 56 UCLA L. REV. DISCOURSE 25, 27 (2009).

<sup>199</sup> Levitin, *supra* note 59, at 7.

<sup>200</sup> Adam J. Levitin, *Priceless? The Social Costs of Credit Card Merchant Restraints*, 45 HARV. J. ON LEGIS. 1, 55–58 (2008).

within a brand (high cost and low cost alike), or (2) bear considerable expense identifying which particular card products to surcharge.<sup>201</sup>

In addition, the proposed settlement's all-or-nothing requirement will prevent merchants from testing surcharging in a few locations to gauge its effectiveness before undertaking the full range of notice and system adjustments that would be needed to surcharge at all outlets.<sup>202</sup> Without the ability to test the competitive impact of surcharging schemes, Levitin concluded, merchants will be reluctant to use them. Finally, Levitin cautioned that (1) existing state law prohibitions on surcharging; (2) the settlement's restrictions when merchants accept the higher-cost American Express card; and (3) Visa and MasterCard efforts to thwart surcharging will combine to prevent the surcharging right under the settlement from creating a meaningful competitive check on interchange fees.<sup>203</sup>

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<sup>201</sup> Levitin, *supra* note 59, at 8–9.

<sup>202</sup> *Id.* at 11.

<sup>203</sup> *Id.* at 9–10. The National Federation of Independent Business Small Business Legal Center agreed with Levitin's assessment of the proposed settlement and also objected to the surcharging provisions on the ground that they would disadvantage small business. "Perhaps most problematic," this organization argued in an amicus brief, "the proposed settlement's restrictions on surcharges are so complex and filled with legal jargon that a small-business owner would need to consult with an attorney in order to determine if the business could add a surcharge." Small Business Brief, *supra* note 82, at 3. That sort of extra cost, the group argued, would discourage most small businesses from even considering surcharging. *Id.*

## 2. Comparative Experience With Surcharging

The court's expert, Professor Sykes, referenced the potentially pro-competitive effect of surcharging in Australia.<sup>204</sup> Coincident with the introduction of the right to surcharge, however, the Australian government mandated a permanent 50 percent interchange fee cut.<sup>205</sup> Moreover, Australian merchants could (and did) impose surcharges "well in excess of acceptance costs."<sup>206</sup> Because the settlement caps surcharging at the merchants' cost and takes no other steps to reduce interchange fees, the Australian experience is unlikely to be replicated in the United States.<sup>207</sup>

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<sup>204</sup> See Sykes Rep., *supra* note 84, at 32–33; see Robert Stillman, William Bishop, Kyla Malcolm & Nicole Hildebrandt, *Regulatory Intervention in the payment card industry by the Reserve Bank of Australia: Analysis of the Evidence*, CRA INTERNATIONAL 24 (Apr. 28, 2008).

<sup>205</sup> Stillman, et al. *supra* note 204, at 1.

<sup>206</sup> Angus Kidman, *Credit Card Surcharges to Be Restricted*, LIFEHACKER AUSTRALIA (Nov. 21, 2014), <http://www.lifehacker.com.au/2012/06/credit-card-surcharges-to-be-restricted>, archived at <http://perma.cc/8AQV-5Y4Y>; Stillman, et al., *supra* note 204, at 27 ("The available evidence on surcharging in Australia reveals that, in line with the schemes' expectations, surcharging on average has not been cost-based: merchants on average appear to have set surcharges on Visa and MasterCard transactions that are greater than merchant service charges"). This provision of the settlement is thus unlikely to have any significant effect. At best, it will benefit a few of the largest merchants.

<sup>207</sup> The court's appointed expert recognized the distinction between the markets. Sykes Rep., *supra* note 84, at 34 (attributing to an objecting merchant expert the statement that "surcharging is relatively uncommon [in markets permitting it] and has not reduced interchange rates . . . significantly").

### 3. Complete Elimination of the Anti-steering Rules

At times, the court suggested that the settlement should be seen as a step in the right direction. The merchants' ability to surcharge, the court implied, would expand as states altered their laws and American Express changed its policies.<sup>208</sup> But attempting to stoke interchange-fee-setting competition by empowering merchants to steer their customers away from credit cards is likely to be either ineffective or counterproductive.<sup>209</sup> Anti-steering rules can enable card systems to account efficiently for differences in demand levels across consumer and merchant groups.<sup>210</sup> For example, cardholders would likely cut back substantially on their card use if issuing banks placed even a small per transaction fee on cardholders. But merchants have always willingly paid a per transaction fee, even if they believe the current one is too high. This difference in demand elasticity between cardholders and merchants means that placing a larger share of the cost of the system on the latter efficiently optimizes system use. Surcharging or other forms of discrimination could enable merchants to undo this efficient pricing mechanism to the detriment of system efficiency and ultimately consumers.

The experience with surcharging in Australia illustrates the danger of relying on merchant customer-steering efforts. Although Australian merchant card-acceptance fees dropped when the merchants' obtained the power to surcharge, cardholders paid a price. Annual cardholder fees increased; credit card rewards were reduced; and banks required cardholders to pay their bills faster.<sup>211</sup> The potentially beneficial effect of surcharging on card acceptance fees must

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<sup>208</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d at 230–34.

<sup>209</sup> Semeraro, Card Rewards, *supra* note 117, at 75–83; *see* Semeraro, Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty, 14 GEO. MASON L. REV. 941, 959–64 (2007),

<sup>210</sup> Semeraro, Economics of Surcharging, *supra* note 117, at 357–58.

<sup>211</sup> Keith Bradsher, *In One Pocket, Out the Other*, N.Y. TIMES, Nov. 25, 2009, at B1.

be balanced against these costs.<sup>212</sup> In addition to the costs that surcharging would shift to cardholders, merchants would bear the costs of determining the appropriate surcharge or discount given market conditions, training sales staff, and educating consumers about the purpose of the practice. Merchants would need to recoup these costs from consumers, limiting the potential efficiency gains.<sup>213</sup>

The benefits of surcharging to consumers, again even under the best of circumstances, are highly uncertain because a merchant's economic interests would lead it to undervalue the utility that its customers derive from using credit cards when they would still make a purchase without them. As a result, at least some merchants would surcharge at excessive levels. The experience in Australia again appears to confirm that this risk is real.<sup>214</sup> Nine years after Australian regulators permitted surcharging, they determined that some merchants were abusing the practice to the detriment of consumers.<sup>215</sup>

Even if a more robust surcharging right than the settlement provides could theoretically reduce interchange fees to competitive levels without harming consumers by increasing the prices they pay or inhibiting their use of credit cards, merchants would be extremely unlikely to get it right. They do not have the correct incentive structure or the information that would be necessary to calculate and

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<sup>212</sup> *Id.*

<sup>213</sup> *Id.* The proposed settlement only exacerbates these problems by imposing burdensome notice requirements on merchant surcharging. See *supra* Part III.

<sup>214</sup> Uta Mihm, *Inflated Surcharges: CHOICE finds credit card surcharges are money for jam for some retailers*, CHOICE: THE PEOPLE'S WATCHDOG (June 9, 2011), <http://www.choice.com.au/reviews-and-tests/money/borrowing/credit-cards/supercharged-surcharges/page.aspx>, archived at <http://perma.cc/5DLQ-V2AJ> (quoting the national regulator as stating that "in recent years surcharging practices, including surcharging well in excess of card acceptance costs, may have reduced the effectiveness of previous surcharging reforms").

<sup>215</sup> Kidman, *supra* note 206 (explaining that the Reserve Bank announced that it would limit merchants' ability to surcharge beginning January 1, 2013).

implement an optimal surcharge. In the end, the likely result of a robust surcharging right could well be that merchants in competitive markets would eschew the practice because its costs outweigh those of anticompetitive interchange fees. And merchants with market power would use surcharging to capture the overcharge themselves, leaving consumers no better off and inefficiently shifting them away from credit cards.<sup>216</sup>

### VIII. ALTERNATIVE RELIEF THAT WOULD CREATE REAL INTERCHANGE FEE COMPETITION: THE INTERBANK COMPETITIVE MODEL

Judge Gleeson concluded that he would not have the authority, even if the merchants prevailed on the merits, to impose injunctive relief that directly altered default interchange and the honor-all-cards rules.<sup>217</sup> Similarly, the court's appointed expert could not identify a market equilibrium that would be economically superior to the current one.<sup>218</sup> Too many factors would change, he reasoned, if a court simply enjoined default interchange or the honor-all-cards rule.<sup>219</sup>

This Part reviews the risk attendant to altering current practices and then proposes a remedy that would minimize that risk by limiting the changes to those necessary to create acceptance fee competition. Under this proposal, the card networks would operate exactly as they do now with one exception: Any merchant could compel one or more of the four largest Visa and MasterCard card-issuing banks to negotiate a bilateral interchange fee acceptable to both parties.

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<sup>216</sup> Semeraro, *supra* note 117, at 364–65. This appears to be exactly what happened in Australia, leading the reserve bank to step in and limit surcharges. Kidman, *supra* note 206.

<sup>217</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 218–19 (E.D.N.Y. 2013).

<sup>218</sup> Sykes Rep., *supra* note 84, at 21–22.

<sup>219</sup> *Id.*

## A. Difficulties Posed by Enjoining Default Interchange and Honor All Cards

If the merchants won their case, and the court enjoined either (1) default interchange; (2) the honor all cards rules; or (3) both, the credit card system could change in unanticipated and potentially negative ways. The subsections below address these risks, and the subsequent section explores an alternative that would minimize them.

### 1. Enjoining Default Interchange

Some commentators have argued that interchange fees are no longer needed.<sup>220</sup> Card issuing banks, they contend, could simply charge their cardholders enough to support their businesses.<sup>221</sup> A careful look at the history of credit card systems, however, indicates that an interchange fee probably is necessary to operate an optimally efficient card system.<sup>222</sup>

All existing payment card networks in the United States with a credit component, regardless of market share, charge a merchant discount that is higher than necessary to support the merchant side of the business.<sup>223</sup> Because merchant banks compete vigorously, one can approximate the revenue necessary to support card-acceptance by examining the non-interchange fee portion of the Visa and MasterCard merchant discounts. This amount is about 0.5 percent of the purchase price.<sup>224</sup> American Express, Diners Club, and Discover all charge merchants significantly above 0.5 percent, indicating that they too shift revenue from the

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<sup>220</sup> Frankel & Shampine, *supra* note 170, at 637–39.

<sup>221</sup> *Id.*

<sup>222</sup> Steven Semeraro, *Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty*, 14 GEO. MASON L. REV. 941, 986–87 (2007).

<sup>223</sup> *Id.*

<sup>224</sup> EVANS & SCHMALENSEE, *supra* note 22, at 11 (stating that when Visa and MasterCard merchant discount fees are at 2%, the interchange fee is about 1.7%); see *In re Visa Check/MasterMoney Antitrust Litig.*, 192 FRD 68, 75 (E.D.N.Y. 2000) (stating that interchange amounts to about 75% of the merchant discount).



merchant to the issuing side. Moreover, increases in interchange fees have had little effect on merchant acceptance,<sup>225</sup> while card pricing decisions appear to affect cardholder activity dramatically.<sup>226</sup>

Millions of merchants accept cards issued by thousands of banks. The singular achievement of Visa and MasterCard has been opening the entire U.S. banking industry to a world-wide credit card infrastructure that has enabled banks large and small to tailor their card offerings to the benefit of millions of cardholders. Forcing card issuers to enter bilateral agreements and essentially build their own merchant networks would threaten a system that has worked spectacularly well. Even the largest Visa and MasterCard issuers that could theoretically support their own merchant networks would incur huge and wasteful costs.

The potential gains from the resulting lower interchange fees could not justify the added cost necessary for each of these banks to build multiple merchant networks. And the impact on the credit card businesses of all but the largest banks would likely be catastrophic. Unless smaller banks could strike deals with Discover or American Express, or team up with a large Visa/MasterCard issuer, they could be driven out of the card-issuing market.

Smaller merchants too would be placed at a huge disadvantage because they would lack the resources and skills needed to effectively negotiate multiple bilateral interchange agreements. At a minimum, the transaction costs would be huge, the ultimate effects on card markets

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<sup>225</sup> *Visa U.S.A.*, 163 F. Supp. 2d at 340 (citing evidence that Visa officials could not identify a single merchant that stopped accepting Visa cards as a result of interchange fee increases).

<sup>226</sup> In the 1980s, the *NaBanco* court cited evidence that cardholder demand would drop dramatically if more direct costs were placed upon cardholders. See *Nat'l Bancard Corp. (NaBanco) v. Visa U.S.A., Inc.* Banco, 596 F. Supp. 1231, 1261. Given the ease with which cardholders can switch cards today, that concern likely remains applicable.

uncertain, and the potential for the benefits to outweigh the costs virtually non-existent.<sup>227</sup>

## 2. Enjoining the Honor-All-Cards Rules While Permitting Default Interchange to Continue

The networks' current rules permit card issuers to enter individual agreements with merchants. But the honor-all-cards rules prohibit merchants from threatening to stop accepting a single issuer's cards if that issuer refuses to enter a bilateral agreement. Enjoining the honor-all-cards rules, but not default interchange, would implement a measure of equity between a merchant and card-issuing banks. As long as an issuer and a merchant wanted to continue with default interchange, they could. But either could insist on a bilateral deal. This relief would thus pose less risk to the system than completely eliminating default interchange. But significant risks would remain.

Wholly eliminating the honor-all-cards rules would again favor the largest merchants and issuers that have the resources and leverage to negotiate numerous bilateral deals. Under such a system, smaller merchants would likely face a competitive disadvantage, because they would generally pay the higher default rate. Or perhaps even more if a powerful issuer insisted on a bilateral deal. On average, interchange fees, and thus consumer prices might increase without any honor-all-cards rule.

And popular merchants might insist on extremely low bilateral deals with small banks, content to stop accepting

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<sup>227</sup> In his memorandum, the court's appointed expert cited an earlier version of this paper, Steven Semeraro, *Taming Credit Card Fees by Requiring the Biggest Banks to Compete for Merchant Acceptance: An Inter-Bank Competitive Model*, SSRN: Legal Scholarship Network, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2223518](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2223518) (Feb. 14, 2013), *archived at* <http://perma.cc/H43A-7RPV>, for the point that a court would be unlikely to enjoin default interchange and the honor-all-cards rule. Sykes Rep. at 25 n.16. Although both the earlier version of this paper and this one agree that a court would not enjoin those rules *in toto*, both papers argue that the court should partially enjoin them as explained in this Part.

them altogether. Simply eliminating the honor-all-issuers rule could thus threaten the continued participation of small banks in the card-issuing market.

## B. The Interbank Competitive Model

This injunctive relief model is designed to stimulate interbank competition on merchant acceptance fees while minimizing the risk of disruption to an otherwise well-functioning market. It would achieve this goal by requiring only the four largest card-issuing banks to negotiate bilateral deals with merchants requesting them. And critically, the bank and merchant would negotiate in the shadow of the threat that the merchant could stop accepting just that bank's cards.

Mechanically, the interbank competitive modal would operate as follows:

- (1) The default interchange fees currently in place would continue to apply to all merchants and card-issuing banks;
- (2) A merchant desiring to negotiate a bilateral interchange fee with one of the four largest card-issuing banks would initiate the process by providing notice to the bank and offering what it believed to be a reasonable interchange fee (merchants could not insist that smaller issues enter bilateral agreements);
- (3) After the issuing bank received this notice, the parties would have six months to negotiate a bilateral acceptance fee agreement, and during this period the merchant must continue accepting the issuer's cards at the default interchange rate;
- (4) If the merchant and issuer agree on a new fee, they would advise Visa and MasterCard to implement that fee into their systems; but if the merchant and card-issuing bank could not agree, the issuer would be required to notify the Visa and MasterCard systems to either

- (a) block acceptance of that issuer's cards at the merchants' stores and websites;  
or alternatively at the card issuer's option
  - (b) permit acceptance to continue at the interchange rate set by the Federal Reserve for debit cards (this option is included to assuage the defendants' alleged fear that failure to accept one issuer could negatively impact the system); and
- (5) Any merchant without a bilateral agreement with a particular card-issuing bank could demand that the issuer offer it the same deal implemented through this procedure (not just the interchange rate but all terms of the deal) that that issuer has provided to another merchant within the same default interchange fee class.<sup>228</sup>

This proposal would bring competitive principles to card acceptance markets. The largest card-issuing banks would face a choice similar to that faced by any supplier of a good or service—charge a price acceptable to the customer or lose the sale. The merchant in this transaction would be the customer, and it too would face a typical competitive choice—pay the price demanded or risk doing without the service. This competitive dynamic does not operate in card acceptance markets today because merchants cannot risk dropping the entire Visa or MasterCard brand. Enabling the merchant to drop a single large issuer, while continuing to accept all other Visa and MasterCard cards at default interchange, would level the competitive playing field so that the merchant and card issuer face a true competitive decision. And if the card network or a particular large issuer believed that inconsistent acceptance across issuers truly

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<sup>228</sup> The Visa and MasterCard default interchange rates segregate merchants into different classes depending on risk and other factors. Under the interbank competitive model, a merchant would be permitted to demand a rate only if the issuer had an agreement with another merchant in the same Visa or MasterCard interchange fee class, *i.e.* if both merchants would have paid the same default rate. *See infra* note 235.

threatened the overall system, this proposal would allow an issuer to compel the merchant to continue accepting all of its cards. Instead of the collectively set default interchange price, however, the merchant would pay the regulated debit card rate.

### C. Likely Critiques of the Interbank Competitive Model

Critics are likely to raise four questions about this proposal:

- (1) Why is it limited to the four largest card-issuing banks?;
- (2) Why does it give banks the option to force a merchant to continue accepting its cards at the regulated debit card rate?;
- (3) Why does it allow merchants to demand the same bilateral arrangement that an issuer extended to another merchant in the same default interchange category?; and
- (4) Will the largest issuing banks have sufficient market power to prevent the inter-bank competitive model from stimulating competitively set interchange fees?

The following sections address these concerns.

#### 1. Limiting the Right to Demand a Bilateral Interchange Fee to the Four Largest Card-Issuing Banks

By limiting the merchant's right to demand a bilateral fee agreement to the four largest Visa and MasterCard issuers, the risk of disrupting a well-functioning system would be minimized. All card-issuing banks could continue to rely on Visa's and MasterCard's merchant bases; use all of the Visa and MasterCard systems; and pay fees to those systems as they now do. In addition, they would all initially continue to receive the default interchange fee. All but the largest four issuers would know that they could continue to count on

default interchange without the need to enter bilateral agreements with merchants.

If merchants could demand bilateral interchange agreements from any bank, the cost of individual negotiations could outpace the competitive gains. Smaller banks and merchants might be unable to develop mechanisms for efficiently negotiating multiple bilateral agreements, and powerful merchants might exercise market power over small banks, forcing their fees to sub-competitive levels. The four largest issuers—Bank of America, Capital One, Chase, and Citibank—have the resources to develop the necessary mechanisms and the cardholder base to deal on equal footing with any merchant.

Although limiting the relief provision to the four largest issuers would reduce the risk of inefficiently harming the card system, it would nonetheless significantly impact interchange fees. These four issuers control the bulk of the credit card volume in the defendants' networks.<sup>229</sup> Creating competition among them for merchant acceptance would thus reduce interchange fees on a large percentage of transactions.

Smaller banks would continue to receive default interchange, which would initially be higher than the bilateral agreements. As they can today, however, merchants could approach Visa and MasterCard to seek special, generally applicable interchange fees that differ from the default rates available to all merchants. And if the largest issuers have negotiated bilateral fees with many merchants that are lower than the default rates, Visa and MasterCard would likely lower default interchange. The largest issues wield the most influence over Visa and MasterCard because their volume drives the networks' revenue. Those large issuers would not want smaller banks to have the competitive advantage of higher fees.

Drawing a line at the top four issuers does bear a measure of arbitrariness. The fifth largest issuer, and probably a few more, could likely handle individualized

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<sup>229</sup> See THE NILSON REPORT, *supra* note 184.

negotiations with the merchants that would request them. But the line can be justified on economic grounds.<sup>230</sup> Only the four largest issuers have charge volume exceeding the independent Discover Card network,<sup>231</sup> making them potential network competitors operating within a cooperative system. By contrast, smaller banks could be unable to issue cards without a default interchange.

In addition, if collectively set interchange fees enable card issuers to retain excess profits at the expense of consumers, the largest issuers who have the greatest economies of scale are likely the prime beneficiaries of that illegal conduct. Requiring only these issuers to compete on interchange fees is an economically sensible way to solve the competitive problem without the costs and complications of requiring each issuer to set its interchange fees independently.<sup>232</sup>

## 2. Permitting the Large Issuers to Compel Acceptance at Debit Card Interchange

The card networks have long argued that a merchant's failure to accept all credit cards within a brand would undermine consumer confidence in the system, leading them to turn away from credit cards. For example, credit card industry economists David Evans and Richard Schmalensee have commented that "the honor-all-cards rule appears to have been used by all systems throughout the history of the industry. It ensures the cardholder side of the market that their cards will be accepted on the merchant side."<sup>233</sup>

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<sup>230</sup> The court could be called upon to reassess which issuers are subject to the interbank competitive model if market conditions change significantly. After a tumultuous period in the late-1990s and early 2000s, however, the position of the top issuers has stabilized and is likely to remain so for the foreseeable future.

<sup>231</sup> See THE NILSON REPORT, *supra* note 184.

<sup>232</sup> This approach is also similar in form to the Dodd-Frank Debit Card legislation that imposed interchange fee limits on debit cards, but exempted cards issued by banks with assets less than \$10 billion. 15 U.S.C. § 1693o-2(a)(6) (2010).

<sup>233</sup> EVANS & SCHMALENSEE, *supra* note 22, at 292; see Baxter, *supra* note 40, at 576.

The claim that cardholders today would be impacted significantly if certain issuers' cards were not accepted by particular merchants seems farfetched. Many merchants refuse to accept American Express and Discover, yet both compete effectively. Virtually everyone has had a card rejected, and most have an alternative card to use in those circumstances. Cardholders also now associate their card as much with the issuer as they do with the Visa or MasterCard brand. Nevertheless, if defendants deem evenhanded acceptance vital to their interests, the inter-bank competitive model would allow them to continue to compel merchants to accept all cards, albeit at the lower debit card rate.

The regulated debit card interchange fee may not be the appropriate one in this circumstance because of differences between debit- and credit-card issuing. But the settlement uses it in a similar role as a default fee when calculating surcharges,<sup>234</sup> and the court could of course ask the parties to present evidence on a more appropriate fee level for this purpose.

### 3. Permitting Merchants in the Same Visa/MasterCard Interchange Fee Class to Choose a Bilateral Agreement Over Default Interchange

Bilateral interchange fee agreements could profoundly affect smaller merchants that lack the resources and acumen to deal with the big-four Visa and MasterCard issuers. Although some extremely large merchants have already negotiated special interchange fees with Visa and MasterCard, and the inter-bank competitive model would empower many more large merchants to do so, smaller merchants could be at a competitive disadvantage if they did not have the resources needed to negotiate bilateral fees.

One potential difficulty with applying this provision might be determining whether two merchants were sufficiently similar to justify applying the same bilateral fee to both. But this potential problem can be resolved by

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<sup>234</sup> Settlement, *supra* note 9, at 41 (Visa); *id.* at 54 (MasterCard).



tracking the Visa and MasterCard default interchange fee schedules. The networks impose different interchange fees on different classes of merchants.<sup>235</sup> Under the interbank competitive model, a merchant could demand the same bilateral rate paid by another merchant only if the requesting merchant would have paid the same default interchange fee as the merchant with the bilateral rate.<sup>236</sup>

#### 4. Large Issuer Market Power

A potential risk of the interbank competitive model is that the four largest issuers would have sufficient individual market power that each could continue to demand supra-competitive interchange fees. A traditional concern with moving solely to bilateral agreements is that large issuers would demand fees even higher than the default rates with respect to merchants over whom they had significant power. The proposed model addresses that concern by allowing all merchants to opt to continue paying the default rate. The interbank competitive model would thus not make things worse. But it might not be powerful enough to force interchange fees down if merchants were unwilling to stop accepting the cards of the four largest issuers.

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<sup>235</sup> Paul Downs, *What You Need To Know About Credit Card Processing*, N.Y. TIMES (Nov. 21, 2008), <http://boss.blogs.nytimes.com/2013/03/25/what-you-need-to-know-about-credit-card-processing/>, archived at <http://perma.cc/PDN2-PXJB> (linking to the Visa and MasterCard interchange fees and explaining that “the type of business you are in can affect the interchange rates”).

<sup>236</sup> In some cases, a bilateral merchant-issuing bank deal might depend on a relationship that could not be extended to other merchants. For example, the issuer might agree to promote the merchant’s business exclusively in its billing and advertising. The value of the exclusive promotion could not be replicated with another merchant. In such a case, other merchants could not obtain the *same* deal because by definition any deal that did not involve exclusive issuing-bank promotion of a single merchant would be a different deal. These situations would add complexity to the remedy. But rules could be developed to enable banks and merchants to know in advance which deals would be open to other merchants.

By seeking to end the honor-all-issuers rules in this litigation, and objecting vigorously to the settlement for not ending that rule, sophisticated merchants are essentially communicating their informed view that issuer-based competition would be an effective means to reduce interchange fees to competitive levels. One data point supporting that view is that many merchants have demonstrated a willingness to refuse to accept cards issued by American Express, which has the largest and most attractive cardholder base.<sup>237</sup> That practice is likely a good indication that merchants would be willing to reject the cards of particular large Visa and MasterCard issuers, enabling competition among those issuers to dictate interchange fees as it does all of the other cardholder and merchant fees.

## IX. SETTLEMENT WITHOUT CONSENT

Parts V–VII showed that the court’s anything-is-better-than-nothing approach to the settlement cannot justify its approval. The merchants’ chances of winning on the merits are strong; the efficacy of the relief provided is at best weak and at worst counter-productive; and more effective relief could be imposed after a victory on the merits.

Putting all that aside, however, the court should not have approved the settlement’s mandatory release. It prohibits all merchants in perpetuity (even those refusing to consent and, even more remarkably, those not yet in existence) from suing the defendants for, well, pretty much anything forever. The Sections below describe the relief provisions and show that they do not satisfy either Rule 23 or public policy principles.

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<sup>237</sup> See Mont Cessna, *Why Do Some Merchants Not Accept Discover or American Express Cards?*, CREDIT CARD PROCESSING SPACE (Nov. 21, 2014) <http://www.creditcardprocessingspace.com/why-do-some-merchants-not-accept-discover-or-american-express-cards>, archived at <http://perma.cc/TK2R-KLXV>.

## A. The Settlement's Release Provisions

Class action releases are typically broad because the defendants want an end to litigation as a quid pro quo for paying damages or significantly altering their conduct.<sup>238</sup> The breadth of the releases here is nonetheless breathtaking because they apply not only to non-consenting class members, but also to those that received no benefit whatsoever.<sup>239</sup>

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<sup>238</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 235 (E.D.N.Y. 2013) (explaining that “the ability to include [claims not litigated] in class action settlements is essential to providing defendants the litigation peace they legitimately expect in return for the settlement of claims”); see Howard M. Erichson, *A Typology of Aggregate Settlements*, 80 NOTRE DAME L. REV. 1769, 1776 (2005) (explaining that “[a] defendant's search for a broadly inclusive resolution reflects a desire to put the dispute in the past and get on with business. It is driven, in part, by the financial markets' demand that businesses contain the liability risk. The broader the resolution, the easier it is for a defendant to quantify the remaining risk.”).

<sup>239</sup> The settlement releases the defendants from liability for claims

regardless of when such claims accrued, whether known or unknown, suspected or unsuspected, in law or in equity that any Rule 23(b)(3) Settlement Class Releasing Party ever had, now has, or hereafter can, shall, or may in the future have, arising out of or relating in any way to any conduct, acts, transactions, events, occurrences, statements, omissions, or failures to act of any Rule 23(b)(3) Settlement Class Released Party that are alleged or which could have been alleged from the beginning of time until the date of the Court's entry of the Class Settlement Preliminary Approval Order in any of the Operative Class Complaints or Class Action complaints, or in any amendments to the Operative Class Complaints or Class Action complaints, including but not limited to any claims based on [a broadly worded list of examples]

Settlement, *supra* note 9, at 34; Second Amended Complaint, *supra* note (1), 72–74. Because the plaintiffs also challenged the defendants' corporate structure in the complaint, *Id.* at 73–74, the release appropriately extends to claims relating to that issue as well. Settlement, *supra* note 9, at 35. Four categories of claims are also excluded from the release: (1) breach of the settlement agreement itself; (2) ordinary commercial disputes; (3) government claims against the defendants; and (4) a claim seeking only

The release also extends beyond the subject matter of the lawsuit to claims relating to all of the defendants' rules, regardless of subject matter or relevance to the litigation,<sup>240</sup> and agreements relating to the issuance or acceptance of credit cards.<sup>241</sup> The drafters demonstrably intended this degree of expansiveness because they referenced the generic "any rule" without limitation after specifically listing the rules relating to interchange fees.<sup>242</sup>

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injunctive relief regarding the legality of Visa's Fixed Acquirer Network Fee. *Id.* at 38, 74; *id.* at 66 (asserting that all class members would release the defendants from future liability "whether or not they [each class member] object to this Class Settlement Agreement, and whether or not they exercise any benefit provided under" it). *Id.* at 73 (explaining the release as follows: "For purposes of clarity, it is specifically intended for the release and covenant not to sue provisions of Paragraphs 66-70 above to preclude all members of the Rule 23(b)(2) Settlement Class from seeking or obtaining any form of declaratory, injunctive, or equitable relief, or damages or other monetary relief relating to the period after the date of the Court's entry of the Class Settlement Preliminary Approval Order with respect to any Rule of any Visa Defendant or any MasterCard Defendant, and the compliance by any Bank Defendant with any such Rule, as it is alleged to exist, now exists, may be modified in the manner provided in Paragraphs 40-45 and 53-57 above, or may in the future exist in the same or substantially similar form thereto.") (emphasis added).

<sup>240</sup> Settlement Definition (mm) states that the term "Rule" "means any rule, by-law, policy, standard, guideline, operating regulation, practice, procedure, activity, or course of conduct relating to any Visa-Branded Card or any MasterCard-Branded Card."

<sup>241</sup> *Id.* at 34. The citations relating to the breadth of the settlement with respect to the types of rules and the future conduct encompassed within it in notes 85-92 refer to the release provided by the b(3) class. Substantially similar conditions are placed on the b(2). *Id.* at 70.

<sup>242</sup> *Id.* at 34 (releasing claims arising out of "any interchange rules, interchange fees, or interchange rates, or any other Rule of any Visa Defendant or MasterCard Defendant, or any agreement involving any Visa Defendant or any MasterCard Defendant and any other Rule 23(b)(3) Settlement Class Released Party, and/or any merchant arising out of or relating to interchange rules, interchange fees, or interchange rates, card issuance, or card acceptance with respect to any Visa-Branded Card transactions in the United States or any MasterCard-Branded Card transactions in the United States") (emphasis added).

Finally, and in sharp contrast to the sunset provisions on the injunctive relief, the release applies in perpetuity. The operative language releases the defendants from liability for claims arising “out of the future effect in the United States”:

- “of the continued imposition of or adherence to any Rule . . . in effect . . . as of the date of the Court’s entry of the Class Settlement Preliminary Approval Order”;<sup>243</sup>
- of the application of any rule that is “substantially similar to any Rule in effect” when the settlement was preliminarily approved;<sup>244</sup> or
- of any “conduct” of a released party that related to those rules.<sup>245</sup>

The final passages of the principal release paragraph confirmed the release’s intended breadth, declaring that the parties “expressly agreed, for purposes of clarity . . . that any claims based on or relating to [the subsections of the principal release paragraphs] are claims that *were or could have been alleged in this Action.*”<sup>246</sup> Those provisions of the settlement, however, purport to release claims, *inter alia*, arising out of the future application of a rule that was

- (1) created after approval of the settlement (so long as it was substantially similar to a then-existing rule);
- (2) applied to future market conditions that could be wholly unanticipated when the settlement was approved; and
- (3) involved the application of a rule having nothing to do with interchange, merchant discount fees, customer steering, or any other allegation in the complaint.

The drafters fail to explain how such a claim “could have been alleged in this Action.”

## B. The Injunctive Relief in the Settlement is Not

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<sup>243</sup> *Id.* at 36.

<sup>244</sup> *Id.*

<sup>245</sup> *Id.*

<sup>246</sup> *Id.* (emphasis added).

### Sufficient to Support a Mandatory Release of the Entire Class' Claims Under Rule 23b(2)

A mandatory Rule 23b(2) class must impose injunctive relief that necessarily affects the entire class.<sup>247</sup> This is because, where the defendant acted on a class-wide basis, relief would necessarily impact the entire class. For example, the advisory committee on the Federal Rules of Civil Procedure cited two examples that demonstrate this: (1) civil rights cases in which the plaintiff alleged class-based discrimination, and (2) challenges to a common overcharge or a patent holder's tying of an unpatented product.<sup>248</sup> A party cannot both discriminate against a class and not discriminate. And a price or tie of two products cannot be both pro-competitive and anticompetitive.

The settlement here, the objectors argue, does not fit this paradigm. Although it restricted Visa's and MasterCard's right to prohibit merchants from surcharging credit card transactions, that relief does not necessarily impact the entire class. Some merchants could be permitted to surcharge while others were not. That possibility is made clear, the objectors contend, by the settlement's empowering the defendants to enter individual no-surcharge agreements with particular merchants.<sup>249</sup> If individual agreements are feasible, opting out would also be feasible, and Rule 23(b)(2) is thus inappropriate.<sup>250</sup>

The court ignored this problem, asserting that “[i]f the merchants could opt out . . . , they would reap the benefits of that relief anyway . . . .”<sup>251</sup> It is unclear why that would be true. A merchant that opted out could be prohibited from surcharging. Perhaps the court believed that if some merchants have the power to surcharge, they would effectively drive down interchange fees for all. But the

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<sup>247</sup> Merchant Objections, *supra* note 49, at 14–15.

<sup>248</sup> FED. R. CIV. P. 23, advisory committee's notes.

<sup>249</sup> Settlement, *supra* note 9, at 49 (Visa); *id.* at 62 (MasterCard).

<sup>250</sup> Merchant Objections, *supra* note 49, at 11–12.

<sup>251</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 236 (E.D.N.Y. 2013).

settlement did not require Visa and MasterCard to continue the practice of setting interchange fees based on merchant classes. The defendants could adopt different fee schedules for those merchants who remain in the settlement and those that opt out.

The court also improperly asserted that a mandatory class was appropriate because opt outs “would eliminate the incentive to settle that Rule 23(b)(2) was designed in part to create.”<sup>252</sup> But that rule was not designed to encourage settlement. It was designed to empower class-wide relief when individual relief could not be fashioned. Neither the language of the rule nor the extensive advisory committee notes mention settlement<sup>253</sup> and the Supreme Court has cautiously cited public policy concerns when rejecting the broad class action settlement releases that have come before it.<sup>254</sup>

The Advisory Committee notes explain that mandatory b(2) classes are appropriate only when “final relief of an injunctive nature . . . settling the legality of the behavior with respect to the class as a whole, is appropriate.”<sup>255</sup> One might contend that that standard could apply here. For example, when a court finds that a manufacturer anticompetitively tied one product to another, it can grant mandatory class relief under Rule 23b(2). But the defendant in such a case might still negotiate a package deal with particular customers, just as Visa and MasterCard might negotiate individual no-surcharge agreements after a class-wide condemnation of blanket no-surcharge rules.

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<sup>252</sup> *Id.*

<sup>253</sup> FED. R. CIV. P. 23(b)(2), advisory committee’s notes.

<sup>254</sup> See *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 842–43 (1999) (adopting a limiting construction of the Rule 23(b)(1)(B) mandatory class in the context of a class settlement in order to avoid “serious constitutional concerns raised by the mandatory class resolution of individual legal claims”); *Amchem Prod. Inc. v. Windsor*, 521 U.S. 591, 625–27 (1997) (holding class representation inadequate in b(3) class with limited opt out rights because class members suffered from diverse medical conditions).

<sup>255</sup> FED. R. CIV. P. 23, advisory committee’s notes.

The U.S. Supreme Court, however, recently rejected that interpretation of Rule 23b(2), holding that a mandatory b(2) class is appropriate only when a single injunction necessarily governs the entire class' claims.<sup>256</sup> "The key to the (b)(2) class," Justice Scalia wrote for the Court in *Wal-Mart v. Dukes*, "is 'the indivisible nature of the injunctive . . . remedy warranted—the notion that the conduct is such that it can be enjoined . . . *only as to all of the class members or as to none of them.*'"<sup>257</sup> Because the settlement here both (1) permits surcharging and (2) specifically authorizes Visa and MasterCard to enter agreements with particular merchants that prohibit surcharging, the proposed settlement would not enjoin the defendants in a way that applies to all merchants or none of them. The injunctive relief provided by the settlement is thus inadequate to justify a mandatory release imposed on the entire class.

C. The Release Offends Public Policy by Binding Objecting and Not-Yet-Existing Class Members and Extending Immunity to Future Rules and Conduct that Have Unpredictable Anticompetitive Effects

Even if the injunctive relief in the settlement necessarily applied to the class as a whole—which it does not—the settlement's release would violate public policy. The Supreme Court has never approved a class settlement releasing class-member claims without individual consent, and it has characterized mandatory class treatment as an exception that runs counter to the public policy tenant that everyone is entitled to a day in court.<sup>258</sup> Justice Souter, writing for the Court, stressed that when a judge considers a

<sup>256</sup> *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2557–58 (2011).

<sup>257</sup> *Id.* (quoting Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. REV. 97, 132 (2009) (explaining that b(2) applies only where "the relief sought must perforce affect the entire class at once"))).

<sup>258</sup> *Ortiz*, 527 U.S. at 846.



mandatory class settlement “the burden of justification rests on the [party seeking the] exception.”<sup>259</sup>

The defendants and supporting class members here cannot meet that burden. Only a small portion of Visa’s and MasterCard’s massive rulebooks were examined during the litigation. But the settlement insulated the defendants in perpetuity from any claim relating to (1) all existing rules and (2) newly adopted rules substantially similar to the current ones.

As an example of their concern, the objectors cited the Department of Justice’s then-on-going investigation of Visa and MasterCard rules imposing new fees on merchants’ banks. The networks adopted the fee only after Congress regulated debit card interchange fees, by all appearances attempting to circumvent the purpose of that legislation.<sup>260</sup> To be sure, the settlement explicitly permitted merchants to sue to enjoin this particular fee.<sup>261</sup> But that exemption from the release illustrated the problem. If a special settlement provision were needed to ensure that merchants could attack this particular new fee, presumably merchants would be barred from attacking other problematic provisions that the defendants might adopt.<sup>262</sup>

Perhaps more importantly, the objectors argued that a particular rule with no anticompetitive impact today might have pernicious effects in the future.<sup>263</sup> For example, prior to the 1990s, the merchants were not concerned about whether the honor-all-cards rules required them to accept debit cards.

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<sup>259</sup> *Id.*; see James Grimmelmann, *Future Conduct and the Limits of Class-Action Settlements*, 91 N.C.L. REV. 387, 397 (2013) (calling for heightened scrutiny of the release of liability for future conduct and recommending that courts permit such a release only if a similar preclusive provision could have been obtained through a litigated judgment).

<sup>260</sup> *Department of Justice Investigating Visa’s Post-Durbin Amendment Fees*, THE FRAUD PRACTICE, [http://fraudpractice.com/fraudblog/?page\\_id=566](http://fraudpractice.com/fraudblog/?page_id=566) (last visited Jan. 15, 2015), *archived at* <http://perma.cc/K6B4-YZ59>.

<sup>261</sup> Settlement, *supra* note 9, at 74.

<sup>262</sup> Merchant Objections, *supra* note 49, at 20–21.

<sup>263</sup> *Id.* at 2–3, 9–10.

Very few consumers used them. But when the debit market expanded, and with it the fee burden, the merchants tried to stop accepting those cards. Visa and MasterCard cited the honor-all-cards rules without alteration as the basis to insist that merchants must accept debit cards if they wanted to continue accepting credit cards.<sup>264</sup> As written, the proposed settlement would prohibit the merchants from suing if the defendants again used an old rule in an unanticipated new way to restraint future competition.

The court responded by declaring that “the releases cover only the claims that may properly be extinguished by the settlement of a class action.”<sup>265</sup> Citing Second Circuit precedent, the court explained that the parties may release future claims in a class action—even those that could not have been presented in the case—“so long as the released conduct arises out of the ‘identical factual predicate as the settled conduct.’”<sup>266</sup> Although the court asserted, *ipse dixit*, that the release did “not cover new, future anticompetitive conduct and rules,”<sup>267</sup> the plain language of the settlement indicates a clear intent to release much more than claims with an *identical factual predicate*.<sup>268</sup> And the court’s expert’s review of the record indicated that the defendants believe that the language means what it says.<sup>269</sup>

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<sup>264</sup> *Id.* at 18 n.24.

<sup>265</sup> Merch. Disc. Antitrust Litig., 986 F. Supp. 2d 207, 235 (E.D.N.Y. 2013).

<sup>266</sup> *Id.* (citing Wal-Mart Stores, Inc. v. Visa U.S.A, Inc., 396 F.3d 96, 107).

<sup>267</sup> *Id.* at 236.

<sup>268</sup> *See supra* Part IV.

<sup>269</sup> Sykes Rep., *supra* note 84, at 49–50 (quoting from a defendant’s memorandum characterizing the risk of losing a future claim based on “currently unforeseeable changes in market conditions” as “part of the bargain inherent in any antitrust settlement”).

Moreover, the court never engaged the objectors' principle concern—that an existing rule that is not anticompetitive today might become so tomorrow without substantive alteration. The court's appointed expert, by contrast, expressed concern that the release created "a danger of adverse, unintended consequences in a technologically dynamic industry."<sup>270</sup> He thus recommended revising it to make clear that the merchants were not releasing claims based on "the future effects of all existing or 'substantially similar' conduct or rules . . . ."<sup>271</sup> The court ignored that recommendation in approving the settlement without alteration.<sup>272</sup>

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<sup>270</sup> *Id.*

<sup>271</sup> *Id.* at 50–51.

<sup>272</sup> The merchants also argued that class counsel could not adequately represent the entire class. Although the release extended in perpetuity, in July 2021, all of the limitations on the defendants' rule-making ability will expire. A merchant entering the market after that date would be barred from seeking damages or injunctive relief flowing from the defendants' rules, even though the settlement provided no benefit to such a merchant. Merchant Objections, *supra* note 49, at 3–4. Class counsel cannot adequately simultaneously represent both (1) this group of future merchants that may receive no benefit at all (if the injunctive provisions are revoked) and (2) the current merchants that are receiving damages and well as several years of an injunctive remedy. *Id.* The court rejected these concerns because it was confident that the settlement was negotiated at arm's length. *Merch. Disc. Antitrust Litig.*, 986 F. Supp. 2d, at 216 (citing its own role in the settlement efforts along with Magistrate Judge Orenstein and two mediators, Judge Infante and Professor Green). That many merchants objected to the settlement, the court explained, does not suggest procedural impropriety, particularly given that some of the objectors initially signed off on the settlement. *Id.* at 222. Finally, the court concluded that representation was adequate because the injunctive relief benefited "every single member of the merchant class." *Id.* Each of the court's points, however, failed to respond to the merchants' objection. The settlement might well be fair for currently operating merchants that received damages and whatever benefit the injunctive relief provided. But that cannot establish that the settlement would also be fair to merchants not now doing business that will be bound by the release even though they receive no damages and perhaps no benefit from the injunctive relief.

With respect to a b(3) opt out class, the release's propriety would be judged through a prism that did require consent. Even in b(3) classes, however, courts must carefully scrutinize whether the named plaintiffs

In addition to the public policy concerns with binding merchants, who may receive no benefit from the settlement, without consent, the public interest in a competitive economy provides a second reason to reject the release. The Third Circuit, for example, has recognized that “there is an unquestioned public interest in the ‘vigilant enforcement of the antitrust laws through the instrumentality of the private treble-damage action.’”<sup>273</sup> The anticompetitive effect of

and the counsel negotiating the settlement can adequately represent each member of the class. *Amchem*, 521 U.S. at 625–27 (holding class representation inadequate because class members suffered from diverse medical conditions). Although the merchants share an interest in competitively set interchange fees, the nature of the proposed relief as well as the release create distinctions among sub-groups of merchants that may render the existing class-wide representation inadequate. For example, because surcharging is the only potential form of relief that could foster a more competitive environment, the varying abilities of merchants in different sectors of the economy and parts of the country to surcharge their customers could lead a court to conclude that unified representation of the class is inadequate. *Id.* at 627–28 (overturning class certification because of differences among class members and unitary counsel negotiating the settlement). That a number of plaintiffs who would otherwise have been in the class settled with the defendants in advance of the global settlement proposal also raises questions about the adequacy of representation. In *Amchem*, the Supreme Court rejected a global class settlement, clearly troubled by class counsel’s settling all of their existing clients’ claims on terms different from those available to the class members. *Id.* at 601 n.3 (explaining that “[o]nce negotiations seemed likely to produce an agreement purporting to bind potential plaintiffs, [the defendants] agreed to settle, through separate agreements, the claims of plaintiffs who had already filed”). Similarly, the proposed settlement purports to release claims that might be filed by future merchants who do not now accept credit cards and thus are not entitled to damages. The interests of these class members obviously differ from those who will receive damages because the entire benefit of the settlement rests on the injunctive remedy. And they would have no ability to opt out, because by definition a future merchant is not a merchant now and thus would not receive notice of the settlement. To ensure adequate class representation, future merchants should have their own counsel participating in the formation of the settlement. *Cf. Amchem*, 521 U.S. at 625–26 (holding named plaintiffs inadequate to represent a class of plaintiffs whose interests were not all aligned).

<sup>273</sup> *Three Rivers Motors Co. v. Ford Motor Co.*, 522 F.2d 885, 891 (3d Cir. 1975).

supra-competitive merchant-acceptance fees impacts everyone. Even consumers who do not use credit cards feel the effects because the prices they pay are influenced by those fees. By prohibiting merchants, in perpetuity, from suing to enforce the antitrust laws the settlement effectively removes the private right of action that is essential to adequate enforcement.

To be sure, the public interest in vigorous antitrust enforcement does not prevent an injured party from releasing its claim “and foregoing the burden of litigation.”<sup>274</sup> As the leading antitrust treatise recognizes, “[r]epose is especially valuable in antitrust, where tests of legality are often rather vague, where many business practices can be simultaneously efficient and beneficial to consumers but also challengeable as antitrust violations . . . .”<sup>275</sup> The issue here, though, is not whether a party should be able to release an antitrust claim, but whether it can be forced to do so without consent.

Perhaps one could accept such a release if consumers or antitrust enforcement agencies could be counted on to uncover anticompetitive conduct. But as Learned Hand recognized in a related context in his famous *Alcoa* opinion, all potential antitrust enforcers are not created equal. Some are better “versed in the craft [and] quick to detect opportunities for saving and new shifts in production,” that others would not see.<sup>276</sup>

In credit card markets, the merchants alone have filled that critical role with respect to interchange fees.<sup>277</sup> Despite

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<sup>274</sup> *Id.* at 892.

<sup>275</sup> II PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW 282 (4th ed. 2014).

<sup>276</sup> *United States v. Aluminum Co. of Am. (Alcoa)*, 148 F.2d 416, 426–27 (2d Cir. 1945).

<sup>277</sup> Merchants first challenged card acceptance fees in the 1990s, filing class actions challenging Visa and MasterCard rules that required them to accept debit cards if they wanted to accept credit cards. *In re Visa Check/MasterMoney Antitrust Litig. (Visa Check I)*, 192 F.R.D. 68, 71 (E.D.N.Y. 2000), *aff'd*, 280 F.3d 124 (2d Cir. 2001); *see Wal-Mart Stores Inc. v. Visa U.S.A. Inc.*, 396 F.3d 96, 101 (2d Cir. 2005). Although the Department of Justice filed suit challenging Visa and MasterCard rules

competitive concerns over those fees extending back more than a quarter century and successful claims leading to billions of dollars in damages, no consumer class, federal enforcer, or state attorney general has stepped forward. The job of ensuring a competitive credit-card-acceptance-fee market has fallen to merchants. The courts should not ignore the possibility that the defendants have placed billions of dollars on the table in this settlement in an attempt to neuter forever the one successful threat that they have faced to charging supra-competitive card acceptance fees.

## X. CONCLUSION

The mandatory class settlement in *In re: Payment Card Interchange Fee and Merchant Discount Antitrust Litigation* should not have been approved. It fails to respond to the core competitive concerns raised in the complaint, and the district court's assertion that it constitutes the best the plaintiff class could get does not withstand scrutiny. The merchants' antitrust case is strong; the injunctive relief in the settlement is ineffectual and potentially counter-productive; and more effective relief would be within the court's purview if the class prevailed on the merits.

Perhaps more importantly, the court should have rejected the settlement because the release violated both Rule 23 and fundamental public policy tenants. Rule 23 does not permit mandatory class-wide releases without consent when the only meaningful relief could reasonably be applied to some class members but not others. And public policy should

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that prohibited banks that issued either a Visa or a Mastercard from also issuing a competitive card, such as American Express. That case did not challenge the fees that the networks charged to accept their cards. *United States v. Visa U.S.A, Inc.* 344 F.3d 229, 234 (2d Cir. 2003). In 2005, the merchants began the litigation at issue in this article attacking Visa's and MasterCard's interchange fees. In 2011, the Department of Justice sued American Express, MasterCard and Visa, attacking their anti-discrimination rules, but again not their card acceptance fees. MasterCard and Visa entered consent decrees in that case, agreeing not to prohibit discounts for using methods of payment other than credit cards. *See supra* note 66.

prohibit the settlement's non-consensual neutering of the only effective enforcer of the antitrust laws in a vital area of the economy that touches every single consumer.