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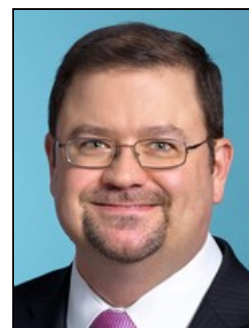
## What Have Merchants Gained From Payment Card Litigation?

Law360, New York (August 10, 2016, 11:50 AM ET) -- In recent years, federal antitrust enforcers and businesses that accept payment cards have been waging a slow war against payment card fees and the card network rules that protect them. The payment card industry's antitrust battles are nothing new, dating back to antitrust lawsuits against the predecessor to Visa in the early 1970s. But more recent developments began to provide tools for businesses that accept payment cards (referred to as "merchants" in the payment card world) to slowly chip away at the effect of those fees on their bottom lines. That progress has recently taken a major step backward.

In June 2016, the Second Circuit Court of Appeals in New York threw out the watershed settlement between the payment card industry and merchants, including \$7.3 billion in damages, and the controversial release of claims against Visa and MasterCard in light of the divergence of interests among the merchants in the class. Moreover, the Second Circuit had under advisement the appeal of the U.S. Department of Justice's antitrust victory against American Express, and many observers felt that the oral argument revealed significant appellate skepticism about the government's case. As a result, this is an opportune time to briefly review the state of play, and where businesses currently stand with respect to their acceptance of payment cards.



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### What's the Problem?

The payment card industry, the merchants who accept payment cards (i.e., credit cards and debit cards), and the consumers who use payment cards engage in a delicate balancing act. Each player in the marketplace benefits from the existence of payment cards, though their incentives differ.

Businesses hate payment card processing fees. That is why some require a minimum purchase for use of a credit card (for example, "no credit cards accepted for purchases under \$10"), and why a taxi driver may run your card through a Square reader on his or her smartphone rather than through the card terminal mounted in the cab. It is why Costco now accepts only Visa credit cards, and why some businesses do not take American Express. To business owners, payment card processing fees (called "interchange fees") are often thought of as a tax for which they get little or nothing in return. Businesses also hate that those fees help fund the "rewards" card issuers offer their card holders.

But business owners do benefit from the acceptance of payment cards. Consumers are using payment cards more and more frequently, for everything from cups of coffee to heart surgery, and using cash less. A business that does not accept payment cards would likely lose a portion of its customers who prefer to make purchases with plastic. Some businesses even rely on the installment-financing feature of credit cards to allow their customers to make expensive purchases they may not otherwise make. And studies suggest that consumers will spend more money with a merchant when paying with a credit card than they would if paying with cash.

At the same time, interchange fees are the lifeblood of the payment card industry, which consists primarily of the payment card networks (Visa, MasterCard, American Express and Discover) and the issuers of payment cards (referred to generally as “banks,” although not all fit the traditional definition of a bank — and in the case of American Express and Discover, each functions both as the issuer and the network). The payment card industry is therefore incentivized to increase consumer usage of payment cards, and is very effective at doing so. Consumers are offered everything from airline miles and travel assistance to preferred theater tickets and “cash back” — which is, from an economic standpoint, simply the sharing with the consumer of a portion of the interchange fees paid by businesses that accept payment cards.

Consumers benefit from the existence of a system of widely accepted payment cards, and from the perks and benefits that those cards provide to them. But they also absorb the costs of that system, which are reflected in the prices of the goods and services that they purchase — even for purchases not made with a card.

## **Why Might There Be Antitrust Issues?**

A competitive market, free of conspiracy, monopoly or the anti-competitive exercise of market power, will self-regulate. Prices, quantities, and terms of sale will be dictated by market forces. There is no need for antitrust enforcement in such a market.

But purely competitive markets are rare. Most markets are susceptible to market failure, whereby one or more players in the market are able to inefficiently allocate resources to themselves that marketplace forces would otherwise have distributed to someone else. The goal of modern antitrust law is to remedy market failure.

In the payment card marketplace, different players compete with each other at different levels. The card networks compete with each other (to some extent) to increase the number of banks that issue their cards, and they compete to convince merchants to accept their cards. The banks compete with each other to issue the most attractive cards to consumers. This is frequently referred to as a “two-sided” or “multisided” market. The competitive dynamics in such a market are complex, and it can be difficult to identify whether a market failure requiring antitrust intervention exists — and at what level of the marketplace.

Despite this complexity, merchants have argued for decades that a market failure exists: that interchange fees are too high, and that the rules imposed by the networks are designed to “rig the game” to keep those fees artificially high. Moreover, card network rules have prevented merchants from steering consumers to alternatives that are either better for consumers, better for the retailers, or both. Through a series of lawsuits over many years, merchants (and the DOJ acting on their behalf) have had some success in challenging these rules.

## **A Number of Antitrust Cases Have Dealt with Payment Card Issues**

Visa and MasterCard are separate entities, each of which began as not-for-profit membership joint ventures with financial institutions — typically banks — as members. Although they have been considered competitors, the two companies have frequently worked together, generally setting similar card policies and fees. At the beginning, banks had to “choose a side” and issue either MasterCard or Visa payment cards. But the associations loosened those rules in the 1970s after the DOJ refused to bless them under the antitrust laws, and since then, member banks have been able to use both networks.

### ***Exclusivity Rule Litigation***

In the mid-1990s, antitrust scrutiny of the payment card industry heightened when the DOJ began investigating Visa and MasterCard’s “exclusivity” rules that prohibited member banks from also issuing Discover or American Express cards. The DOJ successfully challenged the exclusivity rules in court, where in 2001 (affirmed on appeal in 2003) they were found to substantially reduce competition by reducing output, innovation and consumer choice through the exclusion of competing networks from partnership with the majority of card-issuing banks.[1]

### ***“Honor All Cards” Rule Litigation***

Separately in the 1990s, retailers (including Wal-Mart, which would continue to fight the industry in the years to come) filed class action litigation against Visa and MasterCard challenging their "honor all cards" rules, which required merchants to accept all of a network's cards if they accepted any of that network's cards. Under the rules, for example, if a merchant wished to accept Visa or MasterCard credit cards, they had to also accept the network's debit cards. The cases were extensively litigated, and in a 2003 settlement, Visa and MasterCard agreed to make changes to these rules.<sup>[2]</sup> These rule changes unlinked the acceptance of credit cards from the acceptance of debit cards, so that a merchant could accept one but not the other.

This change would eventually gain new value to merchants, as a 2010 law (the Durbin Amendment) limited the interchange fees that could be charged for debit card transactions, which in many instances make debit transactions cheaper than credit transactions. This change also allowed merchants to offer discounted prices to consumers who pay with a debit card instead of a credit card.

But the "honor all cards" rules did not go away completely; although they no longer link credit card acceptance to debit card acceptance, they continue to apply to all cards within a type. So, for example, a merchant who accepts any Visa credit card must accept all Visa credit cards, including cards with higher interchange fees (such as generous rewards cards) that some merchants may wish to decline.

### ***The Interchange Fee Cases***

A primary subject of interest to antitrust enforcers and private plaintiffs since the early 2000s has been interchange fees and related rules. The interchange fee cases have followed a complex and contorted path; the following is a simplified discussion of their progress through the courts.

In 2010, the DOJ filed suit against Visa, MasterCard and American Express alleging that the payment card companies prohibited merchants from steering customers toward cheaper payment methods (via providing information about card costs, discounts and rewards), and that this prohibition hampered price competition for interchange fees among the three networks. The theory underlying the case was that, if a card with high fees could be turned down in favor of a card with lower fees, then the issuer would have an incentive to offer lower fees in general.

Visa and MasterCard immediately settled with the DOJ, and agreed to amend their rules to allow merchants to (1) offer discounts or other incentives to consumers for using a particular credit card network or low-cost card within that network; (2) express a preference for or promote the use of a particular credit card network, low-cost card within that network, or other form of payment; and (3) inform consumers of the cost incurred by the merchant when a consumer uses a particular credit card network, type of card within that network, or other form of payment.

American Express chose not to settle, and instead fought the suit through a bench trial — and lost. The court ruled that American Express, despite its relevantly modest market share, held sufficient market power such that its anti-steering provisions could hamper price competition in the market overall by negating incentives to offer lower interchange fees. Central to the case was the definition of the relevant product market. Although the court recognized that credit card companies compete in two distinct but related markets (the market for card issuance to consumers and the market for card acceptance by merchants), it found that consideration of the merchant market alone was sufficient to identify anti-competitive harm.

The Second Circuit Court of Appeals, which recently heard oral argument in the case but has not issued a decision either affirming or reversing the trial court, questioned at argument whether the trial court adequately explored the two-sided nature of the market. It also discussed whether the 26 percent market share (that the trial court found sufficient to support a finding of market power) could in fact support that finding, as market power is not typically presumed at market shares that low. The Second Circuit's handling of these two issues will be central to its decision, and will establish important precedents for payment card cases (and antitrust cases in general) going forward.

At the same time that the DOJ was developing its cases against Visa, MasterCard and American

Express, a number of merchants were also suing the companies and their issuing banks on similar theories. Beginning in 2006 and continuing since then, a number of merchants have sued Visa and MasterCard and many of their issuing banks and, separately, American Express over rules that they allege unlawfully prop up excessive interchange fees. Those cases have been filed by individual merchants acting on their own behalf and also by class representatives purporting to represent the interests of all merchants. Still other merchants have "opted out" of the class litigation to pursue their claims separately.

Assisted by leverage from the DOJ actions, and after a decade of discovery with hundreds of depositions and millions of documents, the bulk of merchant plaintiffs reached settlements in the Visa/MasterCard case and the American Express case. The settlements would have provided for large cash payments to the settling merchants and changes to certain of the networks' steering and other rules. But both settlements have been rejected, setting back progress in both cases.

The American Express settlement, reached in 2013, was initially approved by the trial court; in August of 2015, however, the settlement was rejected when it was discovered that certain lawyers for the plaintiffs and certain lawyers for MasterCard had been improperly exchanging confidential information that related to American Express. The discovery was made in the course of a separate investigation of one of the lawyers for MasterCard, who is now in prison. The case is therefore moving forward as before the settlement.

The merchants' case against Visa and MasterCard was also settled, and the settlement — the largest antitrust class action settlement ever — was approved by the trial court in 2013. The deal offered different forms of relief for two separate classes of plaintiffs: (1) for the Rule 23(b)(3) damages class, up to \$7.25 billion in monetary relief for merchants who accepted Visa or MasterCard from January 2004 to November 2012; and (2) for the Rule 23(b)(2) injunctive class, merchants that accepted the cards after November 28, 2012 would see a temporary rule change allowing merchants to impose surcharges on consumers paying with cards from Visa or MasterCard. The difference between the damages class and the injunction class is important, since members of (b)(3) classes can opt out and pursue litigation on their own — as big retailers including Wal-Mart, Target and Macy's did — while (b)(2) classes are mandatory, with no ability to opt out, and bind all class members forever.

Many of the merchants in the case did not like this settlement and appealed the trial court's approval of the settlement to the Second Circuit Court of Appeals. On June 30, 2016, the appeals court reversed the trial court's approval, holding that the two separate classes — the (b)(2) damages class and the (b)(3) injunction class — should not have been represented by the same counsel, as their interests were divergent.

The court of appeals held that representation of the two classes by the same counsel was inadequate under Rule 24(b)(4), and that "[p]roblems arise when the (b)(2) and (b)(3) classes do not have independent counsel, seek distinct relief, have non-overlapping membership, and (importantly) are certified as settlement-only," all of which characteristics were present in this case. Also problematic was the questionable value of the injunctive relief, as many class members live in states (such as New York) that ban surcharging, and because merchants who accept American Express would be prevented by the American Express network rules from taking advantage of the surcharging option.

Other interchange fee litigation has been filed outside of the United States as well. Most recently, MasterCard was sued for \$24.7 billion in damages for allegedly fixing interchange fees under the U.K.'s new consumer antitrust class action rules, making it the country's largest opt-out collective action to date. Numerous private suits have also been filed, and on July 14, 2016, the U.K. Competition Appeal Tribunal issued its first ever major antitrust damages award, finding that MasterCard's interchange fee practices violated E.U. and U.K. competition law.

### ***Transaction Verification Litigation — Signature Versus PIN***

As payment cards continue to evolve and the industry changes — notably, MasterCard went public in 2006, and Visa in 2008, in part to improve their antitrust posture — new issues face the industry outside of the realm of fee-setting. For example, recent litigation has arisen over the ongoing transition to chip-bearing cards for consumers and chip-reading terminals for retailers.

Chip cards are more secure than traditional magnetic stripe cards, and are used by inserting the chip-bearing card into a slot rather than swiping it.

A card customer's identity must be verified through either the customer's signature or the entry of a PIN. For debit card purchases, which make up the majority of payment card transactions for many merchants, a merchant pays a lower interchange fee if the customer enters a PIN code to verify the transaction, and a higher interchange fee if the customer verifies the transaction with their signature.

As it transitioned from magnetic card readers to chip-reading terminals in its stores, and in order to decrease its payment processing costs, Wal-Mart began to require all debit card customers to use the cheaper PIN verification method instead of the signature verification method. Visa, however, sought to enforce a rule that merchants must allow customers to use the more expensive signature method. In May of 2016, Wal-Mart alleged that Visa's policy requiring retailers to provide both methods of verification amounted to improper steering, as Visa has exclusive network rights to the signature system while other competing networks offer PIN verification services. Visa's policy, Wal-Mart argued, would force Wal-Mart to exclusively run its transactions through Visa's allegedly "less secure" network. The suit is currently pending in New York state court.[3]

### ***ATM Network Most-Favored Customer Litigation***

Meanwhile, the industry faces new antitrust litigation on a different front, this time regarding alleged price fixing in the market for ATM networks. The plaintiffs — ATM users and operators — sued Visa, MasterCard and various banks alleging that these entities, through bank card association rules, had agreed among themselves to impose a type of nondiscrimination or "most favored customer" clause called the "access fee rules." These rules provided that an ATM operator cannot charge customers a greater access fee whose transactions are processed on Visa or MasterCard networks than that charged to any customer whose transaction is processed on an alternative network.

The suit alleged that member banks developed and adopted the access fee rules when the banks controlled Visa and MasterCard (and had done so for decades before the companies went public) in order to protect Visa and MasterCard from competition with lower-cost ATM networks. The district court dismissed the case on two primary bases: first, it held that the complaints failed to adequately allege a concrete injury to the plaintiffs because lower access fees would have resulted only if Visa and MasterCard actually lowered their fees in reaction to price competition, which was too speculative a theory. Second, it held that the access fee rules could not violate Section 1 of the Sherman Act, because they did not result from any conspiratorial conduct between multiple actors as required by the act. Because the banks were all co-owners of Visa and MasterCard, the court held, they functioned as a single actor incapable of conspiring with itself under applicable precedents.

A panel of judges for the D.C. Circuit Court of Appeals disagreed on both counts, vacating the dismissal and remanding the case for further proceedings. On the question of injury, the appeals court held that the plaintiffs' economic theory of harm, though it relied on assumptions about how supply and demand forces would function, was not overly speculative because it was subject to proof or disproof at trial, and therefore sufficiently concrete to warrant adjudication.

On the question of whether the banks could be liable for conspiring among themselves to establish the access fee rules even though they were all owners of a single association (one each for Visa and MasterCard), the appeals court held that it was the plaintiffs' particular allegations of agreement to the challenged rules, and not just the fact of membership in a trade association, that sufficed to properly plead a conspiracy. The panel acknowledged that although "mere membership in associations is not enough to establish participation in a conspiracy with other members of those associations," allegations that the member banks used the bank card associations to "adopt and enforce a supracompetitive pricing regime for ATM access fees would go far beyond mere membership." The court relied in part on the U.S. Supreme Court's decision in *American Needle v. National Football League*, 560 U.S. 183 (2010), which held that the question of whether the members of a joint venture are acting as a single entity incapable of conspiring with itself or, to the contrary, are acting in their independent capacities to use the joint venture to accomplish anti-

competitive ends, is a question of fact to be developed at trial.

The Supreme Court has agreed to hear the defendants' appeal of the D.C. Circuit decision in order to resolve a split among the US circuit courts of appeal over the appropriate standard for pleading an antitrust conspiracy.

In their petition asking the Supreme Court to hear the case, the defendant card companies and banks argued that none of the factors called out by the D.C. Circuit as contributing to more than "mere membership" in an association actually gave rise to a Section 1 conspiracy. These factors included: the member banks' former membership in the Visa and MasterCard associations, the equity interests in and bank executives' former seats on the boards of Visa and MasterCard, and the banks' enforcement of the network ATM access fee rules. The defendants argued that the banks' "perfectly legal" active participation in a business association did not suggest in any way that the banks communicated with each other about the access fee rules. They further contended that the D.C. Circuit decision conflicted directly with the Ninth Circuit's decision in *Kendall v. Visa USA Inc.*, 518 F.3d 1042 (9th Cir. 2008), as well as decisions by the Third and Fourth Circuits, holding that similar allegations were insufficient to plead a conspiracy under Section 1.

In opposition, the plaintiffs argued that the relevant allegations were not about membership in a trade association; rather, they asserted that the heart of the conspiracy was that the rules of the former bank card associations were agreed to by the banks acting in their independent interests in order to suppress competition. The key difference between the case at hand and the decisions of the other circuits cited by the defendants is that there was an allegation of an express agreement by the banks to fix fees, while the other cases merely alleged membership in a trade association.

## **So Where Does All of This Leave Us?**

It has been hard enough for interested parties, including participants in the industry, to keep track of these cases and where they have been going. It is not going to get any easier as the interchange fee cases proceed after their rejected settlements, and as the ATM fee case makes its way through the Supreme Court (and potentially back to the trial court after that). From a legal standpoint, there are a number of legal issues that are worth following in the months and years ahead. From a business standpoint, there are a number of settled issues to be aware of and a number of issues currently teed up for resolution.

### ***Legal Issues to Watch***

Here are some of the legal questions up for grabs in the near future in these cases:

- How strictly will courts construe the adequate representation requirement of Rule 24(b)(4)? The outcome on this question will affect all class action litigation, not just the Visa/MasterCard case.
- What will be the dividing line between mere association membership and an agreement between association members to conspire under Section 1 of the Sherman Act?
- Will the holding stand that American Express' less-than-30 percent market share is sufficient to confer market power? An affirmation by the court of appeals would change the way that antitrust cases are litigated in the future, with plaintiffs alleging market power against defendants with much lower market shares.

### ***Current Takeaways for Businesses***

As a result of these antitrust cases, businesses that accept payment cards are able to take advantage of certain rule changes of which they may not be aware. There are also additional rule changes that are at least teed up for resolution.

As a result of past antitrust cases, businesses today have the ability to (among other things):

- Choose to accept debit cards but not credit cards, or credit cards but not debit cards, from either or both of Visa or MasterCard;
- Post a "minimum purchase" requirement for Visa or MasterCard credit card transactions, so long as the minimum purchase is no more than \$10 and the minimum purchase requirement applies to all credit cards;
- Offer consumers an immediate discount or rebate, or a free or discounted product or service, for using a particular credit card network, low-cost card within a network, or other form of payment (such as cash) (note that American Express rules continue to prohibit these actions);
- Express a preference for the use of a particular credit card network, low-cost card within a network, or other form of payment, such as cash (note that American Express rules continue to prohibit these actions);
- Post a notice informing customers of the costs associated with various forms of payment.

Depending on how the various ongoing cases turn out (including the American Express and Visa/MasterCard settlements that have been rejected), businesses may eventually be able to:

- Impose a surcharge on consumers who pay with a credit card (in those states that allow it);
- Negotiate with Visa and/or MasterCard for discounted interchange fees as part of a buying group.

For businesses and attorneys interested in these issues, our best advice is to "watch this space."

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[1] United States v. Visa USA Inc., 163 F. Supp. 2d 322, 340–42 (S.D.N.Y. 2001), aff'd, 344 F.3d 229 (2d Cir. 2003), cert. denied, 543 U.S. 811 (2004).

2 In re Visa Check/MasterMoney Antitrust Litig., 297 F. Supp. 2d 503 (E.D.N.Y. 2003).

3 Wal-Mart Stores Inc. et al. v. Visa USA Inc., No. 652530/2016 (Sup. Ct. N.Y. filed May 10, 2016).

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