UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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IN RE: AMERICAN EXPRESS ANTI-STEERING RULES ANTITRUST LITIGATION (II)

This Document Relates To:
CONSOLIDATED CLASS ACTION

11-MD-02221 (NGG) (RER)
ECF Case

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

Plaintiff,

– against –

AMERICAN EXPRESS COMPANY, et al.,

Defendants.

13-CV-07355 (NGG) (RER)

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MEMORANDUM OF AMERICAN EXPRESS IN RESPONSE TO REPORT OF PROFESSOR C. SCOTT HEMPHILL

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PRELIMINARY STATEMENT

Defendants American Express Company and American Express Travel Related Services Company, Inc. ("American Express") respectfully submit this memorandum in response to the report of Professor C. Scott Hemphill dated August 11, 2014 (the "Hemphill Report") to aid the Court in its assessment of how Professor Hemphill's analysis bears on the issue of whether the Settlement[1] is a fair, reasonable, and adequate resolution of the Class's claims in light of the risks of continued litigation.

Professor Hemphill's report on the Settlement is limited "to an assessment of the value to merchants of a parity surcharge right under the Agreement," and includes, "to a lesser degree," a discussion of "the value of a right to levy brand surcharges." (Hemphill Report at 1, 6.) Professor Hemphill acknowledges that the Court's evaluation of the Settlement "includes both an inquiry into the effects of the settlement and a comparison to the outcome of litigation" *viz.*, "an assessment of the relief secured if plaintiffs win, discounted by an estimated probability of plaintiffs losing." (*Id.* at 5, 6.) *See City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 463 (2d Cir. 1974), *abrogated on other grounds by Goldberger v. Integrated Res., Inc.*, 209 F.3d 43 (2d Cir. 2000) (factors 4, 5, 6, and 9 involving litigation risk). Professor Hemphill notes that his report does not attempt to address Class Plaintiffs' "estimated probability of . . . losing", including because he lacks "the materials and mandate to do so." (Hemphill Report at 5, 6.) As a result, Professor Hemphill—quite appropriately—does not take any position with regard to the likelihood that the Class Plaintiffs could obtain any injunctive relief beyond the compromise represented by the Settlement.

[1] Capitalized terms have the same meaning as defined in American Express's Memorandum in Response to Objections to the Class Settlement Agreement and in Support of Final Approval, Dkt. No. 508 (hereinafter Am. Express Resp. Mem.).

Thus, Professor Hemphill's report only analyzes *one* of the many factors the Court must consider under *Grinnell*. As set forth in Section I and addressed in prior submissions to the Court in support of the Settlement, we respectfully submit that a consideration of *all* of the *Grinnell* factors confirms that the Settlement is a fair, reasonable and adequate resolution of the Class's claims under the standard that Professor Hemphill understandably does not consider.

As set forth in Section II, we also respectfully submit that Professor Hemphill's conclusions regarding credit and debit substitutability were—as he correctly noted in his report—necessarily based upon certain assumptions because of the lack of a well-developed evidentiary record on these issues in this Settlement context. However, as the Court is aware, there is now a well-developed evidentiary trial record on a related question of credit/debit substitutability in *United States, et al. v. American Express, et al.* (the "Government Action"), and the Court will soon be required to reach rulings on related issues in that case. Accordingly, to the extent that the Court finds the question of credit/debit substitutability necessary to resolve in determining whether to approve the Settlement, given the similar issues that need to be resolved in the Government Action, we respectfully suggest that the Court defer ruling on the Settlement until it rules in the Government Action based on actual evidence rather than dueling expert affidavits from the Class and objectors.

I. PROFESSOR HEMPHILL'S REPORT DOES NOT ALTER THE SETTLEMENT'S SATISFACTION OF THE *GRINNELL* FACTORS.

Plaintiffs sued American Express on behalf of a putative class of all American Express-accepting merchants seeking to overturn certain vertical restraints in American Express's contracts with merchants. The Class Plaintiffs, not American Express, want surcharging. Indeed, the Department of Justice decided *not* to challenge American Express's restrictions on merchant surcharging in the Government Action. The Settlement obtained by the Class Plaintiffs would make it easier for merchants who want to surcharge to do so. The Settlement would remove American Express's parity surcharge requirement with regard to debit and prepaid cards, permitting merchants to impose a parity surcharge across all credit and charge cards,[2] including American Express credit and charge cards, thus steering consumers from those cards to other payment forms, such as debit cards, prepaid cards, cash, checks, and payments via the Automated Clearing House system, which may be less expensive for the merchant to accept.[3] Additionally, class members do not release claims for prior monetary damages under the Settlement.

As noted above, Professor Hemphill's report addresses only one of the many factors the Court must consider in determining whether the Settlement is fair and reasonable under *Grinnell*. *See Wal-Mart Stores, Inc. v. Visa U.S.A., Inc.*, 396 F.3d 96, 117 (2d Cir. 2005) (examining settlement under the *Grinnell* factors); *United States v. New York*, No. 13-cv-4165 (NGG)

[2] For purposes of imposing a parity surcharge, electronic wallets, such as PayPal, that can be funded by, among other things, credit cards and debit cards are treated as credit cards under the Settlement. *See* SA ¶1(bb).

[3] While Professor Hemphill states, in a footnote, that it is "unclear" whether Paragraph 8(b) of the Settlement Agreement prohibits a surcharge on American Express alone (Hemphill Report at 4, n.2.), the Settlement *does* prohibit American Express-only surcharges. Paragraph 8(b) states that the surcharge imposed on American Express transactions "must not be any higher than any surcharge imposed on transactions effected with any other Credit Card, payment card, payment method, products, or services accepted by the merchant, after accounting for any discounts or rebates offered at the point of sale, except for (i) Debit Cards; (ii) cash; (iii) checks; (iv) transfer of funds to merchants via bank wire transfer or via the Automated Clearing House of the Federal Reserve System; and (v) Proprietary Store Cards." *See* SA ¶8(b). "Any surcharge" includes zero surcharges. *Cf. id.* ¶8(c) (referring to "any surcharge that the merchant is permitted to impose (which may be zero)" in describing the calculation of the surcharge cap). If a merchant presents Visa credit as a "free" option, for example, the merchant cannot impose a surcharge on American Express transactions under the Settlement because the surcharge imposed on Visa (here, zero) cannot be greater than the surcharge imposed on American Express. American Express, the Class Plaintiffs, and the objectors have uniformly interpreted the Settlement Agreement to prohibit American Express-only surcharges. *See* Hemphill Report at 4 ("The parties and objectors understand the Agreement to require that is a merchant imposes an Amex surcharge, it must impose an equal or higher surcharge on Visa and MasterCard credit cards.").

(MDG), 2014 WL 1028982, at *6-8 (E.D.N.Y. Mar. 17, 2014) (Garaufis, J.) (same). The "*Grinnell* factors" are "(1) the complexity, expense and likely duration of the litigation; (2) the reaction of the class to the settlement; (3) the state of the proceedings and the amount of discovery completed; (4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining the class action through the trial; (7) the ability of the defendants to withstand a greater judgment; (8) the range of reasonableness of the settlement fund in light of the best possible recovery; [and] (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation." *Wal-Mart Stores*, 396 F.3d at 117.

Under *Grinnell*, the "proposed settlement cannot be judged without reference to the strength of plaintiffs' claims. The most important factor is the strength of the case for plaintiffs on the merits, balanced against the amount offered in settlement." *Grinnell*, 495 F.2d at 455 (internal quotation marks omitted). "The weaknesses of plaintiffs' case, the availability of defenses to the suit, and the risks of establishing liability and damages at trial must be factored into this balance." *In re "Agent Orange" Prod. Liab. Litig.*, 597 F. Supp. 740, 762 (E.D.N.Y. 1984), *aff'd*, 818 F.2d 145 (2d Cir. 1987). "The essential task of the court, therefore, is to form 'an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated' and 'an educated estimate of the complexity, expenses, and likely duration of such litigation.'" *Spiekermann v. Whittaker Corp.*, 598 F. Supp. 1, 5 (E.D.N.Y. 1978) (quoting *Protective Comm. v. Anderson*, 390 U.S. 414, 424 (1968)).

In applying the *Grinnell* factors, the Second Circuit has emphasized that there is "a range of reasonableness with respect to a settlement—a range which recognizes the uncertainties of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion . . . ." *Wal-Mart Stores*, 396 F.3d at 119 (internal quotation and alteration omitted). "In other words, the question for the Court is not whether the settlement represents the highest recovery possible—which it does not—but whether it represents a reasonable one in light of the many uncertainties the class faces—which it does." *In re Citigroup Inc. Sec. Litig.*, 965 F. Supp. 2d 369, 384 (S.D.N.Y. 2013). This is the proper approach because settlements by their nature are compromises in which each party achieves some of what it desires but fails to achieve what it might otherwise obtain through a successful litigation. *See In re Union Carbide Corp. Consumer Prods. Bus. Sec. Litig.*, 718 F. Supp. 1099, 1103 (S.D.N.Y. 1989) ("The essence of settlement is compromise.").

We submit that the record before the Court already establishes that an application of all of the *Grinnell* factors supports approval of the Settlement. Class Plaintiffs face a significant risk that they would not be able to prove their case on the merits and therefore would not attain *any* relief for the Class if the case proceeded. Further, several of the potential limitations discussed by Professor Hemphill that may affect "parity surcharging" under the Settlement would also apply in some form to "brand surcharging" which Professor Hemphill considers may be relevant to available relief if the Class Plaintiffs litigated their claims to a successful conclusion. For example, several state laws prohibit surcharging (*see* Hemphill Report at 12-13) and, since Professor Hemphill submitted his report, one of those statutes has withstood a constitutional challenge (*see Dana's Railroad Supply v. Bondi*, No. 4:14-cv-134 (HR) (CAS) (N.D.Fl.), Order Granting Mot. Summ. J., Sept. 2, 2014, ECF No. 29 (dismissing constitutional challenge to Florida's no-surcharge statute and finding statute has a rational basis)); there would be practical impediments to implementing surcharging (including a chicken-and-egg problem with regard to merchant interest in surcharging and the technological innovations required to make surcharging more feasible) (*see* Hemphill Report at 13-14); and merchants who choose not to surcharge may gain sales at the expense of merchants who choose to surcharge (*see id.* at 9-12). This last "problem," which Professor Hemphill describes as "potentially the most important, but also the most difficult to assess" (*id.* at 9), stems from the fact that consumers may not like to be surcharged, and may take their business to merchants who choose not to surcharge. In other words, competition between merchants may prevent widespread parity surcharging. But concerns about "merchant competition" and lost sales would exist in some form regardless of whether a merchant implemented a parity surcharge or a brand credit card surcharge.

We are also cognizant of the fact that an analysis of the full *Grinnell* factors could require the Court to address (based upon a different standard and a less developed evidentiary record) various issues that overlap with (although differ in some material respects from) issues that have been addressed in extensive evidentiary detail during the recently concluded trial in the Government Action. To the extent the Court determines it necessary to wade into further detail on those issues in resolving the instant motion, we respectfully request that the Court defer ruling on the Settlement until it has ruled in the Government Action after consideration of a full record on the issue of reasonable interchangeability between credit and debit.

II. PROFESSOR HEMPHILL'S REPORT IS ADMITTEDLY BASED ON AN INCOMPLETE RECORD AND IS INCONCLUSIVE IN IMPORTANT RESPECTS.

A. Professor Hemphill's Assumption That Debit Is Not a Substitute for Credit Is Based on an Incomplete Record.

Professor Hemphill assumes that there are some contexts where debit and credit are "close substitutes" and that there are some contexts where they are not. (Hemphill Report at 16, 29.) This assumption is relevant because, according to Professor Hemphill, whether parity surcharging will be profitable to merchants depends on the number of consumers who will "defect" or take their business elsewhere rather than pay the surcharge or switch from credit to debit. (*Id.* at 16.) According to Professor Hemphill, "the defection problem seems likely to be a serious challenge for efforts to steer customers to debit through parity surcharges, given the low substitutability for many customers." (*Id.* at 16.) The substitutability between credit and debit also factors into Professor Hemphill's comparison of parity surcharging and brand surcharging, the latter of which he says is "more promising" because one credit card is a "close substitute" to another credit card "for more customers." (*Id.* at 29.)

Given the very limited record available to Professor Hemphill, Professor Hemphill understandably made assumptions based upon little data in reaching his conclusions about the substitutability between credit and debit. However, since the briefing on Class Plaintiffs' motion for preliminary approval was completed, this Court has heard detailed testimony regarding credit and debit in the Government Action. In fact, in his report, Professor Hemphill acknowledged that he did not consider the record in the Government Action, while noting that "significant insight could be gleaned by reviewing materials in the two related anti-steering cases", *i.e.*, the Government Action and the Individual Merchant Plaintiffs' action. (Hemphill Report at 6.) Similarly, none of the economists who have submitted a declaration on behalf of the plaintiffs or objectors addresses the record developed in the Government Action.

As the Court is aware, there is substantial evidence in the related Government Action about the relationship between credit and debit, as well as economic analysis concerning such evidence, consisting of, among other things: (1) network documents from all four major payment networks concerning debit as a competitor to general purpose credit and charge ("GPCC") cards; (2) merchants' comparisons of American Express rates with debit rates; (3) testimony that merchants track a blended debit and credit rate in the ordinary course;

(4) testimony and documents demonstrating that American Express's cobrand partners, including large travel and entertainment ("T&E") merchants, have sought to negotiate carve-outs in their agreements with American Express that allow them to partner with banks to issue cobrand debit cards; (5) testimony and documents that American Express has negotiated and been willing to pay for limitations on its cobrand partners' rights to issue such cobrand debit cards out of concern that the cards will cannibalize volume from the cobrand GPCC cards issued by American Express; (6) testimony and documents that, in some cases, co-brand partners have in fact issued such cards out of recognition that consumers are increasingly willing to use debit cards for T&E purchases; (7) market data showing that debit usage has exploded in the past several years across all merchant segments, including at T&E merchants; (8) recently published academic literature finding significant consumer substitution between debit and GPCC, including an article concluding that antitrust regulators should take the nature and degree of that substitutability into account; (9) newly available empirical data, including the Survey of Consumer Payment Choice conducted by the Federal Reserve Bank of Boston, concerning consumer perceptions about debit and GPCC with respect to key metrics (security, acceptance and convenience), and consumer response to a perceived cost increase of GPCC by increasing debit usage and decreasing GPCC usage; and (10) customer loyalty card data produced by the Individual Merchant Plaintiffs, concerning cardmember switching at the same merchant for similarly sized transactions over time, and concerning cardmember switching from American Express to another payment form.

As the Court knows, this evidence will be presented in the form of Findings of Fact and Conclusions of Law the day after the final approval hearing in this action. And it will be on the basis of that well-developed factual record that the Court will need to decide the issue of credit and debit substitutability in the context of the market definition analysis for the Government Action (which is related to, but different from, the question of debit substitutability that the Court will address in the context of the Settlement in this Action).

B. Professor Hemphill's Report Is Inconclusive in Important Respects.

In his report, Professor Hemphill summarizes the position taken by Class Plaintiffs on the one hand and by certain objectors on the other, and states that he is unable to determine which side, in his opinion, has the better of the argument. For example:

1. Professor Hemphill discusses the objection that "merchant competition" (*i.e.*, merchants competing with one another for sales to consumers) would undermine a merchant's incentive to surcharge, stating that merchant competition and likely customer resistance make surcharging a "risky proposition," and further stating that it is possible that some "pioneer merchants" may overcome customer resistance to surcharging. (*Id.* at 9-12, 29.) He also states, however, that he cannot rule out that the effect of the Settlement may be significant. (*Id.* at 43.)

2. Professor Hemphill describes the state laws that prohibit surcharging, but states that it is unclear whether the prevalence of these restrictions will increase or decrease in the long term. (*Id.* at 12-13.)

3. Professor Hemphill acknowledges that there may be practical problems regarding the implementation of surcharging, but that the degree of this problem is unclear based on the submitted materials. (*Id.* at 13.)

4. Professor Hemphill explains that most merchants will not be able to set a surcharge that fully covers the cost of accepting American Express, but he explains that he lacks the information to offer a firm view about whether the

surcharge cap has a significant effect on a merchant's willingness to surcharge. (*Id.* at 26-27.)

5. Professor Hemphill addresses the objection that the Settlement "will make matters worse," points out that these arguments proceed from a baseline of comparing the Settlement against "the relief available if plaintiffs litigated and won their case," and states that this comparison is "legitimate" as part of the assessment "of the relief from a litigation win, discounted by the probability of losing." (*Id.* at 27.) Professor Hemphill, however, does not engage in this overall assessment of risk. (*Id.* at 6.)

6. Professor Hemphill finds that some of the evidence he reviewed about Australia relates to brand, rather than parity, surcharges, stating that a "pressing question is whether the Australia experience with *brand* surcharging is applicable to *parity* surcharging in the United States," (*id.* at 33) and finds that the materials he reviewed are insufficient to answer this question. (*Id.* at 30-38, 42-43.)

* * * * *

Because Professor Hemphill does not reach definite conclusions as to the above issues, his report should not be read as an endorsement of the objections that he describes. Further, the source of uncertainty identified by Professor Hemphill is not the Settlement itself, but rather the nature of the aggressive and untested claims against which American Express is defending itself. The resolution of this very uncertainty through the Settlement only further supports the conclusion that the Settlement satisfies the *Grinnell* standard for final approval.

CONCLUSION

For all of the reasons set forth above, we respectfully submit that the Settlement remains fair, reasonable, and adequate under *Grinnell*.

Dated: September 2, 2014
New York, New York

Respectfully submitted,

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