

## Visa/MasterCard Antitrust Litigation

July 2011 saw stakeholders in the long-running antitrust class action against Visa and MasterCard announce a tentative settlement worth more than \$7 billion. If approved, the agreement would bring an end to seven years of complex litigation and give class plaintiffs at least some of the remedies they seek.

The suit, initiated by retail merchants and trade associations, requests monetary and injunctive relief against Visa, MasterCard, and their member banks based on allegations that they conspired to charge merchants supra-competitive swipe fees, also known as interchange fees, and imposed anticompetitive restraints in violation of federal and state antitrust laws. Weeks before trial was scheduled to begin, the parties hammered out a settlement that many class plaintiffs considered tolerable. However, now a growing number appear ready to reject the deal.

### Background

Visa and MasterCard are bank-card networks comprised of member banks and financial institutions, including Bank of America, Citibank, HSBC, Suntrust, and Wells Fargo, among others. Each network facilitates commerce by allowing cardholders to make noncash purchases using a debit card, charge card, or credit card. A typical transaction involves four players:

- The cardholder;
- The retail merchant;
- The issuing bank, the member bank that issued the cardholder's Visa or MasterCard; and
- The acquiring bank, the member bank that acquires the merchant's payment card receivable and works with the network and issuing bank to settle the transaction.

To illustrate, a cardholder who purchases an item for \$100 can pay with a debit or credit card. To make a debit purchase, the cardholder swipes a debit card at the merchant's payment card terminal and enters a Personal Identification Number or PIN into a number pad. If purchasing on credit, the cardholder swipes a credit card and, if required, enters

the ZIP code for his or her billing address. Transaction and cardholder information is then transmitted electronically to the acquiring bank, which forwards it to the relevant payment card network. The network, in turn, routes the information to the issuing bank, which confirms the data and determines whether the cardholder has sufficient funds or credit for the transaction. If so, the issuing bank accepts the transaction for the amount of sale (\$100.00) less a swipe fee (e.g. 1.65%). The issuing bank's authorisation is then transmitted with a net payment (e.g. \$98.35) through the network to the acquiring bank. The issuing bank covers that payment by deducting the amount of sale from the cardholder's checking account or billing it to the cardholder's credit card. On the other side of the transaction, the acquiring bank earns its payment on the sale by guaranteeing that the merchant receives the amount of sale less a merchant-discount fee (e.g. 2.10%), which includes the swipe fee as well as the acquiring bank's fee. Having received the issuing bank's net payment (e.g. \$98.35), the acquiring bank then deducts its percentage (e.g. 0.45%) and forwards the balance (in this example, \$97.90) to the retail merchant.

### The Antitrust Case

In 2005, the class action plaintiffs filed suit to challenge the networks' interchange fees and certain of the networks' allegedly anticompetitive rules. Multiple suits filed in federal court were eventually transferred for centralised pretrial proceedings in the Eastern District of New York. In 2009, a consolidated complaint was filed on behalf of the putative plaintiff class alleging that the defendants had engaged in an illegal conspiracy to fix

supracompetitive swipe fees and impose unlawful restraints on trade in violation of the Sherman Act, 15 U.S.C. §§ 1 and 2, and an analogous California law, the Cartwright Act.

First, the class plaintiffs alleged that the networks' uniform fee schedule for interchange fees was the result of horizontal price-fixing agreements among and between Visa board members, MasterCard board members, and major financial institutions that were represented on the Boards. According to the complaint, the inflated swipe fees established in the uniform schedules resulted in market distortion because the fees did not account for the range of risks and processing costs associated with payment methods.

To support their claims, the plaintiffs alleged the basic characteristics of an efficient market. In an efficient market, they claimed, a lower interchange rate would apply to electronic debit transactions, which require entry of a PIN and involve almost immediate deductions from the cardholder's checking account. For these transactions, risks of nonpayment and fraud are minimal. By contrast, a higher swipe fee would apply to transactions involving premium credit cards - exclusive payment cards that offer incentives and benefits such as cash back, mileage points or travel upgrades. Premium credit card transactions carry greater risks of nonpayment because the cardholder, who is billed weeks later, may not be able to cover the balance when it becomes due. The transactions are more costly due to the benefits the card offers. Allegedly, the networks' uniform schedule for default interchange concealed these and other costs from the cardholder. The plaintiffs claimed that cardholders with more complete

information might opt for less costly payment methods, which would reduce the retailer's payment card expenses and pave the way for greater cost savings to consumers.

Second, the class plaintiffs alleged that the networks propped up their inflated swipe fees by establishing and enforcing anti-steering rules that prevented merchants from directing cardholders toward less costly payment methods. For example, plaintiffs challenged Visa and MasterCard's 'No Minimum Purchase Rule,' which allegedly prohibited merchants from imposing minimum purchase amounts for payment card transactions. According to plaintiffs, the networks opposed minimum purchase requirements because they encourage low-dollar cash transactions and, thereby, reduce the merchant's total swipe fees as well as the issuing bank's corresponding profit.

Another rule, the 'No Surcharge Rule,' allegedly precluded merchants from adding a surcharge to payment card transactions based on differences in transaction costs. Plaintiffs claimed that the rule effectively prohibited retailers from passing on discounts for less expensive payment methods. According to the plaintiffs, consumers using more efficient payment methods (e.g. debit cards) were forced to subsidise the least efficient methods (e.g. premium credit cards). The plaintiffs claimed that normalising transaction costs in this way deprived consumers of any incentive to reduce swipe fees charged to the merchant.

At the close of discovery, the class action plaintiffs had reviewed more than 50 million pages of documents and deposed more than 400 witnesses. Roughly two months before trial was scheduled to begin, the parties filed a

Memorandum of Understanding ('MOU') with the court stating their intent to settle.

### **The Settlement Agreement**

Under the settlement, the class action plaintiffs will receive roughly \$6 billion in damages. Visa will pay \$4 billion and MasterCard \$2 billion. In addition, Visa and MasterCard agreed to reduce applicable interchange or swipe fees to issuer banks by 10 basis points, but only for an eight-month period following settlement. The temporary reduction in swipe fees is worth about \$1.2 billion. Notably, the settlement will allow merchants to add surcharges to payment card transactions in accordance with rules set forth in the agreement. For example, if a retailer adds a surcharge to a Visa card transaction, the merchant must add a surcharge to every payment card transaction with the same or higher cost of acceptance. In return for these concessions, Visa, MasterCard and their member banks will be released from all present and future claims related to the networks' interchange fees and related rules. If twenty-five percent or more of the cash settlement would otherwise go to stakeholders who opt out of settlement, the defendants may terminate the agreement.

Since the MOU was filed, retailers have been reviewing the settlement to determine whether they will accept the proposal or opt out. Some merchants and groups objected to the deal early on, including Wal-Mart, Target, and the National Association of Convenience Stores. Other retailers are now signaling their opposition as well, including members of the National Home Furnishings Association and National Retail Federation, which recently announced it would try to block

the settlement. They complain that the \$7 billion settlement represents a fraction of the overpayments retailers have been making for years. Not only that, the 0.1% reduction in default interchange is only temporary. After the eight-month period lapses, nothing in the agreement will prevent Visa and MasterCard from returning to current default rates or even increasing them.

Others caution that a retraction of the 'No Surcharge Rule' will be of no consequence in ten states that disallow surcharges on payment card transactions, including New York, California, and Florida. Merchants in other states are not likely to add surcharges. For one, many retailers that accept Visa and MasterCard also accept American Express, which reportedly requires merchants to treat all electronic transactions the same. Under American Express's rules, a merchant that adds a surcharge to credit card transactions must also surcharge debit card transactions. But complying with that rule would violate Visa and MasterCard rules, which prohibit surcharges on debit transactions. Secondly, retailers fear that adding surcharges in this economy will put another drag on sales.

Consumer advocates complain that the settlement transfers wealth from banks to merchants, not to consumers who have been paying higher retail across the board to cover the inflated interchange rates. Although the parties will probably finalise the agreement, it is possible that sufficient numbers will opt out to scuttle the deal. If they do, the class action plaintiffs may get their day in court after all.

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