

Client Alert

February 23, 2015

Does DOJ's Victory over American Express Foreshadow More Antitrust Challenges to Come?

American Express has rules that prohibit merchants from discriminating against American Express cards in favor of those issued by other card networks. On February 18, 2015, following a seven-week trial, Judge Garaufis in the Eastern District of New York issued a decision siding with the United States Department of Justice (DOJ), and holding that these Non-Discrimination Provisions (NDPs) were restraints of trade in violation of Section 1 of the Sherman Act (the "Decision"). The Decision was based on a full Rule of Reason analysis of the competitive effects of the challenged provisions. The DOJ's victory, including a finding that American Express had market power notwithstanding its 26.4% share of the relevant market, is likely to embolden the agency and private plaintiffs to bring challenges under the rule of reason to other "vertical restraints," i.e., agreements between firms at different levels of the production and distribution process relating to the terms on which they may buy or sell goods or services.

BACKGROUND

The DOJ filed a complaint in October 2010 against Visa, MasterCard, and American Express challenging certain rules that prohibited merchants from discriminating against that network's cards in favor of other networks' cards. The DOJ did not challenge rules forbidding surcharges at the point of sale, or rules that prohibit disparaging the network's brand or cards, or providing inaccurate information about the cost of acceptance. Visa and MasterCard settled the case with the DOJ, and agreed to modify their rules to permit certain forms of discounting at the point of sale, and to allow merchants to encourage the use of other card brands. American Express decided not to settle and the case proceeded to trial.

DECISION

In the 150-page Decision, Judge Garaufis held that the American Express NDPs violate Section 1 of the Sherman Act. The DOJ's theory was that the NDPs in the merchant contracts with American Express constituted vertical restraints of trade. The Court conducted a full Rule of Reason analysis and concluded that there was direct evidence of adverse effects on competition that were not outweighed by the pro-competitive benefits of the NDPs.

Of particular interest, the Court agreed with the DOJ that it was not necessary to decide whether American Express has market power, so long as there was direct evidence of adverse effects on competition. Notwithstanding the conclusion that it was not necessary to do so, the Court found that American Express has market power. American Express had fiercely challenged both the argument that finding market power was unnecessary in this case, and that it possessed market power.

The decision discusses at length the relevant market. The Court rejected American Express's arguments that attempted to broaden the relevant market to include all forms of payment or, in the alternative, to include debit cards. The Court also rejected the DOJ's attempt to create a narrow market that included only Travel and Entertainment merchants. In the end, the Court concluded that the relevant market included credit cards and charge cards.

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When the market is defined as credit and charge cards, American Express has 26.4% market share (measured by percentage of credit and charge card purchase volume in the United States). The Court was not persuaded by American Express' arguments that firms with less than 30% market share presumptively lack market power in the Second Circuit.¹ The Court did not rely solely on market share to determine market power, but rather considered the following additional factors: concentration in the market (there are only four major credit card networks), barriers to entry (no new entrants since Discover in 1985), cardholder insistence on use of American Express Cards, and the pricing practices of American Express including price increases without losing merchant acceptance.

COURT ASKED PARTIES TO AGREE ON INJUNCTION

The Court noted several times in the Decision that it would have preferred the parties settle the action rather than proceed to trial. The Court noted that the credit card industry is "complex" and a "critical component of commerce in the United States." The Court "recognizes that it does not possess the experience or expertise necessary to advise, much less dictate to, the firms in this industry how they must conduct their affairs as going concerns." The Court, therefore, gave the parties 30 days to attempt to agree on an appropriate injunction and provide briefing to the Court regarding the rationale for proposed injunction. If the parties cannot agree, the Court will fashion the injunction on its own.

AMERICAN EXPRESS WILL APPEAL THE DECISION

In a statement released the same day as the decision, American Express stated "American Express is disappointed in the court's ruling, which we believe will harm competition to the detriment of consumers and merchants. American Express intends to appeal the court's ruling at the appropriate time."

DOJ'S VICTORY IS LIKELY TO RESULT IN MORE RULE OF REASON CASES CHALLENGING VERTICAL RESTRAINTS AND OTHER BUSINESS PRACTICES

The DOJ's victory in this hard-fought seven-week trial is likely to embolden the DOJ and other plaintiffs to challenge more practices that would be subject to the Rule of Reason. There was no allegation of horizontal agreement in this case, and thus no likelihood of bringing this case under the *per se* rule. The DOJ's success, particularly given the Court's conclusion that a firm with low market share can exercise market power, is likely to increase the number of cases challenging vertical restraints (*i.e.*, agreements between firms at different levels of the production and distribution process relating to the terms on which they may buy or sell goods or services) and other business practices that are subject to the Rule of Reason.

¹ American Express relied on *Commercial Data Servers, Inc. v. International Business Machines Corp.*, 262 F. Supp. 2d 50, 74 (S.D.N.Y. 2003), where Judge McMahon of the Southern District of New York stated "[c]ourts have consistently held that firms with market share of less than 30% are presumptively incapable of exercising market power" (citations and internal quotation marks omitted). Judge Garaufis refused to follow this approach, which he described as "unduly formalistic and arbitrary," absent clear direction from the Second Circuit.

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