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American Express Loses Antitrust Fight against U.S. Department of Justice

By Philip Wiseman, J.D. Candidate 2017 | February 27, 2015

On February 19, 2015, Judge Nicholas Garaufis of the U.S. District Court for the Eastern District of New York ruled that American Express violated U.S. antitrust laws with its practice of preventing merchants from encouraging customers to use some types of credit cards over others.

Not All Cards Are Created Equal

Since 1966, credit cards and debit cards have become an increasingly popular way for consumers in the United States to make purchases. Rather than worry about carrying around cash and loose change, millions of Americans choose to swipe their plastic instead of paying in cash. In 2011, there were 1.4 billion credit cards in circulation in the United States.

For most people, the primary concern regarding paying with plastic is the potential for identity theft. However, at the heart of the *U.S. v. American Express Co.* lawsuit is the concern of merchants over the rising fees they must pay to accept payment via certain cards. Card companies charge them more than $50 billion a year to process consumer transactions by taking a small percentage of each transaction as a fee for using their card. While customers do not get charged up front for these transaction fees, merchants offset these costs by increasing fees on the goods within their stores. As a result of not allowing them to encourage cheaper payment methods, customers are unknowingly locked into higher prices because they are unaware that their choice of payment leads to higher prices.

These fees aren't uniform across the credit card world. While debit cards often impose the cheapest fees, the credit cards that give consumers perks like reward points, airline miles, cash back, etc. are among the most expensive to process. Additionally, not all credit card companies charge the same amount in transaction fees. This is what drove many merchants to encourage customers to use certain methods of payment over others – including not using American Express reward cards in favor of Visa, Discover, or debit cards. *American Express Co.* notes that these "steering" practices contributed to a 25-45% shift in card volume from American Express to Visa [access full opinion here].

Non-Discrimination Policies (NDPs) and Their Impacts

As merchants were encouraging customers to use competitors' cards over American Express, the company decided to contractually prevent this practice by imposing "non-discrimination policies" in each of its merchant contracts. The company's response is not new to the credit card market. Visa and MasterCard both contractually instituted similar policies until a 2010 settlement with the U.S. Department of Justice. However, American Express refused to settle in that round of lawsuits and decided to take its chances at trial last summer.

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At trial, American Express argued that as the third largest network for credit card use in the United States it was not in a position to stifle competition in the market. However, Judge Garaufis rejected that argument noting that, by payment volume, American Express is actually the second-largest network.

Additionally, American Express argued that NDP agreements protect its customers from merchants who try to steer customers away from credit card use to minimize transaction costs. Judge Garaufis rejected this argument as well, stating that American Express customer loyalty would negate such a steering effect.

The Ruling

Judge Garaufis ruled that NDPs reduce credit card companies' incentives to offer lower discount rates and impede significant horizontal competition between brands in the market, and that American Express had unfairly exploited its market share of the credit card industry in violation of U.S. antitrust laws [access full opinion here].

No money damages were sought, but American Express did add that this ruling could have a "material adverse effect" on its business model and its ability to offer customers reward programs in the future. Judge Garaufis asked both American Express and DOJ to submit proposed ideas on how to remedy the situation. Both sides have yet to submit a proposal to the court.

Reactions

American Express issued a statement calling the decision "wrong." In a press release on its website, the company 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."

Mallory Duncan, general counsel for the National Retail Federation, the organization which represents well-known retail companies, stated that "This is a pretty important step forward, and it vindicates what we've said all along: that the credit card market is broken and the consequence has been high fees for merchants and consumers." Douglas Kantor, a partner at Steptoe & Johnson, said that the decision "ought to open up the marketplace for more price competition where there isn't any at all today. That helps merchants and consumers, because it can help keep prices down, and spur spending and economic activity."

This news came amid an already disappointing start of 2015 for American Express as its partnerships with JetBlue and Costco were announced to end in 2016. This only added to the company's announcement last October that it would lay off 4,000 employees in the 2015 fiscal year. After the ruling, American Express stocks closed down $1.38 to $78.40, already a 16% drop this year, but rebounded Friday up $1.43 to $79.83.