UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,	)	
Plaintiff,	)	**98 Civ. 7076 (BSJ)**
v.	)	
VISA U.S.A. INC., VISA INTERNATIONAL CORP., AND MASTERCARD INTERNATIONAL INCORPORATED,	)	**PLAINTIFF'S MEMORANDUM IN SUPPORT OF ITS PROPOSED RELIEF**
Defendants.	)	

This memorandum, along with the attached Proposed Final Judgment ("PFJ"), is submitted by the United States at the request of the Court to address the nature of relief that would be appropriate to remedy defendants' violations of the antitrust laws. With respect to defendants' system of dual governance, the PFJ would prohibit an issuer from participating in governance of an association unless, on a prospective basis, the issuer is dedicated exclusively to the brand of that association. With respect to defendants' exclusionary practices, the PFJ would prohibit defendants from enforcing Visa's By-law 2.10(e) ("2.10(e)") and MasterCard's competitive programs policy ("CPP"). To ensure that this relief is not nullified by contracts that have been negotiated under the cloud of 2.10(e) and the CPP during the pendency of the case, the PFJ would also allow banks to opt out of those contracts at their discretion during the two-year period following entry of the judgment, so that all networks will have an opportunity to compete for the banks' business. In addition to these prohibitions, the PFJ contains other substantive prohibitions intended to prevent continuing violations of the antitrust laws, as well as provisions concerning applicability and

enforcement that are customarily found in antitrust judgments.

I. The Nature and Scope of the Court's Authority

This Court is "invested with jurisdiction to prevent and restrain violations" of the Sherman Act. 15 U.S.C. § 4. When a court determines that defendants have violated the antitrust laws, it is "empowered to fashion appropriate restraints on the [defendants'] future activities both to avoid a recurrence of the violation and to eliminate its consequences." *Nat'l Society of Professional Engineers v. United States*, 435 U.S. 679, 697 (1978). A court may enter "such orders and decrees as are necessary and appropriate" to assure compliance with the antitrust laws. *Northern Securities Co. v. United States*, 193 U.S. 197, 344 (1904). In addition, adequate relief should remove impediments to the restoration of competitive conditions in the affected market and prohibit conduct that might cause a recurrence of defendants' unlawful behavior. District courts "are invested with large discretion to model their judgments to fit the exigencies of the particular case." *International Salt Co. v. United States*, 332 U.S. 392, 400-01 (1947).

II. Substantive Relief Provisions

The complaint alleges that defendants have violated the antitrust laws through their governance structure and exclusionary practices. The substantive relief provisions of the PFJ address each of these violations.

A. Relief for Governance Structure

The defendants' system of dual governance, by which banks with significant economic interests in Visa have been permitted to participate in governance of MasterCard and banks with significant economic interests in MasterCard have been permitted to participate in governance of Visa, must be prohibited. The evidence demonstrates that such banks have diminished incentives

to support competitive initiatives by the defendants that would shift business from one brand to the other, that the presence of such banks on the Visa and MasterCard boards and governing committees has substantially affected the defendants' decision-making processes with respect to competitive initiatives, and that, as a result, the defendants have not competed vigorously with one another with respect to brand promotion and network and product innovations, to the detriment of consumers.[1]

The evidence also demonstrates that the anticompetitive effects of the defendants' dual governance structure would be remedied by requiring that any issuing bank participating in the governance of a defendant -- whether by having a representative on the board of directors or by serving on a committee that deals with competitively sensitive matters -- be dedicated exclusively to that defendant's brand.[2] A dedicated governor's incentives will not be diluted or compromised by economic interests in competing networks. Competitive decisions will be made by governors sharing a common commitment to the association they are governing. Both Visa and MasterCard initiated steps to increase the dedication of the members of their boards of directors after the complaint was filed, and the evidence shows that this has led to increased competition between the defendants.[3]

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[1] *See generally* Government's Proposed Findings of Fact, ¶¶ 40-212.

[2] *See* M. Katz Aff., ¶¶ 248-64.

[3] *See, e.g.,* Government's Proposed Findings of Fact, ¶ 99; Pascarella, Tr. 5248-49, 5252; Dahir, Tr. 4615; Wells, Tr. 4921-22; Heasley, Tr. 5325-26; Boudreau, Tr. 2075-76.

Requiring governors to be dedicated to the association that they govern will be sufficient to ensure that the associations act as truly independent competitors. There is no credible evidence that large, non-governing issuers that have interests in multiple card brands would be able to influence dedicated governors to pull their competitive punches. The governing banks' success will be directly tied to the success of the association. A dedicated governor would not be receptive to complaints or threats by a non-governing bank that it will shift its business to a competing network if the governor supports competitive investments with respect to new products, features, and services: the governing bank will need the association to behave competitively if the bank is going to succeed as an issuer of that association's brand.[4]

The PFJ requires that governing banks issue 100 percent of their payment card products[5] on the network that they govern.[6] The Government believes that this is the surest and simplest

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[4] For example, a bank such as U.S. Bank that is dedicated to Visa would not be receptive to entreaties from a non-dedicated issuer such as MBNA not to invest in developing Visa's corporate card because MBNA was issuing MasterCard corporate cards; any reduction in Visa's investment in corporate cards would hurt U.S. Bank's ability to compete with MBNA as an issuer of corporate cards. *See* Heasley, Tr. 5332-33; *see also* M. Katz, Tr. 3521-23; Pascarella, Tr. 5226-27; Dahir, Tr. 4623.

[5] The PFJ requires exclusive issuance of both general purpose cards and debit cards that operate on a general purpose card network. The complaint alleges, and the evidence proves, that dual governance has had anticompetitive effects in the general purpose card market. However, the associations' governors also make decisions with respect to other products offered by the association, including debit. To the extent some investments (such as brand advertising) affect multiple products, a governing bank that issued debit cards on one network and general purpose cards on another network could have diminished incentives to support those investments. Currently, each defendant's board members issue debit cards only on the network they govern.

[6] In addition, the PFJ would require that the defendants adopt by-laws and rules to prevent the sharing of competitively sensitive information with competing networks. *See* Government's Proposed Findings of Fact, ¶¶ 78-82; Schall, Tr. 5034-36; P-0027; P-0028; P-0318 at MC 0144106.

way to ensure that the defendants' governing banks are dedicated. Although governing banks that issue a very small percentage of their cards on other networks could also be considered "dedicated" in the sense that any blunting of their incentives to compete would be *de minimis*,[7] a remedy that requires governing banks to commit exclusively to the association that they govern has several benefits. First, such a requirement would completely eliminate any incentive for the bank to limit the nature and degree of competition between the associations; the Court would not need to determine how much of its business a bank could do on another network without unduly compromising its incentives to compete with that network.

Second, a requirement that governing banks issue card products exclusively on the network that they govern would ensure that the governing banks' incentives are properly aligned with respect to *all* of the competitive decisions of the association, including decisions with respect to development of new products and services. A governing bank that does not issue cards exclusively on the network that it governs could have an overall portfolio that is skewed toward the association that it governs, but issue most of its cards in a particular product segment on a competing network, thus having diminished incentives to support investments with respect to that segment. Thus, if dedication were defined to mean 80-90 percent skew toward a particular brand, it would have to be measured with respect to different product segments, such as consumer, corporate, and premium cards.

[7] M. Katz Aff., ¶ 189; *see also* Pascarella, Tr. 5162; Dahir, Tr. 4533-343; Heasley, Tr. 5300.

Finally, a requirement that a governing bank issue cards exclusively on the network that it governs, as opposed to maintaining a certain minimum skew level, is more easily monitored and complied with by defendants and their member banks.

B. Relief from Exclusionary Rules and Practices

Defendants' exclusionary rules and practices have, as a practical matter, precluded banks from issuing other networks' cards. As alleged in the complaint, Visa's 2.10(e) and MasterCard's CPP combine the market power of the two largest networks, comprising approximately 75 percent of general purpose card volume,[8] to preclude banks from issuing cards on the smaller general purpose card networks.[9] These exclusionary rules limit the ability of banks to compete with one another with respect to the brands of cards they offer. Such competition would result in banks offering a wider variety of cards that would be more responsive to the needs and preferences of consumers.[10] In addition, the exclusionary rules effectively prevent the smaller networks from competing to get banks to issue their cards. Permitting American Express and Discover to compete for bank issuance would spur innovation in products and services among all general purpose card networks[11] and give the smaller networks the opportunity to increase both their card issuance and their merchant acceptance levels.[12] The PFJ would require Visa to repeal 2.10(e) and MasterCard to repeal the CPP. It would also preclude defendants from adopting or enforcing by-

[8] Government's Proposed Findings of Fact, ¶ 31.

[9] *Id.*, ¶¶ 264-87.

[10] *Id.*, ¶¶ 337-49.

[11] *Id.*, ¶¶ 350-51; 360-68.

[12] *Id.*, ¶¶ 255-63; 312-23.

laws, rules or policies that otherwise prohibit non-governing member banks from issuing cards on other networks.

The PFJ also contains provisions allowing banks the ability to opt out of contracts that they entered into with the defendants while this case has been pending. Both Visa, through its Partnership Program, and MasterCard, through its Member Business Agreements, have negotiated multi-year contracts with banks that commit the banks to meet certain market-share-based targets (requiring, for example, that a bank's payment card transaction volume be skewed at least 90 percent toward that defendant by the end of the contract and that the bank issue new cards exclusively on that defendant's network until that target is met) in exchange for financial incentives worth millions of dollars.[13] These contracts include substantial penalties for banks that fail to meet market share targets during the pendency of the contract.[14] Visa has signed such multi-year contracts with banks accounting for approximately 60 percent of its total transaction volume,[15] and MasterCard has signed similar agreements with a number of large issuing banks.[16]

These contracts were negotiated after the complaint was filed,[17] but before the Court had an opportunity to declare 2.10(e) and the CPP invalid, at a time when both American Express and Discover were effectively precluded from competing for bank issuance. Thus, these agreements

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[13] *Id.*, ¶ 97; Dahir, Tr. 4533-34, 4538, 4540-41; Boudreau, Tr. 2071.

[14] Dahir, Tr. 4540; D-2555R at CMB013613 (Chase/MasterCard agreement); P-0831R at VU1574085 (Bank of America/Visa agreement).

[15] Dahir, Tr. 4538; Pascarella, Tr. 5164.

[16] Hanft Dep. 60-66.

[17] Dahir, Tr. 4605-06; Wells, Tr. 4915; Pascarella, Tr. 5161.

reflect the defendants' joint exercise of market power through 2.10(e) and the CPP. Because these agreements impose significant penalties on banks that fail to meet their market share targets, they would substantially impair the ability of American Express and Discover to compete against defendants for the banks' business many years into the future, even if the Court orders that the defendants eliminate their exclusionary rules today.

Visa and MasterCard should not be permitted to use the unfair advantages conferred on them by their exclusionary rules to lock banks into long-term deals that will continue in effect even if the rules are found to violate the antitrust laws. See *Int'l Salt Co, supra*, 332 U.S. at 400 ("The District Court is not obliged to assume, contrary to common experience, that a violator of the antitrust laws will relinquish the fruits of his violation more completely than the court requires him to do. And advantages already in hand may be held by methods more subtle and informed, and more difficult to prove, than those which, in the first place, win the market."). Thus, to ensure that relief is effective, the PFJ provides that any bank that is a party to a such a market-share-based incentive contract entered into before entry of the judgment should have the right to abrogate that contract for up to two years from the date of the order's entry, with no penalty. However, a defendant would not be precluded by the PFJ from entering into such contracts prospectively.

Many banks that have already signed such agreements, including banks that value the ability to govern the general purpose network on which they issue cards, may choose to continue or sign new agreements with one of the defendants to issue exclusively on that defendant's network, thereby giving up the right to issue other brands of cards. But each bank's decision will

reflect its independent judgment about the relative value of governance, the benefits of being able to issue multiple brands of products, the terms offered by the network, and the competitive strength of each of the different networks' products and services. If a defendant wins a bank's loyalty, it will be a result of unfettered competition among all of the general purpose card networks.

Finally, the PFJ would prohibit the defendants from discriminating in favor of one another to the disadvantage of other competing general purpose card networks. As alleged in the complaint, defendants have on various occasions adopted other rules or engaged in practices that treated one another more favorably than American Express and Discover -- the two networks not owned and controlled by the issuing banks.[18] Such rules allow the defendants to combine their market power in a manner intended to disadvantage the smaller networks and make it harder for them to do business with issuing and acquiring banks. The PFJ would prohibit such discriminatory treatment.

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[18] For example, Visa's By-law 2.06 -- like 2.10(e) -- deems American Express and Discover, but not MasterCard, to be competitors. By-law 2.06 prohibits American Express and Discover from joining Visa. Such rules may legitimately preserve network-level competition. *See SCFC ILC, Inc. v. Visa U.S.A. Inc.*, 36 F.3d 958 (10th Cir. 1994) (the *MountainWest* litigation). In addition, however, the by-law prohibits a bank that issues American Express or Discover cards, but not MasterCard cards, from joining Visa. The PFJ enjoins such rules to the extent they treat MasterCard differently from other general purpose card networks. Nothing in the PFJ would prohibit a defendant from adopting non-discriminatory rules that prevent competitors from becoming a member.

III. Implementation Issues

Because most card issuing banks have significant card portfolios on both Visa and MasterCard, requiring governors to immediately shift their portfolios to a single network could be disruptive to a large number of consumers; consumers holding a MasterCard issued by a Visa governing bank would have to give up their card and either accept a Visa card in its place or turn to another issuer. Although there is evidence that many consumers could be induced to accept a new card from their issuing bank,[19] there is also evidence that some consumers would resist a change to their card brand. There are clear costs to requiring consumers to make that change.[20]

In order to minimize the costs to consumers of moving to a more competitive general purpose card environment, the PFJ would require governing banks to issue cards exclusively on the network that they govern on a prospective basis only. In addition, it would require that, by the year 2003, a governing bank's general purpose card transaction volume be skewed at least 80 percent toward the association that it governs.[21]

These two requirements should be sufficient to ensure that the associations behave as truly independent competitors. The prospective-exclusivity requirement means that the governing banks will know that their ability to issue attractive products and services in the future is

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[19] *See* P-0165R at CC024533; D-2555R at CMB013614.

[20] Wells, Tr. 4919; *see also* Heasley, Tr. 5295-96.

[21] The PFJ provides that a bank may exclude from the skew calculation volume attributable to (i) a card portfolio acquired within the preceding two years, and (ii) cards issued pursuant to a co-branding or affinity agreement that is exclusive to a particular brand and that was entered into prior to the date of entry of the order.

dependent upon the competitive success of the network they govern. As a result, the banks will have strong incentives to support investment by the association they govern in new products and services and network assets. The skew requirement will ensure that banks do not maintain divided loyalties by shifting back and forth between the associations from year to year, issuing one brand of card exclusively for a period of time, and then issuing the other brand. Since there is a significant turnover in cards from year to year, the effect of these two requirements is that governors' portfolios will become increasingly skewed toward the association they govern.[22]

IV. Other Provisions of the PFJ

The PFJ also includes a number of provisions that appear generally in antitrust decrees. The decree would be applicable to all persons acting in concert with defendants, an especially important provision in this case since persons serving as governors will be in the best position to monitor compliance with the duality relief. It also includes a number of compliance provisions intended to ensure that proper steps are taken to implement the requirements of the judgment that appropriate individuals are made aware of their obligations under the judgment. These include appointment of an antitrust compliance officer to monitor and certify compliance and report violations to the United States. Customary inspection provisions, which allow the United States to review documents and speak with individuals for purposes of determining or securing compliance, should also be included.

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[22] *See* Heasley, Tr. 5280, 5294-97 (describing the conversion of U.S. Bancorp's portfolio from 60 percent Visa to 99 percent Visa).

As is customary for judgments in antitrust cases brought by the Government, the term of the judgment would be 10 years. The Court would retain jurisdiction to enforce it.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on August 11, 2000, a true and correct copy of (1) Plaintiff's Memorandum in Support of its Proposed Relief; and (2) Proposed Final Judgment were served by hand upon the counsel listed below.

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