UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

DISCOVER FINANCIAL SERVICES, DFS SERVICES, LLC, and DISCOVER BANK, *Plaintiffs*, v. VISA U.S.A. INC., VISA INTERNATIONAL SERVICE ASSOCIATION, MASTERCARD INCORPORATED, and MASTERCARD INTERNATIONAL INCORPORATED, *Defendants*.	:	**Case No. 04-cv-7844 (BSJ)(KF)** **ECF Case**

MEMORANDUM OF LAW IN SUPPORT OF DISCOVER'S MOTION PURSUANT TO SECTION 5(A) OF THE CLAYTON ACT TO GIVE PRIMA FACIE EFFECT TO CERTAIN FACTS THAT WERE NECESSARY TO THE ULTIMATE RULINGS IN *UNITED STATES V. VISA/MASTERCARD* AND TO CHARGE THE JURY ACCORDINGLY

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INTRODUCTION

With the intent of giving private litigants "any benefit they might cull" from the government actions on which they follow, Congress passed Section 5(a) of the Clayton Act in 1914, a time when courts did not grant nonmutual offensive collateral estoppel.[1] Section 5(a) requires that the findings from a prior government litigation be given prima facie effect in a private follow-on antitrust suit where the elements of collateral estoppel are satisfied. In 1979, the Supreme Court instituted the doctrine of nonmutual offensive collateral estoppel in *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322 (1979), adding an additional discretionary consideration of fairness to the threshold elements of collateral estoppel. Following that, the benefit of Section 5(a) of the Clayton Act became limited to circumstances where the threshold elements of collateral estoppel were satisfied but *Parklane's* additional discretionary consideration of fairness was not. This is such a case.

In its motion for summary judgment, Discover asked this Court to give collateral estoppel effect to 81 factual findings (the "Attachment A Findings") that were fully litigated in the DOJ Case and that were necessary to support the Court's ultimate ruling that the exclusionary rules violated Section 1 of the Sherman Act.[2] This Court declined to grant collateral estoppel to the Attachment A findings solely on fairness grounds. *Discover Fin. Servs. v. Visa U. S. A.*, 2008 WL 3884383 at *5 (S.D.N.Y. 2008). Because that discretionary consideration is typically only

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1 *Minn. Min. & Mfg. Co. v N.J. Wood Finishing Co.*, 381 U.S. 311, 318 (1965).

2 Discover sought collateral estoppel effect only for those facts from the DOJ ruling that, in good faith, could be argued were necessary to the ruling in that case under the law of this Circuit. *See, e.g., Cen. Hudson Gas & Elec. Corp. v. Empresa Naviera Santa S.A.*, 56 F.3d 359 (2d Cir. 1995) (when prior judgments "entailed a finding" on an issue, that issue was "necessary" to the prior judgment); *see also Hoult v. Hoult*, 157 F.3d 29, 32 (1st Cir. 1998) ("But a finding is necessary if it was central to the route that led to the factfiner to the judgment reached . . . . .").

reached once the threshold requirements of collateral estoppel have been met, a fair reading of the Court's August 20 Order is that the Attachment A Findings did satisfy the threshold requirements of collateral estoppel. Accordingly, this is the precise circumstance where Section 5(a) of the Clayton Act applies to give these findings prima facie effect. However, because the Court's August 20 Order obviated the need for all of the Attachment A Findings, Discover's current motion is limited to seeking prima facie effect for just thirty-eight (38) of those findings (the "5A Findings") that are relevant to the remaining issues to be tried.[3] Because Defendants will have an opportunity to rebut the prima facie evidence of these facts, they will be presented to the jury in context and, thus, the introduction of these facts would not be unfair to Defendants. Accordingly, pursuant to Section 5(a), Discover respectfully requests that this Court instruct the jury to accept as prima facie established the 5A Findings, and to admit the 5A Findings as prima facie evidence against Defendants.

ARGUMENT

I. SECTION 5(A) OF THE CLAYTON ACT APPLIES WITHOUT DISCRETION WHERE THE THRESHOLD REQUIREMENTS OF COLLATERAL ESTOPPEL ARE MET.

Section 5(a) of the Clayton Act mandates that

> A final judgment or decree heretofore or hereafter rendered in any civil or criminal proceeding brought by or on behalf of the United States under the antitrust laws to the effect that a defendant has violated said laws ***shall be*** prima facie evidence against such defendant in any action or proceeding brought by any other party against such defendants under said laws as to all matters respecting which said judgment or decree would be an estoppel as between the parties

[3] In light of this Court's October 1 Order, Discover has added the following finding from the DOJ Case to the 5A Findings: "Bylaw 2.10(e) . . . did weak[en] competition and harm consumers by . . . effectively foreclosing . . . Discover from competing to issue off-line Debit cards." *Visa/MasterCard*, 163 F. Supp. 2d at 382. As this Court initially granted collateral estoppel to this finding in its August 20 Order, and reconsidered that decision on discretionary grounds, this finding meets the requirements for 5(a) prima facie treatment.

> thereto . . . Nothing contained in this section shall be construed to impose any limitation on the application of collateral estoppel . . . .

15 U.S.C. § 16(a) (emphasis added). Section 5(a) extends prima facie effect without exception once the threshold elements of collateral estoppel are satisfied. It neither requires nor permits the discretionary consideration of fairness. *See, e.g.,* ABA Model Jury Instructions at G-28 ("The primary application of the statute [section 5(a)] remains allowing prima facie effect to be given to prior government judgments where the stricter requirements of collateral estoppel are not met.").

The non-discretionary nature of Section 5(a) is clear from its plain text ("shall") and confirmed by its history. Section 5(a) was enacted prior to the Supreme Court's creation of nonmutual offensive collateral estoppel in *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322 (1979), which granted an additional benefit over the common law to private follow-on antitrust litigants. As the court explained in *Fleer Corp. v. Topps Chewing Gum, Inc.*, 415 F. Supp. 176 (E.D. Pa. 1976), "Congress enacted Section 5(a) in 1914. At that time, the mutuality doctrine barred the use of collateral estoppel by a non-party. Thus, Congress gave the private antitrust plaintiff an advantage that was not otherwise available." *Id.* at 184 (citing *Bigelow v. Old Dominion Copper Co.*, 225 U.S. 111, 126 (1912)). Section 5(a) was thus written in a world where "an estoppel" needed only four elements — identity, necessity, full and fair opportunity to litigate, and actual litigation and decision. *Parklane* changed that world by imposing an additional condition on nonmutual collateral estoppel — fairness. *See Parklane Hosiery*, 439 U.S. at 331.

In light of *Parklane,* Section 5(a) must provide for something other than the benefits of nonmutual collateral estoppel, or else it would be rendered superfluous. But "[t]here is a presumption against . . . giving [a statute] a construction that would render it ineffective."

Garcia-Villeda v. Mukasey, 531 F.3d 141, 147 (citing *United States v. Blasius*, 397 F.2d 203, n.9 (2d Cir. 1968)); *see also Bird v .United States*, 187 U.S. 118 (1902) (same). As Congress has not elected to rescind Section 5(a), it plainly intends for the provision to have a continuing role in private antitrust cases where the collateral estoppel requirements have been satisfied and the court, nonetheless, invokes *Parklane's* discretionary factors to deny giving the findings collateral estoppel effect.

The benefit for which Section 5(a) provides is that it gives findings from a prior government litigation prima facie effect where -- as here -- the threshold requirements of collateral estoppel have been satisfied but the discretionary consideration of fairness was not.[4] The leading federal case to consider in detail the relationship of Section 5(a) to collateral estoppel in the wake of *Parklane* has come to the same conclusion.

> [T]he correct approach is to analyze collateral estoppel and section 5(a) separately. Collateral estoppel, under which a prior judgment operates as an absolute bar to relitigation of the issues estopped, is governed by common law principles. *See, Parklane Hosiery Co. v. Shore, supra,* 439 U.S. at 326-31, 99 S.Ct. at 649-51; 1B J. Moore, *Federal Practice, supra,* ¶ .441. Section 5(a) of the Clayton Act, in so far as it reflects a congressional determination that prior antitrust judgments shall have *1021 **350 carryover effect in subsequent litigations, ***limits the discretion of the courts to decide whether to give effect to a prior judgment.*** The section, however, accords prior judgments only prima facie effect, thus creating a rebuttable presumption with respect to those issues determined in the prior judgment. *See McCook v. Standard Oil Co. of California,* 393 F.Supp. 256, 259-60 (C.D.Cal.1975). Because the rules for and result of applying collateral estoppel and section 5(a) are different, we shall treat each in turn.

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[4] The rebuttable nature of Section 5(a)'s presumption mitigates the lack of discretion that the judge has in applying it.

S. Pac. Commc'ns Co. v. Am. Tel. & Tel. Co., 740 F.2d 1011, 1020-21 (D.C. Cir. 1984) (emphasis added). The non discretionary character of Section 5(a) suggested by its language and history is thus confirmed by the federal courts.

II. SECTION 5(A) APPLIES TO THE 5A FACTS

This Court granted non-mutual offensive collateral estoppel effect to specific determinations in the prior Order but explicitly declined to include the Attachment A Findings in its decision due to fairness concerns. *Discover Fin. Servs. v. Visa U. S. A.*, 2008 WL 3884383 at *5 (S.D.N.Y. 2008). There would be no reason to reach this discretionary ground if the threshold requirements of collateral estoppel had not been established. *See, e.g., Bear, Stearns & Co., Inc. et al v. 1109580 Ontario, Inc.*, 409 F.3d 87, 91 (2d Cir. 2005); *see also See Parklane,* 439 U.S. at 329-331. Accordingly, because the Attachment A findings satisfy the requirements of Section 5(a), the 5A Findings, which were included within the Attachment A Findings, warrant prima facie effect.

CONCLUSION

Accordingly, Discover respectfully requests that the jury be instructed to accept as prima facie established the 5A Findings and that the 5A Findings be admitted as prima facie evidence against Defendants.

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October 1, 2008

Respectfully submitted,

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ATTACHMENT A

5A FINDINGS

1. "Bylaw 2.10(e) . . . did weak[en] competition and harm consumers by . . . effectively foreclosing . . . Discover from competing to issue off-line Debit cards." *Visa/MasterCard,* 163 F. Supp. 2d at 382.

2. Because of the defendants' exclusionary rules … Discover ha[s] not been able to convince U.S. banks to issue cards over their networks." *Visa/MasterCard,* 163 F. Supp. 2d at 382.

3. As a result of the exclusionary rules, "Discover cannot access the issuing competencies and segmented marketing expertise of the banks, nor their more profitable relationship customers with checking accounts, attributes which cannot be provided by the smaller banks and monoline banks to which American Express and Discover do have access." *Visa/MasterCard,* 163 F. Supp. 2d at 379.

4. The exclusionary rules prevented Discover "from competing in the network services market for the business of bank issuers." *Visa/MasterCard,* 163 F. Supp. 2d at 382 (citations omitted).

5. "The exclusionary rules con[str]ain … Discover's ability to grow market share while effectively maintaining the defendants' market share and power." *Visa/MasterCard,* 163 F. Supp. 2d at 382.

6. "Although First USA would have liked to issue Discover cards itself, it would not do so for fear of losing the ability to issue Visa and MasterCard cards." *Visa/MasterCard,* 163 F. Supp. 2d at 387.

7. "General purpose card issuers, if permitted, would be attracted to features of the … Discover network." *Visa/MasterCard,* 163 F. Supp. 2d at 395.

8. "Nor can . . . Discover profitably compete to buy additional portfolios to increase their size – and therefore merchant 'relevancy' – principally because they cannot be Visa or MasterCard members. If they buy a portfolio they must flip it to their own network immediately; the high loss rates in doing so make it impossible for either proprietary system to bid profitably for such portfolios in comparison to banks, who need not switch bonds at all." *Visa/MasterCard,* 163 F. Supp. 2d at 394.

9. "[T]he associations' past foreclosure of … Discover from competing to enter into the agreements has greatly and impermissibly altered the competitive landscape in the network and card markets." *Visa/MasterCard,* 163 F. Supp. 2d at 408.

10. "Because . . . agreements between issuers and Visa and MasterCard now predominate the market, … Discover ha[s] been effectively foreclosed from a large portion of the card issuing market, and will continue to be so foreclosed for the duration of those agreements." *Visa/MasterCard,* 163 F. Supp. 2d at 408-09.

11. "Discover has already lowered its merchant discount rate to gain acceptance; lowering it further would not close the gap. Discover instead needs more card issuance and transaction volume, which can only realistically be obtained via third-party issuers, to become a more relevant network." *Visa/MasterCard,* 163 F. Supp. 2d at 389 (citations omitted).

12. "[M]ultiple issuers allow a network to take advantage of 'better skills' and 'new techniques' of various issuers, including coming up with new ways to get credit cards to consumers." *Visa/MasterCard*, 163 F. Supp. 2d at 387.

13. Visa and MasterCard "member banks are a unique distribution source for general purpose card products because of their experience and expertise." *Visa/MasterCard*, 163 F. Supp. 2d at 383.

14. Visa and MasterCard member banks "also control access to the primary financial relationship in America – the checking account." Visa/MasterCard, 163 F. Supp. 2d at 383.

15. "No amount of effort by … Discover to issue through non-member banks, retailers or other organizations will provide consumers with the range of choices to which they are entitled." *Visa/MasterCard*, 163 F. Supp. 2d at 383.

16. "Since the bank members of Visa and MasterCard issue over 85% of general purpose cards comprising some 75% of the transaction volume, a huge portion of the market for network services is preserved for Visa and MasterCard" by the exclusionary rules. *Visa/MasterCard*, 163 F. Supp. 2d at 382.

17. "When combined with new products and services that bank issuance provides – such as the practical ability to offer customers a debit product on the network infrastructure … - strengthening the networks in these areas benefits consumers both directly (by ensuring the availability of new products and services) and indirectly (by lowering network costs that are passed on to consumers.)" Visa/MasterCard, 163 F. Supp. 2d at 387.

18. "Through the use of account information uniquely available to banks with whom those customers have a demand deposit account relationship, these bank issuers more cheaply, easily and effectively find and market credit cards to those consumers." *Visa/MasterCard*, 163 F. Supp. 2d at 391.

19. "[N]on-bank issuers are not an economically attractive alternative to member banks for issuing general purpose credit and charge cards. Those organizations lack the expertise, experience, personnel, and reach to be effective marketers of cards." *Visa/MasterCard*, 163 F. Supp. 2d at 394.

20. "Small banks not in the Visa and MasterCard system also lack card-issuing infrastructure and the skills, expertise, and relevance that Visa and MasterCard issuing banks provide." *Visa/MasterCard*, 163 F. Supp. 2d at 394.

21. "Cross-selling by banks at and through their branches is a key channel for profitable new account acquisitions across all product lines and has been acknowledged as the second-most significant driver of new card acquisition." Visa/MasterCard, 163 F. Supp. 2d at 390.

22. "Merchant acceptance, and the consumer perception of merchant acceptance, is vital to a network for obvious reasons. Card features are irrelevant if consumers cannot use the card. As a result, increased merchant acceptance – and increased perception of merchant acceptance – can lead to an increase in card issuance and transaction volume." 163 F. Supp. 2d at 387-88.

23. Defendants real justification for the exclusionary rules was to stop competition from . . . Discover. *Visa/MasterCard*, 163 F. Supp. 2d at 400.

24. “The Visa board has never ‘deemed’ MasterCard (or Diners Club or JCB) to be ‘competitive’ with Visa despite the fact that at the time By-law 2.10(e) was passed, the worldwide volume on the Diners Club and Discover networks were about equal.” *Visa/MasterCard*, 163 F. Supp. 2d at 379-80.

25. “Roughly ninety percent of U.S. families have at least one checking account (‘demand deposit account’ or ‘DDA’). Visa and MasterCard member banks are the custodians of the vast majority of these accounts.” 163 F. Supp. 2d at 392.

26. “Discover ha[s] studied issuing off-line debit products over [its] network[] in the United States to compete with Visa and MasterCard’s virtual monopoly in this area. [Discover has] found, however, that without access to banks’ demand deposit accounts this is not a viable strategy.” *Visa/MasterCard*, 163 F. Supp. 2d 393.

27. “Without access to bank accounts, . . . [a] Discover off-line debit card would have to be authorized and settled through the Automated Clearinghouse (ACH), an inferior system . . . .” *Visa/MasterCard*, 163 F. Supp. 2d at 393.

28. “Bank issuers on the Visa/MasterCard networks simply attach off-line debit functionality to the ATM cards routinely distributed to most banking customers. In contrast, . . . Discover would have to convince bank customers to take a second debit card in addition to the debit card linked to their bank accounts.” *Visa/MasterCard*, 163 F. Supp. 2d at 393.

29. “The inability to provide debit functionality on a cost-effective basis further limits the effectiveness of . . . Discover as [a] supplier[] of credit and charge card network services.” *Visa/MasterCard*, 163 F. Supp. 2d at 394.

30. "Because off-line debit transactions run over the same network as credit and charge transactions, the addition of debit volume improves network economies of scale and increases network relevance." *Visa/MasterCard,* 163 F. Supp. 2d at 394.

31. "In addition, debit functionality makes a network more attractive for consumers and banks desiring a range of products over a single brand or card." *Visa/MasterCard,* 163 F. Supp. 2d at 394.

32. "Although debit cards are similar to credit and charge cards in that they may be used at unrelated merchants, the fact that upon use they promptly access money directly from a cardholder's checking or deposit account strongly differentiates them from credit and charge cards." *Visa/MasterCard,* 163 F. Supp. 2d at 331.

33. "Visa International is a necessary defendant as to Count Two of the [Department of Justice] Complaint because it has the authority to adopt exclusionary by-laws in the United States." *Visa/MasterCard*, 163 F. Supp. 2d at 406.

34. "In the past, Visa International has provided affirmative encouragement for By-law 2.10(e) and would have passed its own international version of that rule absent intervention from foreign competition authorities." *Visa/MasterCard,* 163 F. Supp. 2d at 244; *aff'd*, 344 at 244 ("Nor do we believe, in the specific circumstances presented, that affirmative encouragement was an insufficient legal basis on which to premise liability."); *see also United States v. Visa U.S.A., Inc., et al.,* 183 F. Supp. 2d 613, 617 (S.D.N.Y. 201) ("[B]ecause Visa International not only had the power to preempt Visa U.S.A.'s exclusionary rule, but also provided affirmative encouragement for the illegal bylaw, Visa International was in part responsible for the illegal rule and therefore is liable.").

35. “Through the exclusionary rules, the defendants’ members foreclose . . . Discover from competing for [debit] cardholders.” 163 F. Supp. 2d at 391.

36. “Without access to bank accounts,…[a] Discover off-line debit card would have to be authorized and settled through the Automated Clearinghouse (ACH), an inferior system….” 163 F. Supp. 2d at 393.

37. “Because off-line debit transactions run over the same network as credit and charge transactions, the addition of debit volume improves network economics of scale and increases network relevance.” 163 F. Supp. 2d at 394.

38. “In addition, debit functionality makes a network more attractive for consumers and banks desiring a range of products over a single brand or card.” 163 F. Supp. 2d at 394.