



WILMER, CUTLER & PICKERING

# Antitrust and Competition Law Update

OCTOBER 3, 2003

## U.S. v. Visa: Government Wins Major Rule of Reason Case

On September 17, 2003, the Second Circuit issued an important decision in *U.S. v. Visa U.S.A., Inc.*, 2003 WL 22138519 (2d Cir. Sept. 17, 2003). The court affirmed a district court ruling invalidating Visa and Mastercard rules that prohibit member banks from issuing American Express or Discover.<sup>1</sup> The district court had found that these “exclusionary rules” substantially harmed competition and failed scrutiny under a rule of reason analysis. *Visa* is noteworthy both because it is a (relatively rare) government win in a major rule of reason case — with the Second Circuit affirming the trial court’s rigorous inquiry into the rules’ anticompetitive effects and proffered procompetitive justification — and because it may bring pressure for substantial structural changes in the card industry.

### Background

Visa and Mastercard are network services providers that are owned and supported by thousands of member banks, which act as both issuers<sup>2</sup> and acquirers<sup>3</sup> of Visa and Mastercard charge cards. (Network services are “the infrastructure and mechanisms through which general purpose card transactions are conducted, including the authorization, settlement, and clearance of transactions.”) By contrast, American Express (Amex) and Discover serve as both

network services providers *and* issuers and acquirers for their own cards.

Although Visa and Mastercard compete against each other and Amex and Discover for the loyalty of cardholders, in soliciting banks to issue cards and providing network services to issuing banks, Visa and Mastercard traditionally have competed only against each other. This is due mainly to provisions in the Visa and Mastercard membership agreements providing that each member bank may issue both Visa and Mastercard, but not Amex or Discover. Any

<sup>1</sup> *U.S. v. Visa U.S.A., Inc.*, 183 F.Supp.2d 322 (S.D.N.Y. 2001).

<sup>2</sup> The “issuing” bank interfaces between the *cardholder* and the network by issuing cards to individual cardholders.

<sup>3</sup> The “acquiring” bank interfaces between the *merchant* and the network by acquiring merchants’ charge card transactions.

WILMER, CUTLER & PICKERING

member bank issuing Amex or Discover forfeits the right to issue Visa or Mastercard.

The Department of Justice sued Visa and Mastercard in 1998, alleging that the exclusivity rules violated Section 1 of the Sherman Act and stunted competition in two markets: (a) “general purpose cards” (charge and credit cards) for cardholders and (b) network services for general purpose cards. The district court held that, given Visa’s and Mastercard’s popularity and “must carry” status, the exclusivity rules made it essentially impossible for banks to agree to issue Amex or Discover. As a result, competition suffered in two ways: (a) the rules reduced card output, and cardholders were denied the benefits of innovations and improved service resulting from Amex and Discover partnering with issuing banks (*e.g.*, cards that are linked to customers’ banking accounts) and (b) rivalry for providing network services to issuing banks was limited to Visa and Mastercard. The district court invalidated the exclusionary rules, enjoined the defendants from restricting banks from issuing other cards, and permitted Visa and Mastercard issuers to terminate any contractual obligations to abide by the exclusivity rules.<sup>4</sup>

### **The Second Circuit Decision**

In affirming, the Second Circuit gave a great deal of deference to the lower court’s factual findings. Indeed, Judge Leval’s opinion (with Judges Cabranes and Oakes joining) is notable for its intensive focus on the district court’s findings about facts specific to the industry and practices at issue (rather than on a more general application of economic theory) and how those facts demonstrated that the exclusivity rules harmed competition and offered no substantial pro-competitive benefits.

*Market Power.* The Second Circuit first affirmed the district court’s findings that Visa and Mastercard (jointly and separately) have power in the market for network services, which the court assumed the government must prove to win a rule of reason case.<sup>5</sup> Although the district court inferred market power from Visa’s (47 percent) and Mastercard’s (26 percent) shares of card transactions in a highly concentrated market, the circuit paid special attention to evidence about specific conduct showing that Visa and Mastercard have the power to affect price or exclude competition. In particular, the trial court relied on testimony from merchants that (given customer preference) they could not refuse to accept Visa or Mastercard even if faced with significant increases in interchange fees and evidence that, despite recent increases in both networks interchange fees, no merchant had stopped accepting their cards. Additionally, the Second Circuit pointed to evidence that, despite repeated efforts, Amex had been unable to convince any bank in the continental United States to issue its card because the exclusivity rule would have required the bank to give up membership in Visa and Mastercard. (The court’s reliance on evidence of specific conduct is particularly important here, given that market shares of 47-percent and 26-percent are well below what is generally necessary to prove market power based on inferences from market share.)

*Harm to Competition.* The Second Circuit’s affirmation of the district court’s holding that the exclusivity rules harmed competition was also closely tied to empirical evidence. For the network services market, the circuit relied on specific record evidence that price and innovation competition to provide

---

<sup>4</sup> DoJ had also challenged Visa and Mastercard “dual-governance” rules that permit a member-owner of one of the networks to serve as a director of the other. The district court ruled for the defendants on that claim, and DoJ did not appeal that ruling.

<sup>5</sup> The court observed in a footnote that some authorities, including *FTC v. Indiana Fed’n of Dentists*, 476 U.S. 477, 460 (1990), suggest that a plaintiff need not prove market power to win a rule of reason case if it can show actual anticompetitive effects, but it specifically declined to rule on that issue given its affirmation of the district court’s finding that Visa and Mastercard had market power.

network services to banks would be enhanced with four competitors, rather than just two.

- Both Visa and Mastercard executives testified that greater network competition would force them to offer issuing banks new and better products and services.
- Outside the United States, where Visa's exclusivity rule did not apply, Amex had convinced banks that issue Visa cards also to issue Amex cards, and competition from Amex caused Visa to enhance its product offerings to member banks abroad.
- An internal Visa memorandum stated that Visa would have to compete more aggressively for market share if Amex were permitted to partner with member banks, "[s]ince bank partners could significantly increase [Amex's] acceptance and cards."

Visa and Mastercard argued that, although the rules harmed their *competitors*, they did not harm *competition* because Amex and Discover were able to distribute their cards to cardholders — as evidenced by their status as the first and fifth leading U.S. card issuers respectively. They analogized the rules to a vertical exclusive dealing arrangement, which is presumptively legal under Second Circuit precedent.

The Second Circuit, however, held that the rules were, in fact, horizontal restraints that are not presumptively legal. In effect, the court held that the rules constitute agreements among the 20,000 banks that compete with each other to issue Visa and Mastercard, whereby each bank agrees not to compete with the others in a

way that is harmful to the Visa and Mastercard consortiums' collective interests. In the market for network services, the exclusivity rules have prevented Amex and Discover from selling their products at all, thereby denying banks the benefits of competition from Amex and Discover. In the general purpose card market, the rules have kept cardholders from enjoying the benefits of the increased quality and innovation competition from Amex and Discover cooperating with banks to offer new products. (In effect, Amex and Discover did not have means to distribute products that required partnerships with banks.)

*Pro-Competitive Justifications.* Visa and Mastercard argued that the rules were designed to promote "cohesion" within their networks so that those networks could compete effectively. Therefore, they argued, the rules were ancillary to a legitimate, procompetitive business strategy.

The Second Circuit affirmed the district court's holding that the rules were not necessary to achieve that goal, relying on record evidence that Visa and Mastercard issuers have long issued each other's cards without damaging network cohesion in a way harmful to the competitive process. Further, the district court found there was no evidence that defendants' network cohesion has been harmed overseas, where the exclusivity rules do not apply, and banks issuing Visa and Mastercard also issue Amex cards.

### **Implications Of Visa**

The *Visa* decision has important implications. A Second Circuit panel comprised of very prominent judges handed the government a victory in a major rule of reason case. That, in itself, is important, particularly coming shortly after the DoJ's losses in *Dentsply*<sup>6</sup> and *American Airlines*.<sup>7</sup> That a practice is subject to rule of

---

6 *U.S. v. Dentsply Int'l, Inc.*, 2003 WL 21946402 (D. Del. 2003).

7 *U.S. v. AMR Corp.*, 335 F.3d 1109 (10th Cir. 2003).

reason analysis does not, of course, mean that the defendant always wins.

*Visa* also reinforces that facts matter. Rule of reason analysis requires careful weighing of real world anticompetitive effects and procompetitive justifications. Especially given the growing acceptance of post-Chicago scholarship, we anticipate that courts (like in *Visa*) will increasingly pay even closer attention to record facts and economic testimony that is closely tied to those facts, rather than rely on broad assumptions about likely competitive effects in the abstract. They will not hesitate to declare illegal practices that, in their view, do not withstand close scrutiny. Accordingly, companies and counsel must be prepared to defend controversial practices based on their actual competitive effects, not just theory.

Finally, in light of recent developments, the credit card industry may see continuing pressure for structural changes and continued antitrust controversies. In addition to the *Visa* case, Visa and Mastercard recently settled a challenge by WalMart and other retailers to Visa's and Mastercard's "honor all cards" policy;<sup>8</sup> and a proposed merger between debit card issuers First Data and Concord is currently undergoing intense DoJ scrutiny.<sup>9</sup>

If you would like more information about the *Visa* case or any other issue of U.S. or foreign antitrust or competition law, please contact us at: (202) 663-3600.

Robert Bell  
Lee Greenfield  
Veronica Kayne  
William Kolasky

Jim Lowe  
Doug Melamed  
Thomas Mueller  
Ali Stoepelwerth

---

<sup>8</sup> The "honor all cards" policy required retailers accepting Visa and Mastercard charge cards to also accept the associations' offline debit cards (which are more costly to process than online debit cards) at a similar interchange fee. In April 2003, Visa and Mastercard agreed to modify their rules, allowing retailers to accept either online or offline debit cards beginning in 2004, and to lower interchange fees on debit cards beginning in August 2003. *What Happened: \$3 Billion Payout, Lower Fees, 'Honor All Cards' To Change*, THE GREEN SHEET, Issue 03:05:01 (2003), available at <http://www.greensheet.com/PriorIssues-/030501-/default.htm>.

<sup>9</sup> In April, 2003, debit card issuers First Data Corp. and Concord announced plans to merge, hoping to combine their Star and NYCE debit networks to create a coast-to-coast online and offline debit network. DoJ has issued a Second Request; the parties have announced that they intend to close the transaction in the fourth quarter of 2003, subject to regulatory approval. Steven Marlin, *First Data-Concord Merger Creates Payments Powerhouse*, BANK SYSTEMS & TECHNOLOGY ONLINE (4/24/03), available at <http://www.banktech.com/story/fsconvergence/BNK20030424S0001>.