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November 7, 2001

Antitrust Update:

Visa/MasterCard: Facts Over Theory in Antitrust Litigation

On October 9, Judge Barbara Jones of the Southern District of New York issued an important opinion in the Department of Justice's well-publicized challenge to two allegedly anti-competitive practices of Visa and MasterCard. (*United States v. Visa U.S.A., Inc.*, 98 Civ. 7076 (S.D.N.Y. October 9, 2001)). The opinion is notable for the insight it provides into the court's reliance on real world facts, rather than isolated economic theory, in resolving complex rule of reason issues.

Visa and MasterCard are non-profit, joint venture associations comprised of thousands of financial institutions; each has a board of directors that includes executives from their member institutions. The associations authorize their members to issue credit and debit cards bearing the trademarks the associations own. Membership is open to any qualifying financial institution; by joining either association, a financial institution may issue that association's credit cards. Financial institutions may belong to both associations simultaneously.

Dual Governance

The Department of Justice challenged under the Sherman Act two internal rules or practices of both the Visa and MasterCard associations. First, the Department challenged "dual governance" as an allegedly unreasonable restraint on competition under Section 1. Put simply, dual governance is an association practice that permits executives of financial institutions belonging to one association to sit on the board of the other, rival, association. For example, a bank executive could sit on the MasterCard association board even though his or her bank offered Visa cards to its customers. The Department argued that this practice restricted competition by reducing incentives for the boards (and their associations) to develop and implement competitive strategies that would cause consumers to switch between Visa and MasterCard. Board members, the Department argued, would lack incentives to compete vigorously with the rival association because any customers gained for the association on whose board they sit would come at the

expense of the rival association and could hence mean lost profits for the board members' financial institutions. Therefore, according to the Department, the board members would be indifferent to the competitive success (or lack thereof) of cards sponsored by the association on whose board they sit.

The court rejected this challenge on two grounds. First, it found as a factual matter that, with few exceptions, the dual governance system had not stifled competition between Visa and MasterCard. The court explained that the financial interests of the board members' own institutions were not the only motivating factor in the board members' decision making. Other factors, such as a sense of fiduciary duty and the desire to serve additional terms on the board, also influenced decisions and kept competition between Visa and MasterCard robust. The court cited detailed evidence of vigorous competition between Visa and MasterCard, including a history of share-shifting between the two brands as a result of competitive initiatives. Second, the court determined that, even if dual governance had incidentally harmed competition in the past, any potential for future competitive harm had effectively been eliminated by a new practice under which many financial institutions sign "dedication" agreements requiring them to issue all new cards under only one association and to ensure that a large majority of all their issued cards would be from that association. The court noted that most of the current board members' individual financial institutions had signed such agreements with the association they governed.

Exclusivity Rules

The Department also challenged association by-laws that prohibited association member institutions from issuing cards sponsored by entities other than Visa or MasterCard (such as Discover or American Express). The Department argued that, because financial institutions could not issue cards sponsored by other companies without losing their Visa and MasterCard privileges, competing credit card companies were unduly impaired in signing up new issuing banks (and, hence, new cardholders and new merchants that accept their cards). The court found that the rules therefore weakened competition and resulted in consumers, member banks, and merchants having fewer choices. The court enjoined Visa and MasterCard from continuing to impose the exclusivity rules.

The court cited a variety of evidence in finding that the exclusivity rules had injured competition and failed to pass muster under a rule of reason analysis. The court first concluded that the exclusivity rules were intended to shield the associations from competition and they had achieved their intended effect. It noted that American Express had, by 1995, forged alliances with many international banks (who were not bound by the exclusionary rules). It was only after American Express made a push to enter issuing arrangements with large US banks that the associations drafted the exclusionary rules. As a result of the rules, neither American Express nor Discover has been able to convince an American bank to issue its card. The court heard testimony from several bank executives that, but for the exclusionary rules, they would have sought agreements to issue American Express cards.

After finding that the exclusivity rules had impaired American Express and Discover's access to customers, the court considered Visa and MasterCard's justifications for the rules. The associations contended that the rules promoted loyalty and cohesion among member banks and

offered the testimony of an economist. The court found the proferred pro-competitive justifications unpersuasive, however, because the expert failed to present any empirical analysis that the rules actually had the claimed pro-competitive effects and because evidence about the associations' dealings with individual banks refuted the expert's testimony. The court was especially skeptical about the proffered justifications based on its finding that Visa and MasterCard had implemented the exclusivity rules only after American Express had begun to recruit US banks, thereby (the court found) creating the implication that the associations had imposed the rules to thwart, rather than enhance, competition. Though it did not engage in a detailed balancing analysis, the court held that any minimal, pro-competitive benefits from the exclusivity rules were outweighed by consumer harm.

To find a Section 1 violation, the court was also required to find that Visa and MasterCard enjoyed market power in a properly-defined, relevant market. For this, the court defined a market for network services -- the systems whereby the card issuers receive (through the associations) compensation from banks that sign up merchants. The reductions from the face value of charges that issuing banks must remit are called "interchange fees." The court rejected Visa and MasterCard's argument that network services are not a relevant market because checks and cash are alternative means to conduct transactions and therefore constrain credit card "interchange fees."

That finding was particularly interesting in its reliance on evidence demonstrating Visa and MasterCard's ability to price discriminate among merchants. Although the court acknowledged the evidence that certain types of brick and mortar merchants might be price sensitive and could drop Visa and MasterCard in response to increased interchange fees, it found that other merchants, such as catalog and Internet retailers that rely almost exclusively on credit card transactions, exhibited highly inelastic demand patterns. Citing evidence that Visa and MasterCard had consistently charged higher interchange fees to catalog and Internet retailers than to more price sensitive merchants, the court found that the associations' demonstrated ability to price discriminate was evidence of market power.

Lessons from the Decision

Visa/MasterCard is striking in the court's intensive focus on real-world evidence of competitive effects rather than abstract theory in finding against the government in upholding the dual governance rules and for the government in condemning the exclusivity practices. The opinion spans 157 pages, the great majority of which deals with factual findings rather than discussion of competing theories about the likely competitive impacts of practices of the sort at issue. The decision is notable also in that, like the Court of Appeals decision last summer in the *Microsoft* case, it focused on facts rather than formalistic legal rules. A principal lesson from the case, therefore, is that, in preparing to defend business practices facing scrutiny in antitrust investigations or litigation, it is vital to carefully evaluate not only the pro-competitive benefits that have resulted from the challenged activities, but also how competitive benefits can be proved and assertions of competitive harm disproved based on tangible evidence of competitive effects.

Please contact us if you would like a copy of the *Visa* decision or further information about the case or would like information about any other issue of US or foreign antitrust or competition law.

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