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IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

SCFC ILC, INC., d/b/a/ MOUNTAINWEST FINANCIAL, Plaintiff, v. VISA U.S.A. INC., Defendant.	Civil No. 2:91-CV-0478 Honorable Dee V. Benson VISA'S REPLY MEMORANDUM IN SUPPORT OF ITS MOTION FOR JUDGMENT ON VISA'S CLAYTON ACT SECTION 7 COUNTERCLAIM
VISA U.S.A. INC. and VISA INTERNATIONAL SERVICE ASSOCIATION, Delaware corporations, Counterclaimants, v. SEARS, ROEBUCK AND CO., a New York corporation; SEARS CONSUMER FINANCIAL CORPORATION; and SCFC ILC, INC., d/b/a MOUNTAINWEST FINANCIAL, Counterdefendants.	

VISA's initial brief in support of its Section 7 counterclaim reviewed the evidence VISA relies on, evaluated market structure and explained the various ways in which Sears' proposed VISA membership presents a likely lessening of competition. Other than challenging VISA's standing to assert this claim at all (see pp. 7-9, infra), Sears' reply either concedes VISA's arguments through silence or attempts to overcome them with formalistic assertions that never come to grips with VISA's actual evidence and contentions.

A. Sounds of Silence

VISA's prior brief pointed out the various ways in which both market concentration data and other evidence indicate that a lessening of competition at the system level is a substantial likelihood. See VISA Section 7 Mem. at 2-6; 11-14, citing VISA Rule 50/59 Mem. at 47-52. Sears takes little issue with this analysis.[1/] Instead, Sears attempts to avoid it by asserting that it is based upon mere "assum[ptions]" about "the effect of MountainWest's VISA membership." (Sears Section 7 Mem. at 7.) But since the "events" in a proposed merger case, by definition, have not yet come to pass, no one can do more than offer assumptions about the future -- albeit assumptions grounded in useful structural and other market data plus generally recognized industrial organization principles. Indeed, the very idea of incipiency necessarily implies such an approach.[2/]

1/ Sears also does not take exception to VISA's statement of the governing legal principles -- as opposed, of course, to their applicability. Thus, it does not dispute that Section 7 is concerned with incipiency, that it reaches partial as well as total integrations, and that competitive harm may result from access to confidential information, opportunities for strategic coordination or diminished competitive incentives. (VISA Section 7 Mem. at 7-10; 12-13; see also Rule 50/59 Mem. at 50-51.)

2/ The only actual point of evidentiary controversy is Sears' assertion that "Visa and MasterCard compete vigorously with each other . . . ." (Sears Section 7 Mem. at 7.) We will leave the Court, as trier of fact for this claim, to evaluate the force of that assertion.

As we observe in our Rule 50/59 Reply, filed herewith, Sears' silence may reflect a conviction that VISA's evidence and arguments are too insubstantial to merit a direct reply. Or it may reflect that Sears can think of no reply to make. Either way, none has been offered.

B. What Sears Does Say

Having largely elected not to join issue on the evidence, Sears offers "three key respects" in which "Visa's legal theory is flawed":

1. VISA has not identified "any product market in which competition will be harmed" by Sears' membership in VISA;

2. Sears' interest in VISA will not be "large enough" to "raise Section 7 concerns"; and

3. VISA's "HHI analysis" is "inappropriate."

We respond as follows:

1. Lack of a "Product Market"

Sears argues that VISA posits, but fails to prove, the existence of a "system" market. See Sears Section 7 Mem. at 4: "[A]rgument is not evidence." True enough. But there is abundant evidence about the existence of, and role played by, credit card systems: evidence showing that those systems are an integral part of the process of creating, offering (in the case of proprietary systems) or enabling members to offer (in the case of associations) general purpose charge card products. Both the tangible (e.g., advertising, systems) and the intangible (e.g., trademarks, merchant discount agreements) products of the systems are subject to competition at, or involving, the system level. (Tr.

333, 443-48, 560-61.)[3/] As for "evidence" of likely "effect," see VISA Section 7 Mem. at 10-14; see also VISA's "Summary of the Evidence" id. at 2-6, ¶¶ 1-2, 4-6, 10.

Lest there by any confusion, the ultimate impact of any harm to system-level competition is felt by cardholders and merchants who use or accept general purpose charge cards. However, that harm results from exactly the kinds of competitive failings that are likely to occur as a consequence of Sears' challenged acquisition.[4/]

2. Sears' "Small" Interest in VISA

In an argument one would have expected to come from VISA, Sears argues that there is no antitrust problem here because it "is not likely ever to own a large enough interest in VISA to raise Section 7 concerns." (Sears Section 7 Mem. at 4.) That, too, is a good point: but for another party (VISA) and in opposition to another claim (Sears' Section 1 allegations). As we have explained in considerable detail elsewhere,[5/] where competition takes place at the issuer (or merchant-signing) level, individual market shares are what matter because the individual issuers are the competitors. In this case, however, what matters is system-level competition. Calculating HHI system numbers reflects not only a very high starting index (3231), but an increase of 501 points if Sears becomes a VISA issuer-member. That is a very significant change for Section 7 purposes. See FTC v. PPG Indus., Inc., 798 F.2d 1500, 1502-03 (D.C. Cir.

3/ If there is no competition at the system level, one wonders what in the world was VISA's so-called "anti-Discover" campaign all about, or why Sears cared.

4/ The effects of that competitive harm are not capable of being competed away at the member level (VISA Section 7 Mem. at 10-12) -- a point Sears' opposition also studiously ignores. See also p. 5, infra.

5/ See, e.g., VISA's Rule 50/59 Mem. at 35-37; VISA's Rule 50/59 Reply Mem. at 15-18.

1986); Dep't of Justice & FTC Horizontal Merger Guidelines, § 1.51(c), 57 Fed. Reg. 41,552, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104 (1992).

The fact that Sears' interest in VISA as a whole would be small is, again, not the point. The danger to competition that raises Section 7 concerns here does not flow from Sears' interest in VISA, but from Sears' ability, as a 100% owner of Discover, to use its VISA interest to harm system-level competition in the several respects discussed in VISA's opening brief (at 11-13).

A further point should be noted, even though Sears never mentions it. We have explained in our other briefs that where a competitive market structure exists, the effects of any attempted restraint will be competed away. See, e.g., VISA Rule 50/59 Reply Mem. at 17-18 (and n.23).[6/] Thus, if any harm resulting from Sears' membership in VISA can be competed away at the member level, there would be no cause for Section 7 concern. That is precisely the reason we explained in our opening brief why the types of competitive harm that are threatened by this acquisition are not "capable of being dissipated by competition at the member level." (VISA Section 7 Mem. at 10.) See also id. at 10-11 (and note 5), explaining why that is true.

3. "Inappropriate" HHI Analysis

Sears finally argues that VISA has "misappli[ed]" HHI principles. In particular, Sears contends that VISA errs because the relationships in question are "vertical, not horizontal," that VISA's position is "flatly contradicted" by Professor Schmalensee's testimony and, that, "in any event," HHI numbers are "never considered conclusive." Sears is wrong on all counts.

6/ Which, perhaps, is the reason why Sears doesn't mention the issue: to do so necessarily would concede away its Section 1 claim.

The relationships in issue are plainly horizontal. VISA cards compete directly with Discover cards -- there can be no doubt of that. And the "functions" performed by Discover and VISA are both "similar" and integral to competition in the charge card market. It is, of course, true that because VISA is a joint venture, some of what Discover does is done in VISA at the member level. But that fact is simply beside the point. The concerns that are raised here are all of a horizontal nature and arise because of that relationship. Try though it will, Sears' effort to create a formalistic distinction is overwhelmed by that reality.

Nor does VISA's counterclaim require it to "contradict" or "back away" from the testimony of its expert. Dr. Schmalensee correctly testified about the configuration of the issuer level market (and we are gratified to see Sears implicitly acknowledge that fact).7/ That market is extremely unconcentrated.

The system-level situation is very different. The important elements of competition that take place (and must take place) at that level involve, at best, only five competitors. It is, in short, highly concentrated and has high entry barriers besides. Dr. Schmalensee, himself, testified to those facts. (Tr. 2324-29.) That is the market structure that matters here for reasons already explained. See 3-4, supra. See also VISA Section 7 Mem. at 10-13.

Sears concludes with another true, but unhelpful, observation: High HHI numbers can be rebutted by evidence demonstrating that the market actually is less concentrated than a strict HHI calculation suggests. But where is Sears' rebuttal evidence? It surely did nothing at trial to prove that new systems were easy to start. Its

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7/ Would that Sears were equally willing to acknowledge the necessary implications of Dr. Kearl's "collective share" analysis for its position under Section 7. See Schmalensee, Tr. 2327-31. See also VISA Rule 50/59 Mem. at 52.

every effort was directed at proving precisely the opposite. In short, it, not VISA, needs to be concerned with self-contradiction.[8/]

C. Standing

Sears finally contends that VISA lacks standing because, under Cargill,[9/] "Visa would benefit from a reduction in competition in any market in which it competes," and, thus, "cannot prove injury." (Sears Section 7 Mem. at 9.) But that is an overstatement of the law and a misstatement of the facts.

In Cargill, the Supreme Court denied Section 7 standing to a competitor whose asserted antitrust injury was premised, inter alia, on a theory of anticipated post-merger predatory pricing. The Court held that the plaintiff had failed to raise or prove its predatory pricing theory and, accordingly, failed to prove antitrust injury sufficient to confer Section 7 standing. 479 U.S. at 119. However, the Court further acknowledged that predatory pricing is "a practice inimical to the purposes of [the antitrust] laws, . . . and one capable of inflicting antitrust injury." Id. at 118, quoting Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488 (1977). Thus, the Court specifically refused to adopt a per se rule "denying competitors standing to challenge acquisitions on the basis of predatory pricing theories." Cargill, 479 U.S. at 121. The Court further noted that "nothing in the language or legislative history of the Clayton Act suggests that

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8/ The principal difficulty in creating a new system is the so-called "chicken and egg" problem and the cost and time involved in creating a merchant base. That is not, of course, an insuperable problem as Sears' own experience (as well as that of American Express and, more recently, JCB) attests. In fact, having already created stand-alone merchant programs, Sears and American Express are the two parties who could most easily offer new general purpose charge cards on their own today. See Tr. 160, 163, 708, 1598, 2324-29.

9/ Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104 (1986).

Congress intended this Court to ignore injuries caused by such anticompetitive practices as predatory pricing." Id. at 121-22.

The Supreme Court thus made it clear that competitors potentially could have standing to challenge mergers upon an adequate showing of antitrust injury. And the Court's "such anticompetitive practices as" language (Cargill, 479 U.S. at 122) indicates that predatory pricing is not the only theory upon which such a showing might be premised.[10/]

Cargill does stand for the proposition that private plaintiffs seeking injunctive relief under Section 7 must show "antitrust injury," i.e., "threatened loss or damage' of the type the antitrust laws were designed to prevent and that flows from that which makes defendants' acts unlawful.'" 479 U.S. at 113, quoting Brunswick, 429 U.S. at 489. VISA satisfies that requirement. If Sears were permitted to acquire an ownership interest in VISA, VISA would suffer antitrust injury.

This is not a case in which the merger would only benefit the complaining party. Rather, VISA would suffer injury stemming from the unfair competitive advantage Sears would enjoy by being the only VISA member able to market both VISA and Discover together. Charles Russell, VISA International's CEO, made this point at trial:

10/ Sears also relies on a number of so-called "target takeover" cases. But those cases, too, are not helpful. The justification for denying standing to a target (in those courts that have done so, compare Consolidated Gold Fields PLC v. Minorco S.A., 871 F.2d 252, 258-60 (2d Cir.), cert. dismissed, 492 U.S. 939 (1989)), is that "[i]f the proposed merger is completed, [the target] will be a part of the very entity it claims will have a supercompetitive advantage . . . ." Carter Hawley Hale Stores, Inc. v. The Limited, Inc., 587 F. Supp. 246, 250 (C.D. Cal. 1984). But Sears' proposed acquisition of an ownership interest in VISA is very different, as Sears acknowledges in its brief. See Sears Section 7 Mem. at 10 n.7. VISA would not be subsumed into, or controlled by, Sears. Thus, the "supercompetitive advantages" Sears would gain as a result of its proposed acquisition would not inure to VISA's benefit, except to the extent that Sears has an ownership interest in VISA.

> [I]f you are Discover or Greenwood Trust and you issue a Discover Card and you issue a Visa Card and you can make a public offering of a product that any other . . . Visa issuer cannot, they can issue Visa but they cannot issue Discover Cards. You have an obvious competitive advantage over any bank that is a member of Visa that, as I said before, cannot offer the Discover product.
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> In addition to that, why, there is the merchant sign up situation . . . . Discover could go out and signup merchants . . . not only for Visa and MasterCard but also for Discover. The antithesis of that . . . would not have been the case. In other words banks could have signed up for Visa and MasterCard but not for Discover. They have a competitive advantage there.

(Tr. 1424.)

Bennett Katz, VISA's General Counsel, made much the same point in his testimony:

> Now why would this give an unfair advantage to Sears if it joined Visa? Because now they could go to the merchant and say, Mr. Merchant, if you sign with me I will give you Visa, I will give you MasterCard and also Discover. And if you go to Zions Bank they cannot offer you Discover. So either way, Mr. Merchant, you're going to have to deal with me and if you deal with me in all three of those programs I'll give you a better deal than if you deal with Zions . . . . That is an unfair advantage that the banks and the franchisees in Visa and MasterCard would be put at, a significant disadvantage in competing on the merchant side of the business.

(Tr. 553-54.)

VISA also would suffer harm if Sears became a member because Sears would then have greater access to VISA's confidential business information and a greater ability to tailor competitive strategies with both its VISA and Discover businesses in mind. Those are not only harms to VISA but are precisely the kind of concerns that have been voiced by courts in partial acquisition cases. See VISA Section 7 Mem. at 11-13, and authorities cited therein. Sears does not deny that such activities would harm

VISA, but merely states conclusorily that any injury to VISA would not flow from an injury to competition. (Sears Section 7 Mem. at 9 n.6.) However, injury to VISA's ability to compete against Discover necessarily would result in a reduction in actual competition between the two systems that would, in turn, harm competition in the marketplace.

CONCLUSION

For the reasons set forth above and in VISA's opening memorandum, the Court should enter judgment in VISA's favor on its Section 7 counterclaim.

Dated: December 16, 1992

Respectfully submitted,

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