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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, **Plaintiff,** **v.** **VISA U.S.A. INC., VISA INTERNATIONAL CORP., AND MASTERCARD INTERNATIONAL INCORPORATED,** **Defendants.**	**98 Civ. 7076 (BSJ)** **PLAINTIFF'S MEMORANDUM REGARDING DISCOVERY AND SCHEDULING ISSUES**

INTRODUCTION

The United States of America (hereinafter "Government") submits this memorandum in accordance with the Court's request made during the November 24, 1998 telephone conference. For the reasons stated below, the Court should neither quash the subpoena issued to Wal-Mart Stores Inc. ("Wal-Mart"), nor allow defendants to delay the scheduling order to which they stipulated only six weeks ago. As one defendant, Visa U.S.A., has already recognized by recently agreeing to produce the documents at issue under their control,[1] the CD-ROMs produced to the Wal-Mart plaintiffs in

[1] This agreement was reached subsequent to the telephone conference with the Court on this subject last week.

litigation pending in the Eastern District of New York clearly relate to several issues at the core of this litigation. Moreover, nothing about the discovery necessary in this case, nor any other event, justifies a change to the pretrial schedule carefully negotiated and agreed to by all parties. This case raises issues far too important to American consumers to warrant anything less than an intense effort by all parties to prepare this case for trial within the agreed timetable.

THE NATURE OF THE GOVERNMENT'S ALLEGATIONS

The United States brought this civil action to break up a conspiracy among the banks that govern Visa U.S.A. Inc., Visa International Corp. (collectively "Visa"), and MasterCard International Incorporated ("MasterCard") (collectively, the "defendants") to restrain competition among general purpose card networks. These networks provide the structure (including, for example, brand development and authorization and settlement functions) that allows consumers to make purchases at a wide variety of unrelated merchants without accessing or reserving funds at the time of purchase. That ability to pay for items without the necessity of carrying, or having immediate access to, cash distinguishes these cards from other payment alternatives for a wide array of consumer transactions. Defendants often seek to confuse the services offered by card networks with those offered by their member banks in issuing cards to consumers. While issuers do compete with one another with respect to certain card attributes such as altering grace periods and interest rates, there are certain product attributes, and indeed the very product itself, which can only be created and implemented efficiently at the network level. As described in the Complaint, such attributes include the development of systems and technologies to authorize and settle card transactions as well as to detect fraud. Therefore, arguments about issuer-level competition, such

as the number of mail solicitations consumers receive from various issuers to accept new cards, entirely miss the point of this suit.

Within the market for card network services, Visa and MasterCard collectively control about 75% of the dollar transactions, giving them overwhelming dominance of, and power within, that market. The Government calculates their market share collectively (although they each have substantial individual power in this market as well) because the largest United States banks jointly own, govern, control, and derive profits from both Visa and MasterCard.[2] These banks have used their control of the two associations to limit competition between them.

While Visa and MasterCard present to the world the appearance of being separate entities that compete with each other, both are in fact controlled by the same group of large banks. Because these banks issue large numbers of both Visa and MasterCard cards, have equity positions in both associations, and sit on the boards and important committees of both, these banks do not allow Visa and MasterCard to engage in meaningful competition. It is not in the interests of the banks that govern and control Visa and MasterCard to spend money to develop or improve network products to lure consumers from one brand of card to the other. As a result, consumers lose: innovation and competitive development in network products and services are stifled, product quality suffers and, ultimately, the value received by consumers is diminished. Therefore, in Count I of the Complaint,

[2] This joint control and market structure has come to be referred to by the defendants as "duality." That term is, in fact, a euphemism for collaboration led by the major member banks to (1) prevent competition between Visa and MasterCard, (2) thwart competitive threats from other networks, and (3) use their joint power to enrich the banks at the expense of merchants and consumers.

the Government seeks to ensure that the same banks do not govern both Visa and MasterCard and that the banks that govern each of the networks be dedicated to that network.[3]

In Count II, the Government alleges that the banks controlling Visa and MasterCard have abused the defendants' market power by enacting rules providing that any United States member bank that issues a card that Visa or MasterCard considers "competitive" will lose its right to issue both Visa and MasterCard cards. Consistent with the lack of competition between them, neither Visa nor MasterCard deems the other to be a competitor within the meaning of these rules. Given Visa's and MasterCard's collective dominance of the market, it is hardly surprising that no United States bank issues American Express and Discover/Novus, the cards that Visa and MasterCard do deem competitive. The inability of competitive networks to access Visa and MasterCard member banks to assist in issuing cards creates a major, and ever growing, barrier to effective competition.[4] The

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[3] Defendants contend in their answer and elsewhere that a 1975 Department of Justice business review letter sought by Visa thrust this combination with MasterCard upon them. Such an argument ignores the plain language of the business review letter, which indicated that "a prohibition of dual affiliation [in connection with issuing credit cards] appears unobjectionable to the extent it is necessary to insure continued intersystem competition." (Exhibit 1 at p.2). The fact that Visa understood the Government's position then, as now, is confirmed by the adoption of a by-law permitting ownership and control by banks that are dual issuers on Visa's Board of Directors *over the objections of Visa's general counsel*, who understood quite well that dual issuance had not been compelled by the Antitrust Division.

[4] The Government's contentions in this case are completely consistent with the Court of Appeals for the Tenth Circuit's holding in *SCFC ILC, Inc. v. Visa U.S.A.*, 36 F.3d 958 (10th Cir. 1994), *cert. denied*, 515 U.S. 1152 (1995) ("MountainWest"). In that case, Discover/Novus sought to become an issuer of Visa and MasterCard cards. By so doing, Discover/Novus would have gained ownership and governance rights in the Visa and MasterCard networks. The Tenth Circuit was convinced by Visa's arguments that network-level competition was too important to allow a network competitor such as Discover/Novus to earn profits from and gain governance rights in Visa by issuing cards on its network. *Id.* at 969. Once Discover began earning profits from Visa, its incentive to compete with Visa at the network level would have been diminished. The same principle guides the Government's case here: network-level competition is too important to allow Visa's governors to have profit incentives and governance rights in MasterCard, and vice versa. Count II of the Government's case differs from the MountainWest

barrier erected by these rules is particularly significant in a network industry, where increased usage leads to increased merchant acceptance, which in turn leads to increased usage, in a continuing cycle that economists call "network effects." In other words, because the number of merchants and consumers using a network greatly affects its success, any method that succeeds in materially reducing those numbers is anticompetitive because it negatively affects the growth and ability of a network competitor to compete.

These barriers erected by defendants have become particularly critical to the market recently because of the rising importance of new types of payment products, including smart cards and debit cards.[5] The card industry appears headed towards a unified product — one piece of plastic — that includes multiple functions, such as the ability to debit a cardholder's bank account as well as extend credit. One possible emerging product, called a smart card, contains integrated circuitry and is capable of combining numerous types of information and functions. Other cards simply will combine regular credit and debit functions onto one card. But to efficiently offer debit functions, a network must have ready, cost-competitive access to a consumer's demand deposit account ("DDA"). By barring access to their member banks, who have nearly complete control of DDAs, Visa's and MasterCard's rules prevent competing networks from competitively offering such products. Moreover, these rules prevent banks, as the purchasers of network products and services, from obtaining competitive offers from Discover/Novus and American Express as a way to spur

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case because no competing network would earn profits in Visa or MasterCard. Instead, member banks would be free to choose to deal with other networks as well as Visa and MasterCard, an issue that was not before the Tenth Circuit.

[5] Unlike a general purpose card, a debit card accesses a consumer's bank account shortly after or at the time of the transaction. *See* The Nature of The Wal-Mart Case, *infra* at p.6.

better products and services from each of the networks, including Visa and MasterCard. For these reasons, among others, the Government's Count II seeks a prompt end to these rules.

THE NATURE OF THE WAL-MART CASE

In 1996 a group of retail stores, including Wal-Mart and The Limited, filed a class action suit alleging violations of Sections 1 and 2 of the Sherman Act in which Visa and MasterCard are defendants (the "Wal-Mart case"). The gravamen of the retailers' complaint is that Visa and MasterCard exercise their dominant market power, individually and jointly, to force retailers that want to accept the defendants' credit cards to also accept the defendants' debit cards.[6] By tying the ability of merchants to use Visa and MasterCard credit cards to their acceptance of Visa and MasterCard debit cards, Visa and MasterCard can force merchants to pay the higher fees associated with Visa and MasterCard debit cards than they would pay for use of other debit cards.

As noted above, a debit card allows a cardholder to pay for purchases at the point-of-sale ("POS") by having the purchase price debited from the cardholder's bank account and electronically transferred to the merchant's account. There are two types of POS debit transactions: *on-line* and *off-line*. In an on-line transaction, the bank that issued the card immediately verifies that the cardholder actually has funds available in a DDA account, and authorizes the purchase and the transfer of funds from the cardholder's account to the merchant's account. The funds are usually transferred within 24 hours. In an off-line transaction, the bank that issues the card may or may not actually verify that the cardholder has funds in a DDA account before authorizing the transaction,

[6] Wal-Mart Complaint at ¶¶ 2, 62-97.

and the funds may not be transferred from the cardholder's account to the merchant's account for several days.

From the consumer's standpoint, the main difference between the two types of transactions is that an on-line transaction requires that the consumer enter a personal identification number ("PIN"), and thus is similar to an ATM withdrawal, while an off-line transaction requires that the consumer sign a sales slip, and thus is similar to a credit card transaction. Because on-line transactions require the use of a PIN and immediately put a hold on the funds that will be used to pay for the transaction, they are less subject to fraud. They may also be faster and less costly to process since they allow authorization of the purchase and transfer of funds among accounts to take place at the same time.

Regional ATM networks, such as NYCE and MAC, function as *on-line* POS debit networks. They contract with merchants to install POS terminals that accept ATM cards and allow the cardholder to enter a PIN. These on-line debit networks typically charge a flat fee of between 6 and 10 cents per transaction.[7]

Visa and MasterCard operate off-line debit networks, known as *Visa Check* and *MasterMoney* respectively, that they promote heavily.[8] Debit transactions on these networks are processed through the credit card network. As a result, any merchant that accepts defendants' credit cards can accept defendants' debit cards using their existing credit card terminals. The fee for a Visa Check transaction is a percentage of the transaction plus, in some cases, a fixed amount. The fees vary for different transactions, but for a typical $40 debit transaction, range from approximately 36

[7] Wal-Mart Complaint at ¶ 121.

[8] Both Visa and MasterCard also have on-line networks (Interlink and Maestro, respectively) but they have not aggressively promoted them.

to 47 cents, three to five times the fee charged by the regional on-line networks.[9] For larger transactions, the difference is even greater: on a $100 store purchase, Visa's interchange fee is approximately $1.10, compared to 6 to 10 cents for the on-line debit transactions.[10] MasterCard's fees are even higher.[11]

Because on-line debit card networks charge retailers much less than Visa and MasterCard charge for consumer off-line debit card use, many retailers do not want to accept Visa's and MasterCard's off-line debit cards. According to the Wal-Mart Complaint, the result of Visa's and MasterCard's tying off-line debit card acceptance to credit card acceptance is that merchants, and ultimately consumers, must pay higher prices to use defendants' services rather than cheaper (and safer) competitive alternatives.[12]

THE RELEVANT PROCEDURAL HISTORY

One week after filing the Complaint, on October 14, 1998, the Government asked defendants promptly to provide copies of the documents they had produced to Wal-Mart during the course of discovery in the Wal-Mart case ("the Wal-Mart documents").[13] The request was made in the context of the negotiations that culminated in the stipulated pretrial order signed by Judge Pollack on October 16, which implicitly requires prompt cooperation by all parties in producing discovery

[9] Wal-Mart Complaint at ¶ 72.

[10] Wal-Mart Complaint at ¶ 77.

[11] Wal-Mart Complaint at ¶ 77.

[12] Wal-Mart Complaint at ¶¶ 151, 165.

[13] The Government confirmed its request in writing that day.

material.[14] This initial request, made before the stipulated pretrial order was entered, was followed by several oral and written requests to the parties thereafter. Despite these numerous requests, defendants refused to discuss the issue substantively. Finally, unable to obtain cooperation from defendants, the Government subpoenaed Wal-Mart on November 5 to obtain these documents.

Rather than discussing their concerns with the Government regarding its requests for the Wal-Mart documents, defendants chose to wait until the very last moment (November 19, the day before Wal-Mart was required to comply with the subpoena) to write this Court seeking to quash the subpoena. Thereafter, defendants each filed objections to producing this material themselves.

After the parties' conference call with the Court, Visa U.S.A. agreed to provide copies of the CD-ROMs it produced to Wal-Mart, without prejudice to its ability to preserve all relevance (and other) objections. MasterCard maintains that it will produce that portion of the Wal-mart documents *that it deems otherwise responsive* to the Government's document requests *so long as* the Government and MasterCard are otherwise able to come to an agreement on MasterCard's document production. To do so, however, MasterCard claims it must first review all of the documents. During the conference call on November 24, MasterCard's counsel informed the Court it would take MasterCard until the end of January, 1999, to review the Wal-Mart documents.

Wal-Mart, the party to whom the subpoena has been issued, has no objection to producing the documents Visa and MasterCard produced in that case on CD-ROM. Moreover, Wal-Mart can

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[14] For its part, the Government has sought to expedite discovery pursuant to the spirit of its negotiations with defendants and the stipulated scheduling order. On October 28, 1998, after defendants requested the Government make each other's documents available to them, the Government indicated it was ready to produce 135 boxes of MasterCard and Visa documents. Not until November 25, 1998, almost a month later, defendants' took possession of any documents.

produce copies of all disks to the Government in two weeks. (In the Wal-Mart action, MasterCard produced 226 disks, which Wal-Mart re-formatted to 56 disks.)

THE RELEVANCE OF THE DOCUMENTS PRODUCED TO WAL-MART

MasterCard seeks to quash the Government's subpoena solely because some portion of the Wal-Mart documents are allegedly irrelevant to the Government's case. Given the numerous overlapping issues between the two cases and the broad interpretation of relevancy during pretrial discovery,[15] MasterCard's objections are unfounded. Moreover, even if there were any significant group of irrelevant documents, the needless delay in reviewing the entirety of an existing compilation (already in the hands of MasterCard's adversaries, and therefore presumably already reviewed for privilege) is completely unwarranted.

While the violations alleged by the Government are not the same as those alleged in the Wal-Mart class action, many of the issues presented in the Wal-Mart case are presented in the Government's case. Both plaintiffs allege: (1) a general purpose card market;[16] (2) that debit cards

[15] In pertinent part, Fed. R. Civ. P. 26(b)(1) states that "[p]arties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action . . . ." Information is relevant so long as it is reasonably calculated to lead to the discovery of admissible evidence. *See Daval Steel Products v. M/V Fakredine*, 951 F.2d 1357, 1367 (2d Cir. 1991). It is not grounds for an objection that the information sought will be inadmissible at trial so long as the requested material could lead to other information that may be relevant to the subject matter of the action and "[t]his obviously broad rule is liberally construed." *Id. (citing Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 351 (1978) (relevance under rule 26(b)(1) is broadly construed "to encompass any matter that bears on, or that reasonably could lead to other matter that could bear on, *any issue that is or may be in the case*") (emphasis added).

[16] Wal-Mart Complaint at ¶¶ 47 and 128. Government Complaint at ¶¶ 8-17.

are not part of the general purpose card market;[17] (3) that Visa and MasterCard exercise market power jointly through their joint governance;[18] (4) that the governing banks of both associations are unnamed co-conspirators which control and orchestrate the exercise of that market power;[19] and (5) that the member banks collectively restrain network-level competition by enacting exclusionary rules that prohibit Visa members from issuing cards on a competitive network (with the exception of MasterCard), and prohibit MasterCard members from issuing cards on a competitive network (with the exception of Visa).[20] Therefore, MasterCard should be ordered to promptly produce, on CD-ROM, all of the Wal-Mart documents, as well as the responsive documents Wal-Mart did not copy (on CD-ROM, if MasterCard has already formatted those documents in that manner).

[17] Wal-Mart Complaint at ¶ 129. Government Complaint at ¶ 8.

[18] Wal-Mart Complaint at ¶¶ 43-46. Government Complaint at ¶¶ 23-31.

[19] Wal-Mart Complaint at ¶ 32. Government Complaint at ¶ 6.

[20] Wal-Mart Complaint at ¶¶ 49-50. Government Complaint at ¶ 153.

THE SCHEDULING ORDER

The scheduling order signed by Judge Pollack was agreed to by all parties[21] as reflected in the Rule 16 hearing transcript.[22]

Moreover, there has been no change in circumstances in the past six weeks that warrants delaying the stipulated schedule. As the Court recognized in the telephone conference last week, it is clear from the face of the complaint that the Government's action encompasses numerous aspects of the industry structure. Defendants can not justifiably contend that the Government's comprehensive document request is surprising. In fact, in the context of negotiating the scheduling order with the defendants, the Government emphasized the nature of its discovery requests.[23] Therefore, any claim that the document requests are a superceding event warranting altering the stipulated schedule is disingenuous. No one with any experience in antitrust litigation — let alone the senior members of the antitrust bar who are defense counsel in this case — could genuinely claim to have been surprised by the Government's document requests.

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[21] In fact, the initial schedule the Government proposed to defendants was significantly different from the agreed-upon, stipulated schedule the parties presented to Judge Pollack. In the October 14, 1998 telephone conference, the Government proposed the following schedule: January 18, 1999, completion of party document production; February 26, commencement of depositions; May 21, completion of depositions and third party discovery; June 4, designation of witnesses and experts; July 16, submission of joint pretrial order; and August 30, trial. Defendants sought a protracted schedule with trial beginning on December 1, 1999. After negotiation, the parties compromised on the dates reflected in the stipulated scheduling order presented to and signed by Judge Pollack.

[22] Transcript of proceedings before Judge Pollack, October 16, 1998 at p.5 (Exhibit 2). ("Mr. Schwarz: [W]e got agreement from all the parties [on the proposed scheduling order] . . . The Court: Good. I see no reason why I shouldn't adopt it . . . ")

[23] Letter from Steve Semeraro to defense counsel, dated October 14, 1998 (Exhibit 3). ("As we indicated, we intend to serve our document requests on each defendant next week. Since we will be calling for a substantial number of documents, we requested in our call that you agree to a rolling production to begin as soon as practicable.")

Moreover, the schedule agreed to by all parties is quite consistent with — indeed, slower than — schedules in other recent major antitrust actions brought by the Government. The Primestar case (concerning the merger of satellite television interests and involving 11 major corporate defendants) was filed on May 12, 1998, and prior to settlement was scheduled for full trial on the merits for February 1, 1999. The Lockheed-Martin/Northrop Grumman merger complaint (challenging a merger with regard to 11 separate product markets — the largest ever challenged by the Government) was filed on March 23, 1998, and full trial on the merits was scheduled to commence on September 8. The Government's case against Microsoft was filed on May 18, 1998, and trial began on October 19, 1998. Although discovery in each of these cases was very document intensive, and dozens of depositions were contemplated (and, in the case of Microsoft, completed), none of these cases had a trial date longer than 9 months from the filing of the complaint. Therefore, this Court should not allow defendants' stalling tactics to delay the stipulated scheduling order that, like those schedules mentioned above, is in the public interest.

DISCOVER'S OBJECTIONS TO THE PROTECTIVE ORDER

Morgan Stanley Dean Witter & Co. ("Discover") objects to three provisions in the Final Protective Order stipulated to by the parties on November 16, 1998, and entered by the Court on November 18 ("Protective Order"). The Government's views on those three objections are:

First, the Government has no objection to modifying paragraph 10 of the Protective Order in a manner consistent with the modifications Discover suggested in its November 20th letter to the Court, except that it believes that a five-year bar on involvement by any party's agent with

any defendant or member or affiliate of a defendant may be considerably longer than necessary to protect any of Discover's legitimate concerns.

Second, the Government does not object to modifying paragraph 15 of the Protective Order to limit the disclosure permitted by that paragraph to management employees of the producing party or non-party, but does object to Discover's proposal to delete paragraph 15 entirely. It is important that the parties have the flexibility to disclose documents to management employees of the producing party or non-party without seeking that party's or non-party's prior consent. However, the Government agrees with Discover's concern that this provision, as currently written, is broader than necessary given the confidentiality concerns that have been raised. Disclosure of Confidential and Highly Confidential Information to a party's or non-party's own management employees does not entail the same confidentiality concerns that might arise if such information is disclosed to lower-level employees who do not normally have access to such information. Therefore, the Government proposes to modify paragraph 15 to limit disclosure to management employees of the producing party or non-party.

Third, the Government does not object to modifying paragraph 27 of the Protective Order to provide an opportunity for non-parties to object to the use of their Confidential and Highly Confidential Information at trial or other evidentiary hearing. However, the notice period sought by Discover is too long and could impinge the flow of testimony, including cross-examination and impeachment of witnesses at trial. To balance these interests, the government proposes to modify the stipulated order to: (a) provide non-parties with notice of potential use at trial of any Confidential or Highly Confidential documents produced by them if and when they are listed as potential exhibits in the required filings prior to commencement of trial, and (b) give notice as

soon as practicable after a Confidential or Highly Confidential document which is not listed on the exhibit list is determined to be used by counsel for a party in the course of examination or cross-examination at trial (but, of course, before the document is actually used at trial). Such provisions would appropriately balance the confidentiality concerns of Discover (and other non-parties) without unduly fettering counsel's witness examinations at trial.[24]

CONCLUSION

The Government requests that this Court take the steps necessary to ensure that this matter is brought to trial expeditiously, consistent with the due process rights of all parties. Defendants professed to share that goal when they agreed to the Stipulated Pretrial Order entered by Judge Pollack. There is no reason to deviate from that goal now by permitting delays such as lengthy, needless reviews of existing CD-ROMs containing documents already reviewed,

[24] Based on our meet and confer discussions with defendants' counsel earlier this week, we believe that defendants' counsel agrees in principle with the second and third proposals set forth above.

compiled and produced to defendants' adversaries. It is time for all parties to engage their full resources to complete discovery and prepare for trial next Fall.

Respectfully submitted,

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