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February 21, 2007

**VIA ELECTRONIC FILING**

The Honorable Magistrate Judge James Orenstein
225 Cadman Plaza East
Room 456 North
Brooklyn, NY 11201

Re: In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation
1:05-MD-1720-(JG)(JO)
Our File No.: 123630.0000

Dear Magistrate Judge Orenstein:

Following the February 2, 2007, oral argument on Defendants' motion to dismiss Class Plaintiffs' First Supplemental Class Action Complaint, this Court offered Defendants the opportunity to present further explanations as to (1) analogous transactions to the MasterCard IPO and Agreements that were not analyzed under the antitrust laws, and (2) why the pre-IPO shares in MasterCard previously held by MasterCard's Member Banks should not be treated as "assets" within the meaning of Section 7 of the Clayton Act, 15 U.S.C. § 18.[1] Class Plaintiffs submit this letter brief in response to the Supplemental Brief submitted by MasterCard, and the letter brief submitted by the Bank Defendants. As the discussion below demonstrates, Defendants' supplemental arguments do not change the conclusion that Class Plaintiffs have adequately pled violations of Section 7 by MasterCard and the Bank Defendants.

**MasterCard Acquired The "Assets Of Another" When It Acquired MasterCard Stock That Previously Belonged To Its Member Banks**

Section 7 states unequivocally that "no person shall acquire the whole or the part of the assets of another person," when "the effect of such acquisition may be substantially to lessen competition." MasterCard argues, based on selected excerpts from legislative history, that Section 7 cannot possibly mean what it says. This argument fails.

The antitrust laws are no exception to the general principle that statutes are interpreted to give effect to the intent of Congress and the "dominating general purpose" of the Act, as

[1] Feb. 2, 2007, Minute Order; Feb. 2, 2007, Oral Arg. Tr. at 65-66, 78-79.

reflected in the statutory text.[2] Webster's dictionary defines asset broadly as "an item of value owned."[3] The Financial Accounting Standards Board ("FASB"), whose financial accounting standards courts recognize as authoritative,[4] provides further support for this Court's intuition that the Member Banks enumerate MasterCard stock among their assets.[5] Under the Board's standards, assets are defined as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events."[6]

In opposition, MasterCard argues primarily that interpreting the Member Banks' ownership of MasterCard stock as an "asset" for purposes of Section 7 would render the term "stock" superfluous. MasterCard's interpretation, however, is at odds with the undisputed purpose of Congress in expanding Section 7 in 1950 to include asset acquisitions. Congress sought to close the loophole in the original version of Section 7 that limited the Act's scope to stock acquisitions.[7] By expanding the statute to reach anticompetitive asset acquisitions, Congress expanded Section 7 to include "the entire range of corporate amalgamations."[8] The House Report, quoted by the *Philadelphia National Bank* Court, stated that the amendments intended to protect the "central purpose" of merger enforcement by "cover[ing] not only the purchase of assets or stock but also any other method of acquisition."[9] The Court further noted that if a transaction "were tantamount in its effects to a merger," it would be treated under Section 7, even if it didn't fit squarely into the box of an asset acquisition.[10]

The United States District Court for the Southern District of New York, in one of the early interpretations of the current version of Section 7, confirmed that "the words 'acquire' and 'assets' are not terms of art or technical legal language" and should be read broadly as "generic, imprecise terms encompassing a broad spectrum of transactions."[11] As pointed out in Class Plaintiffs' initial brief, other courts have followed that court's lead to hold that the broad language of Section 7 applies to a wide array of transactions that foster anticompetitive effects.[12]

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2 *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 337 (1963); *Frank G. v. Board of Educ. of Hyde Park,* 459 F.3d 356, 371 (2d Cir. 2006) (quoting *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943)).

3 Webster's Third New Int'l Dictionary of the English Language Unabridged 131 (Merriam-Webster 1986). Webster's defines the plural, "assets," in a way that further supports Class Plaintiffs' reading of the term as "the series of items on a balance sheet representing the book values at a given date of resources, rights, or items or property owned…" *Id.*

4 The FASB promulgates the well-known Generally Accepted Accounting Principles ("GAAP").

5 Feb. 2, 2007, Oral Arg. Tr. at 74.

6 Elements of Financial Statements, Statement of Fin. Accounting Concepts No. 6, § 25 (Fin. Accounting Standards Bd. 1985). The FASB further notes that "investments in securities of other entities . . . so obviously qualify as assets that they need no further comment . . . ." *Id.* § 177.

7 *Philadelphia Nat'l Bank*, 374 U.S. at 342.

8 *Id.*

9 *Id.* at 346 (quoting H.R. Rep. No. 1191, 81st Cong., 1st Sess. 8-9).

10 *Id.* at 344 n.22.

11 *United States v. Columbia Pictures*, 189 F. Supp. 153, 181-82 (S.D.N.Y. 1960).

12 Class Pls.' Br. at 14, 15 & n.14 (citing *United States v. ITT Cont'l Baking Co.*, 485 F.2d 16, 20 (10th Cir. 1973), *rev'd on other grounds*, 420 US. 223 (1975); *Mr. Frank, Inc. v. Waste Mgmt., Inc.*, 591 F. Supp. 859, 866-67 (N.D. Ill. 1984); *United States v. Archer-Daniels-Midland Co.*, 584 F. Supp. 1134, 1138-39 (S.D. Iowa 1984); *Columbia Pictures*, 189 F. Supp. at 181-82).

What truly ends the inquiry, however, is the competitive significance of the asset – MasterCard stock – that MasterCard acquired from the Member Banks. Before the IPO, the Member Banks' MasterCard stock allowed them to, among other things, elect members to MasterCard's Board of Directors and other important committees.[13] The Board of Directors, in turn, set default Interchange Fees for all MasterCard transactions.[14] In this way, the Member Banks' ownership of MasterCard stock allowed them to set Interchange Fees as a cartel.[15] According to MasterCard's public statements, the IPO stripped the Member Banks of some of their ownership interests and their ability to elect a majority of Board members, which then purportedly stripped the banks of their ability to set interchange fees. Thus the "asset" that the banks had – which MasterCard acquired through the IPO – is the ability to set supracompetitive Interchange Fees, which lies at the heart of this litigation. Because MasterCard's acquisition of the Member Banks' MasterCard stock allowed it to consolidate price-setting authority, it is precisely the type of "asset acquisition" that Congress targeted in its 1950 amendments to Section 7.

Nor does MasterCard's reference to Section 7A of the Clayton Act alter this conclusion. Section 7A, commonly known as the Hart-Scott-Rodino Antitrust Improvements Act, requires that mergers and acquisitions over a certain transaction threshold be reported to the antitrust agencies for review, and prevents parties from consummating transactions during this review process.[16] But unlike Section 7, Hart-Scott-Rodino addresses only the procedural aspects of pre-merger review and does not alter the substantive analysis of mergers.[17] Accordingly, several mergers have been challenged successfully, even though they fell outside of the reporting requirements of Hart-Scott-Rodino.[18]

The Hart-Scott-Rodino regulations cited by MasterCard must therefore be read in this context. Because Hart-Scott-Rodino is intended to alert the antitrust agencies only to mergers that may potentially harm competition, the statute exempts certain transactions from reporting if they are made "solely for investment."[19] Not surprisingly then, 16 C.F.R. § 801.21, cited by MasterCard, explains that securities do not count toward the Hart-Scott-Rodino reporting thresholds. Moreover, other sections of 16 C.F.R., not cited by MasterCard, lend additional support to Class Plaintiffs' position that MasterCard is an acquirer of bank assets. Section 801.1(a), for example, which defines "acquiring and acquired persons," states unequivocally that "any person which, as a result of an acquisition, will hold voting securities or assets…is an

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13 Cl. Pls' First Supp. Cl. Action Compl. ¶ 45.

14 First Am. Consol. Cl. Action Compl. ¶ 134.

15 *Id.*

16 15 U.S.C. § 18A; *United States v. Archer-Daniels-Midland Co.*, 584 F. Supp. 1134, 1139 (S.D. Iowa 1984).

17 *Archer-Daniels-Midland*, 584 F. Supp. at 1139.

18 *See, e.g., id.* The antitrust-enforcement agencies have also secured consent remedies in acquisition cases that were not reportable under Hart-Scott-Rodino. *See, e.g.,* Decision and Order, *In re Aspen Technology, Inc.*, No. 9310 (F.T.C. Dec. 20, 2004); Agreement Containing Consent Order, *In the Matter of MSC.Software Corp.*, No. 9299 (F.T.C. Aug. 14, 2002).

19 Class Plaintiffs believe that discovery will demonstrate, if the publicly-known facts do not, that the member Banks did not hold MasterCard stock "solely for investment."

acquiring person."[20] Because MasterCard held assets after the IPO, it is considered an acquiring person, even under Hart-Scott-Rodino.

**The Nasdaq IPO Provides No Support For Defendants' Argument That The MasterCard IPO Is Beyond The Reach Of Section 7**

In response to this Court's query about whether MasterCard's IPO was novel in that it featured "the dilution of rights, giving up the voting rights but getting the kind of rights that you have with the class [M] shares," Defendants raised the example of NASD/Nasdaq transactions that occurred from 2000-2002.[21] While the NASD/Nasdaq market is analogous to the relevant Payment-Card market in this case in several important respects, the NASD/Nasdaq public share offering is not analogous to the MasterCard IPO in the manner the Bank Defendants suggest.

To fully appreciate the extent to which the NASD/Nasdaq comparison differs from the MasterCard IPO requires only a review of stated motivations driving each transaction. According to Mr. Greene, NASD needed to execute a dual-class stock sale because the regulatory framework required NASD to maintain control of Nasdaq until the SEC certified it as an exchange.[22] By contrast, MasterCard, by its own admission, executed the transaction because "[m]any of the legal and regulatory challenges we face are in part directed at our current ownership and governance structure in which our customers—our member financial institutions—own all of our common stock and are involved in our governance…"[23] NASD did not use the avoidance of antitrust liability as a stated goal of its stock issuance, and the fact that NASD retained control disproportionate to its ownership suggests that any effort to do so would have been a failure.[24]

Not only were the motivations for the two sets of transactions different, but the transactions themselves are different in several respects. First, in the MasterCard IPO Agreements the MasterCard Member Banks acquired MasterCard Class M stock which Class Plaintiffs allege, and Defendants deny, gave the Member Banks veto powers that amount to effective control of the New MasterCard. In addition, the Member Banks claim that they relinquished voting control of MasterCard, the very aspect of ownership that NASD was required by the SEC to retain in the NASD/Nasdaq transaction. Moreover, MasterCard's own admissions explain that the appearance of losing voting control will help avoid antitrust liability, a goal not expressed by NASD. Finally, the acquisition of veto powers on key management decisions affords the Member Banks with something that they could only get through this transaction: the

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20 Section 801 further clarifies that, like the Bank Defendants, "a person may be an acquiring person and an acquired person with respect to separate acquisitions which comprise a single transaction." 16 C.F.R. § 801.2(c).

21 We note at the outset that Mr. Greene's letter cites no factual support, in the form of SEC filings or otherwise, for his assertions regarding the nature of the NASD/Nasdaq transactions.

22 The Nasdaq Stock Market, Inc., Amendment No. 2 to Form S-3 Registration Statement, at 114 (Feb. 8, 2005).

23 Amendment No. 4 to Form S-1, filed with the SEC on April 14, 2006, at 67.

24 As detailed below, Nasdaq market makers were accused of fixing the "spreads" on Nasdaq trades. As Mr. Greene acknowledges, however, NASD "remains a membership corporation," such that a new agreement among market makers to fix prices would presumably still be subject to Section 1 of the Sherman Act.

opportunity to control key aspects of MasterCard while claiming to have given up their control of MasterCard.[25]

Although the NASD/Nasdaq transactions tell us nothing about the application of Section 7 to the facts alleged in the Supplemental Complaint, the Nasdaq market is instructive for another purpose. The "spreads" which the Nasdaq market makers charge for bringing together buyers and sellers of stock[26] are analogous to the Interchange Fees set by MasterCard to purportedly bring together issuing banks and acquiring banks on Payment-Card transactions. In 1995, the Department of Justice challenged as horizontal price fixing the collusive setting of spreads by the Nasdaq market makers.[27] After the Justice Department's suit, and a private class action on behalf of injured investors, spreads fell from an average of $.25 per share to a fraction of that price—a price reduction that saved consumers billions of dollars.[28] Class Plaintiffs expect to achieve similar salutary results in this case.

Sincerely,

ROBINS, KAPLAN, MILLER & CIRESI L.L.P.

K. Craig Wildfang

KCW/tlo
cc: Counsel of Record (Via ECF)

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25 Cl. Pls' Br. at 5, n. 6, (citing Victor Fleischer, *The MasterCard IPO: Protecting the Priceless Brand,* Harv. Negotiation L. Rev. (forthcoming 2007) ) (manuscript at 2-3, Univ. of Colo. Law School Research Paper Services No. 06-25 (Draft of August 11, 2006) *available at* http://ssrn.com/abstract=888923). (Attached at Ex. 1 to Declaration of Ryan W. Marth)

26 *See, e.g.,* Arthur M. Kaplan, *Antitrust as a Public-Private Partnership: A Case Study of the NASDAQ Litigation*, 52 Case W. Res. L. Rev. 111, 114-15 (2001) (citing William Christie & Paul Schultz, *Why do NASDAQ Market Makers Avoid Odd-Eighth Quotes?*, 49 J. Fin. 1813, 1840 (1994)).

27 *See* Complaint, *United States v. Alex Brown & Sons Inc*, 96 CIV 5313 (RWS) (S.D.N.Y. July 17, 1996), *available at* www.usdoj/atr/cases/f0700/0740.htm; Competitive Impact Statement, *Alex Brown & Sons*, 96 CIV 5313 (RWS) (S.D.N.Y. Jul. 17, 1996), *available at* www.usdoj/atr/cases/f0700/0739.htm.

28 Affidavit of Prof. Paul H. Schultz ¶¶ 4, 6, *In re Nasdaq Market Makers Antitrust Litigation*, M.D.L. 1023, No. 94 Civ. 3996 (RWS) (S.D.N.Y.); Kaplan, 52 Case W. Res. L. Rev. at 129-30.