UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

IN RE PAYMENT CARD INTERCHANGE FEE AND MERCHANT DISCOUNT ANTITRUST LITIGATION This Document Relates To: 1:05-CV-3925 1:05-CV-4650 1:05-CV-4677 1:05-CV-4799 1:06-CV-0039 1:06-CV-0078 1:06-CV-2534	MASTER FILE 05-MD-1720(JG)(JO)

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF MASTERCARD'S MOTION TO DISMISS INDIVIDUAL MERCHANT PLAINTIFFS' CLAIMS UNDER SHERMAN ACT SECTION 2

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Defendants MasterCard International Incorporated and MasterCard Incorporated (collectively, "MasterCard") respectfully submit this reply memorandum of law in further support of MasterCard's motion to dismiss with prejudice all claims asserted against MasterCard under Section 2 of the Sherman Act by the Individual Merchant Plaintiffs.[1]

PRELIMINARY STATEMENT

In their opposition, Individual Merchant Plaintiffs do not dispute that MasterCard is currently alleged to have a 30% market share in the purported market for general purpose card network services in which its chief competitor Visa U.S.A. allegedly commands a larger share.[2] As a matter of law and fundamental economics, the Individual Merchant Plaintiffs cannot maintain their claims under Section 2 of the Sherman Act that MasterCard is monopolizing or dangerously close to monopolizing this purported market.

Individual Merchant Plaintiffs attempt, therefore, to limit the relevant market solely to MasterCard's own branded credit card network services. But, in order to state a cognizable claim under that purported market definition, Individual Merchant Plaintiffs must allege facts demonstrating that MasterCard's network services are so unique that Visa, American Express, and Discover's network services cannot serve as functional and economic substitutes.

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[1] The Individual Merchant Plaintiffs are identified in MasterCard's moving memorandum. (Mem. of L. of Defs. MasterCard Int'l Inc. & MasterCard Inc. in Support of Their Mot. to Dismiss Individual Merchant Pls.' Claims Under Sherman Act Section 2 ("Defs.' Mem.") at 1.) In addition, after the filing of MasterCard's Motion to Dismiss, Plaintiffs BI-LO, LLC, Bruno's Supermarkets, Inc., Meijer, Inc., and Meijer Stores Limited Partnership filed complaints containing Section 2 claims identical to those asserted by the other Individual Merchant Plaintiffs, and these new plaintiffs joined Individual Merchant Plaintiffs' Response to the Motion to Dismiss. Accordingly, MasterCard now moves to dismiss the new plaintiffs' Section 2 claims as well.

[2] *See* First Consolidated Am. Class Action Compl. ¶ 203 ("CACC"). Visa is alleged to have a 43% share. *Id.* ¶ 202.

Plaintiffs make no such allegations. Nor could they, because the previous Department of Justice litigation on which Plaintiffs rely for their primary market definition considered a network services market that encompassed the services provided by all four of these entities.[3] None of the purported "single market" cases cited by Individual Merchant Plaintiffs uphold alleged single-*brand* markets where other competitors provide substitutable services.

Nor may Individual Merchant Plaintiffs simply disregard MasterCard's low market share in the alternative alleged market for general purpose card network services by making conclusory allegations of MasterCard's supracompetitive pricing in this purported market. Even assuming that courts are free to assess other factors, Individual Merchant Plaintiffs still fail to cite to a single case in which a Section 2 claim was properly stated or upheld against an entity with only a 30% market share facing a larger competitor in the alleged market. Although Individual Merchant Plaintiffs rely on Judge Jones's findings from 2001 regarding MasterCard's purported pricing power in *United States v. Visa*, when faced with similar allegations of supracompetitive pricing under Section 2 in the *Discover* case, Judge Jones more recently dismissed those claims against MasterCard due to its lack of monopoly power.

ARGUMENT

I. INDIVIDUAL MERCHANT PLAINTIFFS CANNOT PROPERLY PLEAD A MASTERCARD-ONLY MARKET DEFINITION

Individual Merchant Plaintiffs first contend that they have cured their market-power pleading deficiencies by alleging that MasterCard possesses monopoly power in a market for MasterCard credit card network services. (*See* Individual Pls.' Consolidated Resp. to

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[3] MasterCard, of course, accepts the primary proposed market definition set out in Individual Merchant Plaintiffs' Complaints (Kroger Am. Compl. ¶¶ 27-33) for purposes of this motion only.

MasterCard Defs.' Rule 12(b)(6) Mot. to Dismiss ("Pls.' Resp.") at 14; *see also* Kroger Am. Compl. ¶ 29.) Yet Individual Merchant Plaintiffs' allegations do not fit within the very narrow exceptions for such brand-specific markets.

Product- or brand-specific market definitions are disfavored within the Second Circuit unless the product in question is so unique that it has no functional or economic substitutes. *See United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377, 393 (1956) (holding that relevant market for monopolization claim is comprised not of trademarked products of one manufacturer but rather "commodities reasonably interchangeable by consumers for the same purposes"); *Todd v. Exxon Corp*, 275 F.3d 191, 200 & n.3 (2d Cir. 2001) ("Cases in which dismissal on the pleadings is appropriate frequently involve . . . failed attempts to limit a product market to a single brand . . . that competes with potential substitutes . . . ."). A plaintiff propounding a brand-specific market must plead facts from which the non-substitutability of other products can reasonably be inferred; in the absence of such allegations, the complaint is subject to dismissal. *Arnold Chevrolet LLC v. Tribune Co.*, 418 F. Supp. 2d 172, 187 (E.D.N.Y. 2006) (dismissing claims where plaintiff failed to allege facts showing non-interchangeability); *Carell v. Shubert Org.*, 104 F. Supp. 2d 236, 264 (S.D.N.Y. 2000) ("A plaintiff's failure to define its market by reference to the rule of reasonable interchangeability is, standing alone, valid grounds for dismissal."); *Re-Alco Indus., Inc. v. Nat'l Ctr. for Health Educ., Inc.*, 812 F. Supp. 387, 391 (S.D.N.Y. 1993) ("If a complaint fails to allege facts regarding substitute products, to distinguish among apparently comparable products, or to allege other pertinent facts relating to cross-elasticity of demand, . . . a court may grant a Rule 12(b)(6) motion.").

There is no factual allegation in Individual Merchant Plaintiffs' complaints supporting the assertion that MasterCard network services are not interchangeable with other

network services. Indeed, although the Individual Merchant Plaintiffs specifically allege that network services are not interchangeable with "other payment methods (such as cash, checks, or debit cards)" (Kroger Am. Compl. ¶ 31), and point to sections of the Complaints that "explain[] the rationale for Plaintiffs' alternate single brand market definition" (*see* Pls.' Resp. at 16), none of these allegations set forth facts demonstrating why MasterCard's network services are not interchangeable with Visa's or American Express's network services. Rather, these paragraphs are either conclusory legal assertions (*see, e.g.*, Kroger Am. Compl. ¶¶ 1, 29) or discuss matters unrelated to interchangeability of network services (*see* Kroger Am. Compl. ¶¶ 23, 32-33 (market power allegations), ¶ 40 (cardholder behavior), ¶¶ 47-54 (tying allegations).)

At bottom, Individual Merchant Plaintiffs rest their purported MasterCard-only market on the justification that "the merchants' only option in the face of an increase in interchange fees is to decline MasterCard products entirely, an option that merchants are not in an economic position to exercise." (Pls.' Resp. at 12.) As set forth in MasterCard's moving brief, a merchant's business decision to accommodate the demand of its customers does not make a product so unique as to make it a market onto itself. (Defs.' Mem. at 13.) Thus, allegations implying that a merchant's customers like to use MasterCard cards does not justify a MasterCard-only market any more than certain cola drinkers' preference for Pepsi over Coke justifies a Pepsi-only market. (*See id.*)

In response, Individual Merchant Plaintiffs merely argue that there is no rule prohibiting brand-specific market definitions, relying primarily on *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992), and *Geneva Pharm. Tech. Corp. v. Barr Labs., Inc.*, 386 F.3d 485 (2d Cir. 2004). (Pls.' Resp. at 14.) Neither of these cases, however, is instructive here.

In *Kodak*, the Supreme Court expressly confirmed *Du Pont's* holding that "one brand does not necessarily constitute a relevant market if substitutes are available." *Eastman Kodak*, 504 U.S. at 482 n.30 (emphasis omitted). But it upheld a Section 2 claim based upon a Kodak-only services market because consumers of Kodak equipment who needed parts and services could not purchase non-Kodak parts or services elsewhere and thus were "locked-in" to a Kodak-services "aftermarket." *Eastman Kodak*, 504 U.S. at 482 ("[S]ervice and parts for Kodak equipment are not interchangeable with other manufacturers' service and parts . . . .").

This "lock-in" situation differs starkly from the alleged MasterCard-only network services market, since the consumers[4] of MasterCard network services are both able to and do purchase network services from MasterCard's competitors and have the ability to switch networks should MasterCard somehow impose prices significantly above that of its network competitors. *See United States v. Visa U.S.A. Inc.*, 163 F. Supp. 2d 322, 333, 339 (S.D.N.Y. 2001) (noting competition among MasterCard, Visa, American Express, and Discover within alleged network services market), *aff'd* 344 F.3d 229, 239 (2d Cir. 2003) (recognizing "the network services provided by the four major brands"); *Carell*, 104 F. Supp. 2d at 265 (holding that "*Kodak*'s narrow exception for a one market brand is inapposite" to claims not involving lock-in effect); *Mathias v. Daily News, L.P.*, 152 F. Supp. 2d 465, 483 (S.D.N.Y. 2001) (dismissing monopolization claims and holding that "*Eastman Kodak* created a limited exception

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[4] Individual Merchant Plaintiffs fail to acknowledge that issuing banks indisputably are consumers in the network services market, and, as such, these banks readily switch between networks in response to economic incentives. *See United States v. Visa*, 163 F. Supp. 2d at 376-77. Thus, even if one credits (for purposes of this motion only) Plaintiffs' allegation that merchants do not view MasterCard and Visa as substitutes, other purchasers in the market consider the networks to be interchangeable. Accordingly, Individual Merchant Plaintiffs cannot legitimately limit the network services market to a MasterCard-only definition.

for a market . . . when, as a result of an expensive investment in a primary market, the purchaser is locked into an aftermarket").

Geneva is equally unavailing. In that case, the Second Circuit held that there was a market for generic versions of warfarin sodium (a blood thinner). *Geneva*, 386 F.3d. at 495-500. Recognizing that there were several participants in the alleged generic warfarin market, the court merely held that the alleged monopoly power of the largest participant in the generic market (Barr Laboratories) could not be determined on summary judgment on the facts present there. *Id.* at 501. The court did not — contrary to Individual Merchant Plaintiffs' suggestion — find there to be a relevant market comprised of Barr Laboratories generic warfarin sodium.

The other cases Individual Merchant Plaintiffs cite in support of a MasterCard-only market definition either rely on the *Kodak* "lock-in" framework, *i.e.*, involve unique products with no functional or economic substitutes, or otherwise do not concern single-*brand* product markets at all. *See, e.g., Intellective, Inc. v. Mass. Mut. Life Ins. Co.*, 190 F. Supp. 2d 600, 605, 611 (S.D.N.Y. 2002) (alleged market for studies of the investment performance of life insurance companies is not limited to a "particular brand," and thus "does not present the 'one brand' problem"); *Hewlett-Packard Co. v. Arch Assocs. Corp.*, 908 F. Supp. 265, 270 (E.D. Pa. 1995) (rejecting alleged single Hewlett-Packard brand market definition in favor of properly defined alleged market for "computer printers").[5] None support a finding that Individual Merchant Plaintiffs can properly allege a MasterCard-only market.

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[5] *See also Nat'l Ass'n of Pharm. Mfrs. v. Ayerst Labs*, 850 F.2d 904, 915 (2d Cir. 1988) (market for branded drug made by one supplier with patent protection); *Vitale v. Marlborough Gallery*, No. 93 Civ. 6276, 1994 WL 654494, *3-4 (S.D.N.Y. July 5, 1994) (finding a "unique" sub-market for Jackson Pollack paintings); *U.S. Anchor Mfg., Inc. v. Rule Indus., Inc.*, 7 F.3d 986, 996 (11th Cir. 1993) (market not limited to a single brand but rather "light weight generic and economy fluke anchors"); *Woods Exploration & Producing Co. v.*

II. INDIVIDUAL MERCHANT PLAINTIFFS CANNOT PROPERLY PLEAD THAT MASTERCARD POSSESSES MONOPOLY POWER IN THE PURPORTED RELEVANT PRODUCT MARKET

All parties agree that, to state a valid claim under Section 2 of the Sherman Act, a plaintiff must properly allege that the defendant possesses either monopoly power in the relevant market (for a monopolization claim) or a "dangerous probability" of achieving such power (for an attempted monopolization claim). (Defs.' Mem. at 6; Pls.' Resp. at 5-6.) Individual Merchant Plaintiffs do not dispute that MasterCard is alleged to have only a 30% market share in a purported "network services market" in which Visa U.S.A. is alleged to have the largest share. *See United States v. Visa U.S.A. Inc.*, 344 F.3d 229, 240 (2d Cir. 2003) (noting 1999 Visa share of 47%); CACC ¶¶ 202-203.

Individual Merchant Plaintiffs further acknowledge that, in the Second Circuit, their "market power allegations must be 'plausible' in light of the marketplace realities." (Pls.' Resp. at 10.) Here, this undisputed market framework is dispositive. Individual Merchant

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Aluminum Co. of America, 438 F.2d 1286, 1305 (5th Cir. 1971) (market for extraction of natural gas from one geographic location); *In re NCAA I-A Walk-On Football Players Litig.*, 398 F. Supp. 2d 1144, 1150 (W.D. Wash. 2005) (alleged market for "Division I-A football" with only one supplier); *In re Cardizem CD Antitrust Litig.*, 105 F. Supp. 2d 618, 680 (E.D. Mich. 2000) (alleged market for branded and generic versions of drug made by different suppliers); *Mut. Pharm. Co. v. Hoechst Marion Roussel, Inc.*, No. Civ.A 96-1409, 1997 WL 805261, *3 (E.D. Pa. Dec. 17, 1997) (alleged market for patent-protected drug with "unique" chemical compounds); *Picker Int'l, Inc. v. Leavitt*, 865 F. Supp. 951, 958-59 (D. Mass. 1994) (*Kodak*-type aftermarket for services for CT scanners); *Brownlee v. Applied Biosystems Inc.*, No. C 88 20672 RPA, 1989 WL 53864, *3 (N.D. Cal. Jan. 9, 1989) (market for capillary electrophoresis separators with competing manufacturers); *Cutters Exch., Inc. v. Durkoppwerke GmbH*, No. 3-85-1005, 1986 WL 942, *7 (M.D. Tenn. Jan. 22, 1986) (involving allegation of products "so unique or so dominant . . . that any action by the manufacturer to increase his control . . . virtually assures that competition in the market will be destroyed"); *Am. Std., Inc. v. Bendix Corp.*, 487 F. Supp. 265, 270-71 (W.D. Mo. 1980) (alleged United States government market for APX-72 transponders produced by multiple manufacturers).

Plaintiffs have not and cannot identify a single case in which Section 2 has been applied to a defendant with a market share as low as MasterCard's operating in an alleged market against a larger competitor.[6] Nor should they find any such case law. Section 2 "is not designed to curb all concentrations of economic power that could theoretically be used to restrain trade, but only those that will actually be used to do so." *United States v. Int'l Bus. Mach. Corp.*, 163 F.3d 737, 741 (2d Cir. 1998); *see* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 236 (5th ed. 2002) ("[C]ourts virtually never find monopoly power when market share is less than about 50 percent.") (collecting cases); Defs.' Mem. at 7-9 (collecting additional cases); *see also Commercial Data Servers, Inc. v. Int'l Bus. Mach. Corp.*, 262 F. Supp. 2d 50, 74 (S.D.N.Y. 2003) (holding that "low market share numbers are dispositive" of Section 2 claim in which defendant's market share was 23% at most); *United States v. Eastman Kodak Co.*, 853 F. Supp. 1454, 1471 (W.D.N.Y. 1994) (holding, "on the basis of market share alone," that defendant with 36% market share did not possess monopoly power), *aff'd* 63 F.3d 95, 109 (2d Cir. 1995).

Individual Merchant Plaintiffs attempt to respond to this significant body of case law in two ways. First, in order to rely upon the findings in *United States v. Visa*, they conflate market power with monopoly power. But market power and monopoly power are not legally equivalent: The Supreme Court has specifically held that market power, which is the standard in Sherman Act Section 1 cases, is a lower standard than that for monopoly power, which applies to Section 2 claims. *Eastman Kodak*, 504 U.S. at 481 ("Monopoly power under § 2 requires, of course, something greater than market power under § 1.").

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[6] *Broadway Delivery Corp. v. UPS*, 651 F.2d 122 (2d Cir. 1981), *Hayden Pub. Co. v. Cox Broad. Corp*, 730 F.2d 64 (2d Cir. 1984), and *Energex Lighting Indus., Inc. v. NAPLC*, 656 F. Supp. 914 (S.D.N.Y. 1987) all relied upon by Individual Merchant plaintiffs, are not to the contrary. None address market "realities" akin to those faced by MasterCard.

This distinction is vividly demonstrated by two opinions at the heart of Individual Merchant Plaintiffs' brief. Initially, in the *United States v. Visa* opinion, Judge Jones addressed the issue of whether MasterCard had market power under Section 1. *United States v. Visa*, 163 F. Supp. 2d at 341-42. The opinion did not address Section 2. Then, in the *Discover* litigation, Judge Jones conducted an entirely different analysis, holding that MasterCard's alleged 29% market share in the same purported market[7] was "clearly insufficient as a matter of law for a claim for either actual or attempted monopolization against MasterCard" under Section 2. *Discover Fin. Servs., Inc. v. Visa U.S.A., Inc.*, No. 04 Civ 7844, slip op. at 3 (S.D.N.Y. Oct. 24, 2005) (Defs.' Mem., Noti Decl. Ex. A). This is because, as discussed above, the standard for a proper allegation of Section 1 market power is lower than the standard for pleading Section 2 monopoly power.[8]

Second, Individual Merchant Plaintiffs assert that market share is irrelevant because they have alleged that MasterCard directly controls prices in the alleged market. (*See*

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[7] *Compare United States v. Visa*, 163 F. Supp. 2d at 322 ("general purpose card network services"), *with* First Am. Compl. and Jury Demand ¶ 85, *Discover Fin. Servs., Inc. v. Visa U.S.A., Inc.*, No. 04 Civ 7844 ("[g]eneral purpose card network services") (Defs.' Mem., Noti Decl. Ex. B).

[8] Individual Merchant Plaintiffs nonetheless cite three cases for the proposition that "market power is synonymous with monopoly power" or "monopoly power is substantial market power." (Pls.' Resp. at 6 (emphasis omitted).) All, however, only confirm that a low market share cannot support a finding of monopoly power sufficient to state a Section 2 claim. *See AD/SAT v. Associated Press*, 181 F.3d 216, 229 (2d Cir. 1999) (holding it was "clear that [the defendant's] market share [was] not sufficient to support an attempted monopolization claim"); *Tops Mkts., Inc. v. Quality Mkts., Inc.*, 142 F.3d 90, 98-99 (2d Cir. 1998) (defendant's market share of 72%-74% was insufficient to constitute monopolization); *Int'l Distrib. Ctrs., Inc. v. Walsh Trucking Co.*, 812 F.2d 786, 793 (2d Cir. 1987) (17% market share did not demonstrate a dangerous probability of achieving monopoly power). In none of these cases did the Second Circuit hold that evidence of some market power, without reference to market share, could constitute a sufficient basis for a finding of monopoly power under Section 2.

Pls.' Resp. at 21.) Yet, while Individual Merchant Plaintiffs assert in a conclusory manner that MasterCard controls price in this alleged market, they allege no facts demonstrating how this can even be plausible in view of the presence of Visa, as well as American Express, which charges higher fees to Individual Merchant Plaintiffs than MasterCard charges. *See United States v. Visa*, 163 F. Supp. 2d at 332-33 (noting MasterCard merchant discount of 2% and American Express merchant discount of 2.73%). No case Individual Merchant Plaintiffs cite addresses a claim in an analogous setting to that presented here.

Moreover, Judge Jones in *Discover* recently was faced with allegations regarding MasterCard's purported pricing power similar to those that Individual Merchant Plaintiffs make here. In its complaint, Discover supported its monopoly power allegations by asserting, as Individual Merchant Plaintiffs do here, that "Visa and MasterCard have recently raised interchange rates charged to merchants a number of times, without losing a single merchant customer as a result." (*Discover* Compl. ¶ 27 (Defs.' Mem., Noti Decl. Ex. B) (*citing United States v. Visa*, 163 F. Supp. 2d at 340).) Nonetheless, Judge Jones did not find such allegations to be sufficient support for a monopolization claim in light of MasterCard's market share and position and thus dismissed the Section 2 claim against MasterCard in the *Discover* action. Individual Merchant Plaintiffs accordingly cannot rely solely on allegations of direct pricing power to salvage an improper Section 2 claim against MasterCard.

CONCLUSION

For the foregoing reasons, MasterCard respectfully requests that this Court enter an order dismissing with prejudice all of the claims under Section 2 of the Sherman Act in each of the above-captioned actions.

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