UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

In re PAYMENT CARD INTERCHANGE FEE AND MERCHANT DISCOUNT ANTITRUST LITIGATION

MASTER FILE NO. 1:05-md-1720-JG-JO

This Document Relates To:
All Class Actions

CLASS PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS FIRST AMENDED SUPPLEMENTAL CLASS ACTION COMPLAINT AND SECOND SUPPLEMENTAL CLASS ACTION COMPLAINT

TABLE OF CONTENTS

Page

INTRODUCTION 1

FACTUAL BACKGROUND 2

I. VISA, MASTERCARD, AND THEIR MEMBER BANKS CONTROL LED THE RELEVANT MARKETS BY ADOPTING ANTICOMPETITIVE RESTRAINTS. 2

A. Issuing Banks Have Historically Controlled The Networks. 2

B. Before Their Restructurings, Visa And MasterCard Had Been Adjudicated To Be Structural Conspiracies. 4

II. THE PROCESS LEADING UP TO THE RESTRUCTURINGS DEMONSTRATES THAT VISA AND MASTERCARD INTENDED TO PRESERVE THEIR ANTICOMPETITIVE STRUCTURES WHILE CIRCUMVENTING THE ANTIRUST LAWS. 5

A. MasterCard And Its Member Banks Realized That Antitrust Enforcement Threatened To Slash Issuer Revenue And Impose Enormous Liability On Them. 6

B. After Concluding That Alternative Fee-Setting Mechanisms Deprived The Banks Of Control, Old MasterCard's Bank-Controlled Board Of Directors Decides To Conduct An IPO With A Three-Class Share Structure. 7

1. The Member Banks on Old MasterCard's Board Evaluated Restructuring Options According To Projected Antitrust Protection And Bank Control. 7

2. MasterCard's Board Adopted a Three-Class Voting Structure, Ownership Restrictions, and Bank Veto Rights to Preserve Bank Control. 8

C. The Member Banks That Controlled Old MasterCard Gave Away MasterCard's Right Of Assessment Without Adequate Consideration. 10

III. THE MEMBER BANKS THAT CONTROLLED OLD VISA ALSO SOUGHT A RESTRUCTURING SOLUTION TO TRY TO AVOID ANTITRUST LIABILITY WHILE PRESERVING THE ABILITY OF NEW VISA TO TRANSFER INTERCHANGE FEES FROM MERCHANTS TO ISSUERS. 11

A. Visa's Management And Bank Directors Admitted That Their Business Model Was "Fraught With Risk" And Threatened Ruinous Monetary Damages... 11

B. Visa Management And Member-Bank Directors Decided To Alter Visa's Corporate Form While Leaving Intact The Anticompetitive Business Model That The Member Banks Had Created.. 12

C. Visa Adopts a Multi-Class Share Structure Similar to MasterCard's................. 14

1. Ownership Restrictions, Supermajority Voting Provisions And Veto Rights Give Banks The Ability To Prevent Changes In Visa's Core Business.. 14

2. Visa And Its Member Banks Adopt A Retrospective Responsibility Plan That Guarantees Bank Control Over The Future Of Visa's Business. 16

IV. THE VISA AND MASTERCARD RESTRUCTURINGS THREATEN TO SUBSTANTIALLY LESSEN COMPETITION. 16

A. The Restructurings Created New Single Entities With Market Power In The Relevant Markets And The Ability To Continue Setting Supracompetitive Interchange Fees. 16

B. The Ownership And Control Restrictions Constitute Barriers To Entry That Protect The Networks' Ability To Charge Supracompetitive Fees............ 18

C. Through Their Restructurings, Visa and MasterCard Perpetuate A Market Structure In Which The Only Possible Method Of Competition For Issuance Is Through Ever Increasing Levels Of Interchange To Issuing Banks... 20

ANALYSIS..20

I. LEGAL STANDARD.. 20

A. Plaintiffs Properly Challenge The Restructurings Under The Antitrust Laws Governing Mergers. 21

B. Section 7 Aims To Prevent Harms To Competition In Their Incipiency. 22

II. THE RESTRUCTURINGS ARE LIKELY TO SUBSTANTIALLY LESSEN COMPETITION. 23

A. The Restructurings Created Single Entities With Market Power In The Relevant Markets. 24

B. The Fifteen Percent Ownership Limitations Constitute Barriers to Entry........ 26

C. The Restructurings Preserve The Member Banks' Control Over The Networks' Fee-Setting Practices. 27

1. The MasterCard Restructuring Provides The Member Banks With A Vehicle To Control New MasterCard. 28

2. The Visa Restructuring Allows The Banks To Continue To Control Visa's Competitive Behavior. 30

III. THE ELIMINATION OF THE SPECIAL ASSESSMENT RIGHT IS A FRAUDULENT CONVEYANCE 32

A. Plaintiffs Were Legally Harmed by the Fraudulent Conveyance. 32

B. Plaintiffs Have Stated A Claim For Actual Fraudulent Conveyance Under Section 276........ 33

1. Plaintiffs' Section 276 Allegations Satisfy Rule 9(b) by pleading actual Fraud with Particularity........ 33

2. Plaintiffs Pleaded Actual Fraudulent Intent........ 34

3. Even if Plaintiffs Did Not Plead Actual Fraudulent Intent, They Adequately Pleaded Badges of Fraud. 35

a. Grossly Inadequate Consideration. 35

b. Close Relationship Between MasterCard and the Member Banks........ 37

c. General Chronology of Events........ 38

d. Impairment of MasterCard's Capital Position 39

e. Bank Defendants' retention of control over MasterCard........ 41

C. Plaintiffs Stated A Claim For Fraudulent Conveyance Under Section 275........ 42

1. Old MasterCard Did Not Receive "Fair Consideration" for Releasing its Special-Assessment Right. ... 43

2. MasterCard Believed that It Would Incur Debts Beyond Its Ability to Pay When It Conveyed the Special Assessment Right. ... 44

CONCLUSION ... 46

TABLE OF AUTHORITIES

Page

Cases

Bon-Ton Stores, Inc. v. May Dep't Stores Co.,
881 F. Supp. 860 (W.D.N.Y 1994) 26

Brown Shoe Co. v. United States,
370 U.S. 294 (1962) 22

Bulkmatic Transp. Co. v. Pappas,
No. 99 Civ. 12070 (RMB)(JCF), 2001 WL 882039 (S.D.N.Y. May 11, 2001) 37

Continental Ore Co. v. Union Carbide & Carbon Corp.,
370 U.S. 690 (1962) 30

F.T.C. v. Elders Grain, Inc.,
868 F.2d 901 (7th Cir. 1989) 23

F.T.C. v. H.J. Heinz Co.,
246 F.3d 708 (D.C. Cir. 2001) 21, 22, 24, 25, 30

F.T.C. v. Procter & Gamble Co.,
386 U.S. 568 (1967) 22, 30

Gafco, Inc. v. H.D.S. Mercantile Corp.,
263 N.Y.S.2d 109 (Civ. Ct. N.Y. City 1965) 41

Geneva Pharms. Tech. Corp. v. Barr Labs. Inc.,
386 F.3d 485 (2d Cir. 2004) 24, 25

Grace Plaza of Great Neck, Inc. v. Heitzler,
770 N.Y.S.2d 421 (N.Y.. App. Div. 2003) 44

Hasset v. Goetzmann,
10 F. Supp. 2d 181 (N.D.N.Y. 1998) 36, 39

HBE Leasing Corp. v. Frank,
48 F.3d 623 (2d Cir. 1995) 33, 44

In re Bennett Funding Group, Inc.,
220 B.R. 743 (Bankr. N.D.N.Y. 1997) 35

In re Borriello,
329 B.R. 367 (Bankr. E.D.N.Y. 2005) 43

In re Brosnahan,
324 B.R. 199 (Bankr. W.D.N.Y. 2005) 44

In re Checkmate Stereo & Electronics, Ltd.,
9 B.R. 585 (Bankr. E.D.N.Y. 1981)... 44

In re Kaiser,
722 F.2d 1574 (2d Cir. 1983)... 34, 39, 41

In re Murphy,
331 B.R. 107 (Bankr. S.D.N.Y. 2005) 32

In the Matter of Evanston Northwestern Healthcare Corporation,
Opinion of the Commission, Docket Number 9315 (F.T.C. Aug. 2007) 25

Kramer v. Time Warner Inc.,
937 F.2d 767 (2d Cir. 1991).. 21

Lippe v. Bairnco Corp.,
99 Fed. Appx. 274 (2d Cir. 2004)... 33, 40, 41

Marine Midland Bank v. Murkoff,
120 A.D.2d 122 (N.Y. App. Div. 1986) 38, 41

McTamney v. Stolt Tankers & Terminals (Holdings), S.A.,
678 F. Supp. 118 (E.D. Pa. 1987) 27, 32

Mills v. Everest Reinsurance Co.,
410 F. Supp. 2d. 243 (S.D.N.Y. 2006).. 42

N. Sec. Co. v. United States,
193 U.S. 197 (1904).. 25

Newman & Schwartz v. Asplundh Tree Expert Co., Inc.,
102 F.3d 660 (2d Cir. 1996).. 21

Official Committee of Asbestos Claimants of G-I Holdings, Inc. v. Heyman,
277 B.R. 20 (Bankr. S.D.N.Y. 2002) 33, 39

Pen Pak Corp. v. LaSalle Nat'l Bank of Chicago,
658 N.Y.S.2d 407 (N.Y. App. Div. 1977) 39

R.C. Bigelow, Inc. v. Unilever N.V.,
867 F.2d 102 (2d Cir. 1989).. 22

Reading Int'l, Inc. v. Oaktree Capital Mgmt, LLC,
317 F. Supp 2d 301 (S.D.N.Y. 2003)... 23, 24

Reyn's Pasta Bella v. Visa U.S.A., Inc.,
C-02 3003 (N.D. Cal. Jun 24, 2002) 6

Roth v. Jennings,
489 F.3d 499 (2d Cir. 2007)... 21

Shelly v. Doe,
671 N.Y.S. 2d 803 (N.Y. App. Div. 1998) 44, 45

SIPC v. Stratton Oakmont,
234 B.R. 293 (Bankr. S.D.N.Y. 1999)... 33, 35, 38

Southern Indus. v. Jeremias,
411 N.Y.S.2d 945 (N.Y. App. Div. 1978) 43

Subaru Distribs. Corp. v. Subaru of Am., Inc.,
425 F.3d 119 (2d Cir. 2005)... 21, 29

Sullivan v. Kodsi,
373 F. Supp. 2d 302 (S.D.N.Y. 2005).. 35, 39

Sullivan v. NFL,
34 F.3d 1091 (1st Cir. 1994).. 26, 34

United States v. 58th St. Plaza Theatre, Inc.,
287 F. Supp. 475 (S.D.N.Y. 1968).. 37

United States v. Addyston Pipe & Steel Co.,
175 U.S. 211 (1899).. 21, 25

United States v. Columbia Pictures Industries, Inc.,
507 F. Supp. 412 (S.D.N.Y. 1980)... 23, 27

United States v. Dairy Farmers of Am.,
426 F.3d 850 (6th Cir. 2005) 27, 28, 31

United States v. E.I. du Pont de Nemours & Co.,
366 U.S. 316 (1961).. 27, 29, 30, 31

United States v. McCombs,
30 F.3d 310 (2d Cir. 1994).. 34, 43

United States v. Philadelphia Nat'l Bank,
375 U.S. 341 (1963).. 27

Vantico Holdings S.A. v. Apollo Mgmt. LP,
247 F. Supp. 2d 437 (S.D.N.Y. 2003)... 22

Statutes and Rules

15 U.S.C. § 18 .... 23, 25, 32

Clayton Act Section 7 .... 2, 21, 22, 23, 24, 27, 28, 29, 32

Fed. R. Civ. P. 56 34

Fed. R. Civ. P. 8(a) 43

Fed. R. Civ. P. 9(b) 33

New York Debtor and Creditor Law Section 275 .... 32, 42, 43, 44, 45

New York Debtor and Creditor Law Section 276 .... 32, 33, 35, 38, 41

Sherman Act Section 1 .... 3, 21, 22

Other Authorities

Areeda & Hovenkamp,
Antitrust Law § 902a2 .... 21, 23, 24, 25, 32

Lawrence A. Sullivan & Warren S. Grimes,
The Law of Antitrust § 9.1 (2000) 21

Testimony of Timothy J. Muris On Behalf of the Electronic Payments Coalition,
Before The Subcommittee On Commerce, Trade, And Consumer Protection
Of The Committee On Energy And Commerce, House Of Representatives,
February 15, 2006, "The Law And Economics Of Interchange Fees" ("a fixed
interchange fee is essential") 16

Victor Fleischer, *The MasterCard IPO: Protecting the Priceless Brand*,
12 HARV. NEGOTIATION L. REV. 137 (2007) 31

INTRODUCTION

America's largest banks have long conspired through the Visa and MasterCard Networks to impose supracompetitive interchange fees on merchants for each transaction made with a Visa or MasterCard product, and further conspired to stifle the usual operation of price signals by preventing merchants from steering consumers to cheaper forms of payment. This bank-created market structure was threatened by decisions of courts, regulatory agencies, and central banks throughout the world that deemed the old networks "structural conspiracies" of competing banks. But instead of conforming their conduct to the law, the Visa and MasterCard banks reorganized themselves to create "single entities," that would continue to impose supracompetitive interchange fees on merchants, but — they believed — without the threat of antitrust regulation. Fearful they would lose control over the New Visa and New MasterCard and the vast streams of interchange revenue that they provide, the banks imposed restrictions on the new entities to guarantee that the New Networks would continue to transfer supracompetitive fees from merchants to issuers.

In addition, the Old MasterCard member banks defrauded the class as well as the public owners of New MasterCard stock through two interconnected transactions. First, the bank-controlled Board removed MasterCard's ability to assess the member banks to satisfy a judgment in this litigation, in exchange for a one-time payment of $650 million. Second, the banks on Old MasterCard's board voted to redeem their stock in Old MasterCard with the proceeds from an IPO. As a result of these two separate but interrelated transactions, MasterCard was left with very little cash to pay a judgment or settlement in this litigation. Because of its weakened financial position, New MasterCard is dependent on its member banks for its solvency, which further entrenches the banks' control over New MasterCard.

Class Plaintiffs ("Plaintiffs") challenge the formation of the New Visa and MasterCard as illegal acquisitions and combinations under Section 7 of the Clayton Act and Section 1 of the Sherman Act, respectively, and also challenge MasterCard's release of its assessment right as a fraudulent conveyance under New York law. Responding with corporate-law definitions of control, Defendants argue that their restructurings cannot harm competition because they purportedly do not allow the banks to "control" the New Networks. But the Defendants' arguments are inapplicable to an antitrust analysis, which focuses on the influence that an acquisition allows a firm to exert over the competitive decision making of another firm. And more fundamentally, Defendants' arguments ignore the fact that even an "independent" New Visa or New MasterCard could harm competition by imposing and continuing to increase interchange fees, and by maintaining the anticompetitive rules. Plaintiffs have also alleged sufficient facts to demonstrate that the Old MasterCard banks released the right of special assessment for inadequate consideration and thus engaged in a fraudulent conveyance. For these reasons and all the other reasons set forth below, Defendants' motions to dismiss should be denied.

FACTUAL BACKGROUND

I. VISA, MASTERCARD, AND THEIR MEMBER BANKS CONTROL LED THE RELEVANT MARKETS BY ADOPTING ANTICOMPETITIVE RESTRAINTS.

A. Issuing Banks Have Historically Controlled The Networks.

Since their beginnings, Visa and MasterCard (collectively "the Networks") have operated as consortia of competing banks, and have been controlled by the large banks that participated in their governance and issued cards over their networks. (SSC ¶ 37; ASC ¶ 31.) Before the

Restructurings,[1] the Networks' Boards of Directors were composed exclusively of representatives from the member banks. (SSC ¶ 38; ASC ¶¶ 46, 48.) Importantly for the present motion, the banks took advantage of this structure to establish rules requiring the payment of an interchange fee on every transaction, implemented uniform schedules of default interchange fees and adopted rules that hinder merchants from avoiding these high fees. (SSC ¶¶ 38, 44, 46; ASC ¶¶ 46-47, 51.) As Visa and MasterCard's market power increased, their member banks collectively raised interchange fees to increasingly supracompetitive levels. (SSC ¶ 43; ASC ¶ 45.) But for the banks' collective exercise of market power through the Visa and MasterCard Boards, they would not have been able to require the payment of default interchange fees or raise those fees to supracompetitive levels. (*E.g.,* SSC ¶¶ 47-48, ASC ¶¶ 53-54).

The combination of the networks' market power and their rules, such as the Honor-All-Cards Rule, the rule requiring the payment of an interchange fee, and the rules that impose the Anti-Steering Restraints, has created markets in which the only way the networks can compete is by continually increasing the interchange fees transferred from merchants to their issuing banks. (SSC ¶¶ 40, 45, 76; ASC ¶¶ 42, 45.) If these were competitive markets, merchants could use ordinary market responses such as declining high-priced cards or charging a fee to consumers who used those cards to exert downward pressure on interchange fees. (SSC ¶¶ 54, 56; ASC ¶¶ 60, 62.) But the networks' collusive practices and their market power prevented competition from acting in the usual fashion to reduce interchange fees. Plaintiffs have alleged throughout the pleadings that these practices harm merchants by inflating the costs elevating the price they pay for card-acceptance services.

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[1] The supplemental complaints define the term "Restructuring[s]" as "the series of agreements and transactions entered into by [the old networks] and [their] Member Banks, the goal of which was to transform [the networks] from [] "structural conspiracy[ies]" to [] "single entit[ies]," whose Interchange-Fee-setting activity Defendants hoped would be outside the reach of Section 1 of the Sherman Act." (ASC ¶ 22g; *see also* SSC ¶ 18f.)

B. Before Their Restructurings, Visa And MasterCard Had Been Adjudicated To Be Structural Conspiracies.

Courts, competition authorities, and central banks across the globe began investigating Old Visa and Old MasterCard's structure and conduct of Visa and MasterCard in the late 1990s. Every significant investigation concluded that Old Visa, Old MasterCard, and their member banks abused their collaborative structure and the collective market power. Findings that were adverse to Defendants in the past decade include:

- The United States District Court for the Southern District of New York concluded that Visa and MasterCard possessed market power, and that their rules that prevented member banks from issuing American Express or Discover cards unreasonably restrained trade. *United States v. Visa USA, et al.*, 163 F. Supp. 2d 322 (S.D.N.Y. 2001) The Second Circuit affirmed and rejected the Defendants' argument that they should be treated as single entities under the antitrust laws and determined instead that the two networks' rules constituted collusive actions among competitors. 344 F.3d 229, 242 (2d Cir. 2003);

- In 2003, this Court issued a summary judgment opinion in a merchant class action challenging portions of Visa and MasterCard's Honor-All-Cards Rule and concluded among other things that Visa possessed market power in the Credit and Debit Card markets as a matter of law and that evidence existed to support a finding that MasterCard also possessed market power. *In re Visa Check and Master Money Antitrust Litigation*, No. 96-cv-5238, 2003 WL 1712568, *3-*4 (E.D.N.Y. Apr. 1, 2003);

- In 2000 and 2003, the European Commission filed Statements of Objections[2] against Visa and MasterCard, respectively, claiming that the networks' collectively-set interchange fees violated Article 81(1) of the E.C. Treaty, the European Commission's counterpart to § 1 of the Sherman Act. Visa settled the European Commission's action by reducing its interchange fees by over 50 percent to just 70 basis points. The MasterCard proceeding culminated in a December 19, 2007 decision by the European Commission that MasterCard's cross-border interchange fee violated Article 81 because it was not necessary to the functioning of a payment card network (SSC ¶¶ 65-67;)

- In 2003, the Reserve Bank of Australia ("RBA") found that Visa and MasterCard's interchange fees were established collusively among competing

[2] Under European Commission law, a "statement of objections" is the equivalent to a civil complaint by the Department of Justice on FTC.

banks, designated the networks for regulation, and ordered them to greatly reduce their domestic Interchange Fees. (ASC ¶ 77; SSC ¶ 73;)

- In 2005, the United Kingdom's Office of Fair Trading ("OFT") found that MasterCard's domestic interchange fees violated the U.K. equivalent of Section 1 of the Sherman Act. (ASC ¶ 74; SSC ¶ 71.) In addition to finding that MasterCard had market power in the relevant markets, the OFT found that the interchange fee was not necessary to the functioning of the MasterCard network and was used to extract extraneous costs from merchants, *i.e.* those not necessary to the functioning of a payment card network. (ASC ¶ 76; SSC ¶ 72.)[3]

II. THE PROCESS LEADING UP TO THE RESTRUCTURINGS DEMONSTRATES THAT VISA AND MASTERCARD INTENDED TO PRESERVE THEIR ANTICOMPETITIVE STRUCTURES WHILE CIRCUMVENTING THE ANTIRUST LAWS.

Old Visa, Old MasterCard, and their member banks heard the drumbeat of civil litigation and regulatory proceedings concluding that the networks were structural conspiracies. (ASC ¶¶ 63-78; SSC ¶¶ 57-73, 97.) The Defendants understood that the networks' association structure, if left unchanged, would have been undone by regulatory challenges and could lead to ruinous antitrust liability. (ASC ¶¶ 82-84; SSC ¶¶ 74-77.) Thus, the networks undertook their restructuring efforts with the primary purpose of maintaining the anticompetitive market structure that they had created but free of antitrust scrutiny. (ASC ¶ 104; SSC ¶¶ 78-80.) Far from being "factual clutter," Plaintiffs' allegations demonstrate that the primary goal of Defendants' restructuring transactions was to preserve their ability to extract supracompetitive interchange fees from merchants.

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[3] The decision of the OFT was vacated on appeal on a procedural issue, but the OFT then began a new proceeding.

A. MasterCard And Its Member Banks Realized That Antitrust Enforcement Threatened To Slash Issuer Revenue And Impose Enormous Liability On Them.[4]

By March 2004, opt-out plaintiffs in the *Visa Check* action had amended their complaints to assert interchange-fee price-fixing claims against Visa and MasterCard in federal court in San Francisco. (ASC ¶ 69;) s*ee also*, Compl., *Reyn's Pasta Bella v. Visa U.S.A., Inc*., C-02 3003 (N.D. Cal. Jun 24, 2002). Around this time, Old MasterCard's CEO and COO had publicly acknowledged that antitrust enforcement threatened MasterCard's ability to continue transferring funds from merchants to issuers. (*Id.* ¶¶ 80-81, 84.) MasterCard executives and board members also expected by this time that MasterCard and its banks would face a "tsunami" of damage claims in U.S. class-action litigation challenging interchange fees. (*Id.* ¶ 116.)

MasterCard's consultant, Boston Consulting Group, estimated MasterCard's potential damages arising from an interchange litigation event at $200 billion and a system loss of interchange revenue at $16 billion annually. (*Id.* ¶¶ 5, 9.) MasterCard was also aware of independent analyses reinforcing its risk assessments. (*Id*. ¶ 91.) For example, a 2004 Morgan Stanley analysis, titled "Attacking the Death Star" pointed out that adoption of the Australian-payment-card reforms in the United States would cause a multi-billion dollar decrease in annual Interchange revenue to banks. (*Id*. ¶ 177.)

Thus, in November 2004, the MasterCard Board of Directors passed a resolution stating that, "MasterCard in its current form may not be an acceptable alternative" and that a new governance and ownership structure needs to "significantly mitigate antitrust risks." (ASC ¶ 103)

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[4] The factual record with respect to the MasterCard restructuring is more complete than the record with respect to Visa's restructuring because MasterCard went first and did not anticipate an antitrust challenge to its restructuring, and thus was less careful to shield its analyses and decision-making through use of the attorney-client privilege. By the time that Visa intensified its restructuring planning, it knew that Class Plaintiffs had sued MasterCard over its restructuring and what the Class' legal theories were. Visa shielded much more information through the use of attorney-client privilege and was less candid about its goals and motivation than was MasterCard.

The board spent the next several months examining various corporate structures, arriving at a solution whereby MasterCard would undertake an IPO. (*Id.* ¶ 121.)

B. <u>After Concluding That Alternative Fee-Setting Mechanisms Deprived The Banks Of Control, Old MasterCard's Bank-Controlled Board Of Directors Decides To Conduct An IPO With A Three-Class Share Structure.</u>

1. The Member Banks on Old MasterCard's Board Evaluated Restructuring Options According To Projected Antitrust Protection And Bank Control.

Realizing that they could not continue to collusively establish uniform schedules of default interchange fees without facing catastrophic liabilities, the banks on Old MasterCard's board and management first examined alternative fee-setting mechanisms. (*Id.* ¶¶ 96-105.) But these alternatives were rejected because they would cause the banks to cede too much control over the setting of interchange fees and merchant rules. (*Id.* ¶¶ 98-100.)

When they began considering restructuring in earnest, the MasterCard Board and its Nominating and Corporate Governance Committee — both of which consisted of bank representatives and MasterCard's CEO — evaluated potential restructuring options based on factors such as the likelihood of achieving the dual goals of protection from antitrust liability and the preservation of bank control (referred to, respectively, as "U.S. Antitrust Certainty" and "Takeover Protection.") (*Id.* ¶¶ 133-34.) "U.S. Antitrust Certainty" was determined according to MasterCard's "90% standard," which required that a new business structure have 90 percent probability that a post-restructuring antitrust challenge would be dismissed without a trial on the merits. (*Id.* ¶¶ 114, 118, 133, 136.)

Old MasterCard considered but rejected several options that imperiled member bank control over MasterCard, including selling the company to private equity investors or selling a 70 percent equity stake in the New MasterCard to the public. (ASC ¶¶ 142-46.)

2. MasterCard's Board Adopted a Three-Class Voting Structure, Ownership Restrictions, and Bank Veto Rights to Preserve Bank Control.

Old MasterCard's Board ultimately settled on an IPO with a three-tier voting structure, after concluding that it: (a) satisfied the "90% standard" by protecting Old MasterCard and its member banks from future antitrust liability, and (b) guaranteed that the new entity would act in the Banks' interests. (ASC ¶¶ 122; 133-134.) As MasterCard's CEO and General Counsel explained to the MasterCard Europe Board, "[c]ombined with the other governance provisions, this [structure] should be sufficient to demonstrate to a court that the structural conspiracy previously found to exist by the courts in the United States has been terminated" and that the new entity would continue to operate in the interests of the banks. (ASC ¶ 133.) MasterCard's bank-controlled Board chose this option even though the Ownership and Control Restrictions would depress MasterCard's public share value. (ASC ¶ 146.)

Under the Restructuring plan, Old MasterCard redeemed member banks' shares and New MasterCard issued three classes of shares that entailed different rights and ownership restrictions. (ASC ¶¶ 124-129.)

MasterCard Class A shares, constituting a 41 percent equity share in the company, were sold to the public. (ASC ¶ 125.) MasterCard Class B shares, constituting 41 percent equity ownership, were issued only to member banks. (ASC ¶¶ 125, 128.) Class B shares were transferable only among member banks for four years after the IPO, after which they could be sold to outside investors. (*Id.*) If Class B shares were sold to non-bank investors those shares would automatically convert to Class A shares. (*Id.*) By redeeming their shares in Old MasterCard and obtaining Class B shares in New MasterCard, the MasterCard member banks took substantial profits from the MasterCard Initial Public Offering. (ASC ¶¶ 121, 126.) The vast majority of the money raised from the IPO went to the banks, with MasterCard holding back one

billion dollars ($650 million after taxes) to use for costs of litigation related to pre-IPO conduct. (ASC ¶¶ 125-26.) Class M shares gave he member banks the right to elect 25 percent of the board and exclusive rights to veto significant company decisions, including (i) a sale of the Company's assets; (ii) a merger or consolidation of the Company; (iii) a waiver of beneficial owner limitations; and (iv) ***any discontinuation of the core payments business.*** (ASC ¶ 129.)

In addition to the Three-Class voting structure, and in order to further ensure the continued flow of interchange revenue to member banks from merchants, as part of the Restructuring the bank-controlled MasterCard Board imposed "Ownership and Control Restrictions" cementing member bank control over New MasterCard. (ASC ¶¶ 134-37.) One restriction prevents any single shareholder or a group of shareholders from owning more than a 15 percent stake in New MasterCard. (ASC ¶127.) This restriction was designed to address the member banks' specifically-articulated concern in January 2005 that the New MasterCard not be taken over by an entity that was hostile to their interests in preserving high interchange fees, such as "a non-bank, for instance a large retailer." (ASC ¶ 142.) The same concern is also was also articulated by a Citigroup executive who noted that the Restructuring needed "to safeguard who owns/controls the company if not the Banks" and expressed concern over "[w]hat [would] happen [] if Wal-Mart or Microsoft want[ed] to buy it?" (ASC ¶ 143.) In relaying his conversations, the Citigroup executive said that MasterCard's COO "seemed very clear that any new MasterCard needed to protect and even increase Interchange to keep and attract Banks." (*Id.*)

MasterCard also granted the member banks special rights to continue to exert control over MasterCard by issuing each bank one Class M share. (ASC ¶ 138-40.) Class M share ownership, which is exclusive to the member banks, confers the right to veto certain transactions

such as an acquisition of MasterCard or a sale of substantially all of its assets. (ASC ¶¶ 127, 129.) But the key Class M right allows a majority vote of the Class M shares – *i.e.*, banks – to prevent MasterCard's exit from the "core payments business." (ASC ¶ 138.) MasterCard and its member banks believed that the "core payments business" included the setting of interchange fees; therefore, granting this right exclusively to the member banks was vital to continuing the flow of supracompetitive fees from merchants to issuers. (ASC ¶¶ 138-40.) In their motion to dismiss, Defendants dispute that the Class M rights allow them to block the elimination of interchange and thereby ask the Court to resolve a fact issue in their favor on a Rule 12 motion. (MC Br. at 11-12.) Defendants support their view of the facts by pointing to Class Plaintiffs' allegation that interchange fees are not in fact a core function of operating a payment-card network. (*See* MC Br. at 12 (citing SCACAC ¶ 176).) But because the veto right rests with the banks and the banks' perceptions will ultimately determine how they use their Class M rights, it is irrelevant whether interchange *is actually* a core function of a payment-card network.

C. The Member Banks That Controlled Old MasterCard Gave Away MasterCard's Right Of Assessment Without Adequate Consideration.

Even if they were successful in restructuring away their prospective antitrust liability, the banks that sat on MasterCard's Board of Directors knew that New MasterCard could still face hundreds of billions of dollars in liability for its past fee-setting practices that could potentially render it insolvent. (ASC ¶¶ 174, 177.) The potential liability to MasterCard was a real concern to the banks because Old MasterCard had a "Right of Special Assessment" that allowed it to assess its member banks for losses flowing from, among other things, litigation judgments. As fully described in Section III below, Old MasterCard released this Right of Special Assessment in exchange for holding back from Member Banks $650 million of the IPO proceeds. (ASC ¶¶ 125-26.) The bank-representative directors in Old MasterCard recognized the holdback was

wholly inadequate consideration for the release of the assessment right because it threatened to leave New MasterCard insolvent if it sustained a damages judgment in this litigation of the magnitude that its restructuring advisors had predicted. (ASC ¶¶ 149d, 177-78, 180.)[5]

In addition to defrauding MasterCard's litigation creditors (*i.e.,* the merchant class), the release of the assessment right has the effect of giving the banks further control over the competitive practices of MasterCard. Without the special-assessment right, New MasterCard could receive only voluntary contributions from the banks if it entered into a settlement or received a judgment that it was unable to pay out of its own funds. (*See* ASC ¶ 205.) Under this scenario – which Old MasterCard's advisors predicted and its directors feared – New MasterCard would be at the mercy of financial contributions from its member banks to remain solvent. (*See id.* ¶¶ 149d, 205.) In this scenario, the banks have tremendous leverage over MasterCard to ensure that it did not agree to any settlement or injunctive relief that contradicted the banks' interest in continued flows of interchange fees from merchants. (*See id.*)

III. THE MEMBER BANKS THAT CONTROLLED OLD VISA ALSO SOUGHT A RESTRUCTURING SOLUTION TO TRY TO AVOID ANTITRUST LIABILITY WHILE PRESERVING THE ABILITY OF NEW VISA TO TRANSFER INTERCHANGE FEES FROM MERCHANTS TO ISSUERS.

A. Visa's Management And Bank Directors Admitted That Their Business Model Was "Fraught With Risk" And Threatened Ruinous Monetary Damages

Even before the 2003 settlement in *Visa Check*, Visa U.S.A.'s management, like MasterCard's understood that the networks' business model was "untenable for the future" because it mandated ever-increasing interchange fees and would ultimately lead to ruinous antitrust liability. (SSC ¶¶ 74-76.) In September 2002, Visa's head of Interchange Strategy

[5] MasterCard's 30(b)(6) designee testified the $650 Million was a "business compromise" not based on any estimate of MasterCard's antitrust liabilities. (ASC ¶ 196 .)

warned a colleague that the Networks' business model which was driven by the banks insatiable demands for interchange revenues was "fraught with risk (*i.e.*, continued [interchange] escalation)" and that "[t]he fact that all of the banks, and their two general purpose acceptance brands, are taking on this risk together should be of no consolation." (SSC ¶ 77.)

After the judicial decisions against the Networks described in Section II.A. above, the prospect of Visa's enormous antitrust liability became more concrete. (SSC ¶ 78.) By 2005, the banks that controlled Visa International and the other Visa regions also understood the impact of the antitrust liability facing Visa in the United States. (SSC ¶ 80.) In January 2005, following a board meeting, the CEO of Visa International wrote, "the Regions now understand that:- [sic] Old Visa's days are numbered. No one can stay as they are. . ." (*Id.*) In December 2005, after these actions were commenced after giving serious consideration to restructuring, Visa estimated that it could suffer catastrophic damages from U.S. class-action lawsuits. (SSC ¶ 79.)[6]

B. Visa Management And Member-Bank Directors Decided To Alter Visa's Corporate Form While Leaving Intact The Anticompetitive Business Model That The Member Banks Had Created.

In a March 2006 presentation discussing Visa's "Future State," Visa U.S.A. acknowledged that merchant litigation could reduce interchange fees to par, and sought ways to reinvent interchange fees as another form of transfer payment from merchants to issuers. (SSC ¶ 93.) Visa management considered whether it could "[m]anage merchant discount to provide merchants with more certainty and control; provide issuer revenue, *not necessarily interchange.*" (*Id.*) Because this would cause Old Visa's member banks to lose control over interchange, the member banks dismissed this proposal and decided instead to maintain Old Visa's

[6] Old Visa's precise calculation is available in the nonpublic version of the Second Supplemental Complaint ¶ 79.

anticompetitive business model and interchange fee practices while simply altering Visa's corporate form. (SSC ¶ 94.)

In April 2006, in an attempt to "strengthen Visa's position with regard to legal issues concerning the impartiality and autonomy of directors," Old Visa adopted the "interim solution" of adding four "independent" directors (persons not employed by member banks) to the Visa U.S.A. board and nominally delegating the authority for approving interchange fees to those "independent" directors. (SSC ¶¶ 83, 95-96.) Visa admitted, however, that nothing about its interchange-setting methodology changed with the appointment of the "independent" directors. (SSC ¶ 101.)

Pre-restructuring discussions also demonstrate that Visa intended to maintain its anticompetitive issuer-centric business model even after its restructuring. In early 2006, in the course of its "MasterCard IPO Intelligence Initiative," Visa discovered that its member banks perceived MasterCard's IPO as an effort to "mitigate future litigation," and that their "big question [was] when will Visa do the same thing?" (*Id.*) Additionally, Visa's dual-issuer member banks were primarily concerned that MasterCard might subvert its member banks' interests to those of its shareholders, causing the banks to "lose control" over MasterCard. (SSC ¶ 103.) To address this concern, the member banks intended to cede only the minimum amount of control necessary to create the appearance that Visa was a "single entity," while ensuring that Visa would continue its bank-focused strategy. (SSC ¶ 104.)

Visa's management informed the member banks that their interests would continue to drive Visa, even after restructuring. For example, Visa informed the head of Chase's payment strategy group, Vincent D'Agostino, that it preferred certain reorganization options "because it will take a full vote of the membership (12-14M banks) to change anything about how Visa

operates – so Visa believes it will always remain bank/issuer centric." (SSC ¶ 105.) Similarly, Chase's representative on the Visa U.S.A. board stated that he understood that Chase would retain effective control over Visa's "structure and governance" even after the installation of the "independent" directors. (SSC ¶¶ 106-07.) As Mr. D'Agostino expressed, Chase was concerned with preventing Visa from "becoming a competitor." (SSC ¶ 107.)

C. Visa Adopts a Multi-Class Share Structure Similar to MasterCard's.

Under Visa's Restructuring, the Visa regions first engaged in a series of mergers that resulted in two entities: Visa, Inc. and Visa Europe.[7] (SSC ¶ 113.) These transactions were completed by October 3, 2007. (*Id.*) Next, on March 18, 2008, Visa, Inc. conducted an Initial Public Offering of 406,000,000 Class A shares. (SSC ¶ 114.) By redeeming the member banks' shares and reclassifying them as publicly-held Class A shares, Visa, Inc. effectively purchased the member banks' shares in Old Visa. (*Id.*) In exchange, the member banks also received a large portion of the IPO proceeds, as well as Class B and C shares in Visa, Inc. (SSC ¶ 114-15.)

1. Ownership Restrictions, Supermajority Voting Provisions And Veto Rights Give Banks The Ability To Prevent Changes In Visa's Core Business.

As they had done with MasterCard, Old Visa's member banks placed restrictions on New Visa to preserve the market structure that fostered the transfer of funds from merchants to issuing banks at supracompetitive levels. (*Id.* ¶ 116.) New Visa's board of directors was granted the authority to prevent any non-Bank shareholder from owning more than 15% of the aggregate shares of Class A common stock. (*Id.* ¶¶ 116, 128.) As holders of Class B and C shares, Visa's member banks are empowered to elect 6 of 17 directors, until the latter of (a) three years

[7] Visa U.S.A., Visa Canada and Innovant, LLC became subsidiaries of Visa, Inc., which then issued common stock to the Member Banks of Visa U.S.A., Visa Canada, Visa International, Visa Europe and Visa Europe's subsidiary, VESI. (SSC ¶ 113.)

following the IPO, or (b) the conclusion of this litigation. (*Id.* ¶¶ 116, 118.) Continued Member Bank presence on New Visa's Board of Directors ensures that this ownership limitation will not be overridden. (*Id.* ¶ 129.)

Visa member banks have veto power over certain extraordinary transactions relating to the consolidation or merger of Visa, Inc. (*Id.* ¶ 117.) These changes would require the approval of an 80% supermajority of voting shares. (SSC ¶ 117.) Because Visa member banks retain well over a 20% equity stake in New Visa through their ownership of Class B and C shares, the banks can collectively block any action of New Visa's "independent" board that would threaten their interests, such as the merger of Visa or New Visa's exit from the "discontinuation of the core payments business."[8] (*Id.* ¶¶ 151-54.) As holders of Class B and C stock, Visa's member banks have the power to prevent any changes to Visa Inc.'s Certificate of Incorporation that would remove this veto right. (*Id.* ¶ 117.)

Plaintiffs allege that the member banks could use this veto right to block an attempt by Visa to eliminate interchange fees. (*Id.* ¶ 133.) The banks may accomplish those ends by invoking the *de facto* veto right that their Class B and C shares confer to prevent Visa from exiting the "core payments business." (*Id.*) On October 3, 2007, after Plaintiffs challenged New MasterCard's "Class M" veto right, Visa amended its certificate of incorporation to define exiting the core payments business as "no longer operat[ing] a consumer debit/credit payments business."[9] Even though Visa, unlike MasterCard, purported to define the "core payments business," its definition could nonetheless allow the banks to attempt to block an attempt by New Visa to eliminate interchange fees. The banks could accomplish this by arguing, as they and Visa

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[8] Immediately following the Visa IPO, there were over 956 million outstanding shares of Visa, Inc., of which approximately 555 million shares were classified under the bank-owned classes B and C.

[9] *Compare* Visa, Inc., Amendment No. 5 to Form S-1 Registration Statement (Form S-1/A) § 4.7(b) (Oct. 3, 2007); *with* Visa, Inc. Amendment No. 4 to Form S-1 Registration Statement (Form S-1/A) § 4.7(b) (Jul. 24, 2007).

have argued before courts and regulatory agencies, that interchange is necessary to the functioning of a payment-card network and therefore that without interchange Visa could not "operate a consumer debit/credit payments business." (Testimony of Timothy J. Muris On Behalf of the Electronic Payments Coalition, Before The Subcommittee On Commerce, Trade, And Consumer Protection Of The Committee On Energy And Commerce, House Of Representatives, February 15, 2006, "The Law And Economics Of Interchange Fees," p. 11 ("a fixed interchange fee is essential"); ASC ¶ 139.)

2. Visa And Its Member Banks Adopt A Retrospective Responsibility Plan That Guarantees Bank Control Over The Future Of Visa's Business.

In the course of restructuring, Visa U.S.A. and its member banks also adopted a Retrospective Responsibility Plan. (SSC ¶ 120.) Under this plan, the signatory banks fixed their respective monetary liabilities arising from any judgment against them or Visa in this litigation. (*Id*.) The purpose of this agreement is to fix, at an artificially low level, the rebates provided to Class Members for interchange fee overcharges resulting from the Defendants' conduct challenged in this litigation. (*Id*.) The Retrospective Responsibility Plan also creates a Litigation Committee appointed by the Visa U.S.A. member banks and composed of representatives of U.S. banks. (*Id*. ¶ 121.) One of the Litigation Committee's responsibilities is to make recommendations regarding settlement in this litigation. (*Id*.) Accordingly, the Litigation Committee provides yet another mechanism through which the member banks can control Visa.

IV. THE VISA AND MASTERCARD RESTRUCTURINGS THREATEN TO SUBSTANTIALLY LESSEN COMPETITION.

A. The Restructurings Created New Single Entities With Market Power In The Relevant Markets And The Ability To Continue Setting Supracompetitive Interchange Fees.

Depending on the definition of the relevant market, the Reorganizations had the effect of either mergers to monopoly or the creation of two firms with substantial market power in the

relevant markets. (*Id*. ¶ 143; ASC ¶ 156.) Given their substantial market power, the New Visa and New MasterCard Boards of Directors have the power to unilaterally determine (a) the interchange fees that will be transferred from merchants to issuers, and (b) what, if any, services that issuers will offer to merchants in exchange. (SSC ¶ 146; ASC ¶ 159.) Plaintiffs have alleged — and are prepared to establish at trial — that uniform schedules of default interchange fees would not exist in a market untainted by Defendants' anticompetitive conduct. (SSC ¶¶ 144-45; ASC ¶¶ 157-58.) Before the Restructuring, these supracompetitive fees could be imposed only via collusion among member banks, acting through the networks' Boards of Directors. (SSC ¶ 146.) In other words, the restructured networks consolidated the rate-setting authority previously held by a consortium of member banks into "single entities" with market power and the attendant ability to continue increasing interchange fees. (*Id*. ¶¶ 138-39; ASC ¶¶ 150-51.)

Visa and MasterCard have each essentially conceded that their new forms threaten to substantially lessen competition. Documents created by both networks demonstrate that the networks intended to convert themselves into American Express-style "three-party" systems through their restructurings. (ASC ¶ 90.) For many years both Visa and MasterCard have criticized the three-party model as significantly less competitive than the "four-party" association model that Old Visa and Old MasterCard employed. (ASC ¶ 162; SSC ¶¶ 149-150.) Before the Restructuring Visa stated to the FTC that its "structure preclude[d] it or its [member banks] from using interchange to extract supracompetitive profits from consumers." (SSC ¶ 150.) "Because Visa operate[d] on a not for profit basis," Old Visa argued, "the organization itself ha[d] no incentive to use the interchange fee to extract supracompetitive profits." (*Id*. (citing Paul A. Allen, Visa U.S.A., Inc., Comment on Issues Relating to Joint Venture Project at 8 (FTC July 31, 2007)).) Although Old Visa's history of steady, significant interchange fee increases shows that

it could, in fact, extract supracompetitive fees from merchants, Visa's statement to the FTC implies that converting into a for-profit entity enables it to force merchants to pay even higher acceptance fees. (*Id*.) Furthermore, economists retained by both Network Defendants have similarly argued that "[t]here would be far less competition in this industry if Visa and MasterCard had chosen to operate as single companies … as did American Express …." (ASC ¶¶ 160-61; SSC ¶¶ 147-48.) Thus, according to the Networks' own arguments, the Restructurings have resulted in a less competitive payment-card industry. (ASC ¶¶ 160-61; SSC ¶¶ 147-48.)

As predicted by Defendants' lawyers and economists, the market power that the New Visa and New MasterCard "single entities" acquired through the restructuring has allowed both networks to increase the levels of "effective" interchange fees. (SSC ¶¶ 139, 167-169, 187, 191, 201, 210, 218; ASC ¶¶ 151, 220-222, 238, 242, 251; SCACAC ¶ 171.) These increases have not been attributable to any increase in the Networks' operation costs and are not necessary to the efficient functioning of a payment-card network. (SSC ¶ 168; ASC ¶ 221.) New Visa and New MasterCard have also continued to force merchants to accept high-Interchange Premium Credit Cards, which were first implemented before the Restructurings. (SSC ¶ 174; ASC ¶ 226.) Then, as now, merchants have been unable to refuse paying the higher interchange fees on these card products due to the Networks' substantial market power. (SSC ¶ 174; ASC ¶ 226.)

B. <u>The Ownership And Control Restrictions Constitute Barriers To Entry That Protect The Networks' Ability To Charge Supracompetitive Fees.</u>

Each network imposed a 15 percent cap on the ownership interests that any one owner or group of owners could acquire.[10] Thus, if a merchant or merchant joint venture acquired New Visa or New MasterCard, that entity would have an incentive to reduce interchange fees and to

[10] Visa's restriction may be overridden by a vote of its Board of Directors. But because the banks control six of the 17 seats on the Board, an acquisition may be blocked with the vote of only three of the 11 non-bank directors. (SSC ¶ 130.)

eliminate the Network's anticompetitive rules and practices. (SSC ¶ 152; ASC ¶ 165.) Even a non-merchant-owned network could lower interchange fees to compete for merchant acceptance, but for the Ownership and Control Restrictions. (SSC ¶ 153; ASC ¶ 166.) To illustrate, Visa's market capitalization is approximately $34 billion. (SSC ¶ 154.) Interchange fees imposed on merchants by Visa member banks exceed $25 billion annually. (*Id.* ¶ 154; ASC ¶ 167.) If merchants could collectively acquire control of Visa and operate it as a low-fee competitor to MasterCard, they may do so, as long as they could acquire it for less than the present-value cost of interchange fees over several years. (SSC ¶ 154; ASC ¶ 167.) From the perspective of a potential entrant, acquiring control of Visa would be cheaper than starting a new network and securing the necessary merchant and cardholder acceptance.[11] If Visa were acquired, MasterCard would have a strong incentive to lower its interchange fees to compete with Visa for merchant acceptance.[12] (SSC ¶ 155.) Visa and MasterCard documents indicate that Old Visa, Old MasterCard, and their member banks imposed their respective Ownership and Control Restrictions precisely to avoid this possibility. (*See Id.* ¶ 104-07; ASC ¶ 141-44, 163-73.) By preventing potential competition via entry by acquisition, New Visa and New MasterCard protect their ability to transfer fees from merchants to issuers.

Similarly, the networks' multi-class voting structures have the effect of preventing actions that, while they may be in the interests of the new "independent" networks, would be contrary to the banks' interests of receiving supracompetitive fees from merchants. If, for example, MasterCard's "independent" directors wished to discontinue imposing interchange fees

[11] Visa's former CEO, J.P. Coughlan, essentially admitted this in deposition testimony. (SSC ¶ 176.)

[12] This is precisely what American Express was compelled to do in Australia when government intervention substantially reduced Visa and MasterCard's Interchange Fees. (SSC ¶ 155; ASC ¶ 168.) But for the Ownership and Control Restrictions, the reverse scenario would also be plausible, in which Visa would be forced to lower its fees to compete with a merchant-owned MasterCard. (ASC ¶ 167.)

on merchants, the banks could block that move through a majority vote of MasterCard's Class M (bank) shareholders. (ASC ¶¶ 170-72.) Furthermore, as Class M shareholders, the member banks can prevent MasterCard from entering the issuing and acquiring markets, even if doing so would increase MasterCard's revenues. (*Id*. ¶ 172.) Regardless, MasterCard has told its member banks that it has no intention of competing with them. (*Id*.)

C. Through Their Restructurings, Visa and MasterCard Perpetuate A Market Structure In Which The Only Possible Method Of Competition For Issuance Is Through Ever Increasing Levels Of Interchange To Issuing Banks.

The Restructurings are substantially likely to harm competition by breathing new life into an anticompetitive business model that was placed on life support by the threat of antitrust enforcement. Both Visa and MasterCard confirmed that the Restructurings would preserve the issuer-centric focus of both networks. For example, in response to concerns that Citigroup executive, Alan Silverman, raised about losing control of New MasterCard, MasterCard executive, Alan Heuer, reassured him that "any new MasterCard needed to protect and even increase [i]nterchange to keep and attract [b]anks." (ASC ¶ 143.) Similarly, Visa's interchange strategy group admitted that even after "independent" directors began to approve Visa's interchange fees, "the process that [it] go[es] through to develop and deploy interchange enhancements will remain largely the same." (SSC ¶ 101.) In fact, the networks have continued on the course that their member banks set by increasing interchange fees since the restructurings and continuing to enforce the anticompetitive anti-steering restraints.

ANALYSIS

I. LEGAL STANDARD

Plaintiffs incorporate by reference the description of the legal standard on a Rule 12(b)(6) motion, as stated in Section II of Class Plaintiffs' opposition to Defendants' motion to dismiss the Second Consolidated Amended Class Action Complaint.

A Rule 12(b)(6) motion challenges only the face of the pleadings and the court must limit its analysis to the four corners of the complaint. *Newman & Schwartz v. Asplundh Tree Expert Co., Inc.*, 102 F.3d 660, 662 (2d Cir. 1996). In appropriate circumstances, the court may also consider documents attached to the complaint or incorporated by reference, as well as relevant public records such as SEC filings. *Roth v. Jennings,* 489 F.3d 499, 509 (2d Cir. 2007). But if the court considers the movant's SEC filings in the context of a Rule (12)(b)(6) motion, it may do so "'only to determine *what* the documents stated,' and '*not to prove the truth of their contents*.'" *Roth*, 489 F.3d at 509 (quoting *Kramer v. Time Warner Inc.*, 937 F.2d 767, 774 (2d Cir. 1991)) (emphasis in original). When a court considers materials outside the complaint on a Rule 12(b)(6) motion, it is nevertheless constrained to accept as true all factual allegations in the complaint, and must resolve in the plaintiff's favor any ambiguities arising from the external document. *Subaru Distribs. Corp. v. Subaru of Am., Inc.*, 425 F.3d 119, 122 (2d Cir. 2005); *Newman & Schwartz*, 102 F.3d at 662.

A. **Plaintiffs Properly Challenge The Restructurings Under The Antitrust Laws Governing Mergers.**

Plaintiffs properly challenge the Restructurings as unlawful acquisitions under Section 7 of the Clayton Act and the Sherman Act's prohibition on "combinations" in restraint of trade because those laws are concerned with market structures and the creation of firms with market power. *See F.T.C. v. H.J. Heinz Co*., 246 F.3d 708, 713 (D.C. Cir. 2001) (quoting Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust* § 9.1, at 511 (2000)). This case is similar to the cases that led to the genesis of the merger laws, when cartels threatened by the application of Section 1 of the Sherman Act merged as a way of continuing their anticompetitive conduct by way of consolidation. *See* Areeda & Hovenkamp, *Antitrust Law* § 902a2 (describing the fallout of *United States v. Addyston Pipe & Steel Co.*, 175 U.S. 211 (1899), in which the defendants

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merged after being found guilty of conspiring). This Court has already concluded that the Networks' Restructurings are governed by Section 7 of the Clayton Act and Section 1 of the Sherman Act, (Nov. 25, 2008 Op. at 15, 17;) and Defendants do not seriously dispute that the merger laws are the correct analytical lens through which to view their Restructurings.

B. Section 7 Aims To Prevent Harms To Competition In Their Incipiency.

Plaintiffs challenge the restructurings under both Section 1 of the Sherman Act and Section 7 of the Clayton Act. In prior pleadings, Plaintiffs cited treatises and authority from other jurisdictions, which state that the substantive standard governing acquisitions under Section 1 and Section 7 are identical. (Pls.' Mem. Opp'n. Mot. Dismiss Supp. Compl. at 18, Oct. 30, 2006) (citing *Vantico Holdings S.A. v. Apollo Mgmt. LP*, 247 F. Supp. 2d 437, 458 (S.D.N.Y. 2003)). While the Court ultimately disagreed with Plaintiffs' arguments, Plaintiffs respectfully reassert these arguments here to preserve their appeal.

The central focus of Section 7 is preventing the creation of firms with market power. *R.C. Bigelow, Inc. v. Unilever N.V.*, 867 F.2d 102, 107-08 (2d Cir. 1989) (citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 343 (1962)). Since the Clayton Act was amended to its current form, courts have noted that Congress was concerned with "'probabilities [of anticompetitive effects], not certainties.'" *H.J. Heinz*, 246 F.3d at 713 (quoting *Brown Shoe Co.*, 370 U.S. at 323). This is evidenced by the fact that Congress chose the words "*may* be substantially to lessen competition" for the text of the Clayton Act. *Brown Shoe*, 370 U.S. at 323.[13] Because Section 7 focuses on prospective probabilities, there is no requirement that an acquisition "manifest itself in anticompetitive action before § 7 can be called into play." *F.T.C. v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967).

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[13] While the precise holding of *Brown Shoe* is often criticized, its interpretation of the Congressional intent behind § 7 is still relied upon by courts to this day.

Because of the need to arrest anticompetitive aggregations of market power in their incipiency, Section 7 scrutiny intensifies in markets in which there has been a demonstrable history of collusion. 15 U.S.C. § 18; *F.T.C. v. Elders Grain, Inc*., 868 F.2d 901, 905 (7th Cir. 1989) (Posner, J.); *see also* Areeda & Hovenkamp, *supra*, ¶ 944b. And a defense predicated on the lack of competition in the market before the transaction cannot excuse the creation of an anticompetitive market structure through acquisition. *See* Areeda & Hovenkamp, *supra*, ¶ 944b. Further evidence of this principle can be found in *United States v. Columbia Pictures Industries, Inc.*, in which a court found that a transaction between firms can be struck down even when those firms did not compete with each other before the transaction. 507 F. Supp. 412, 434 (S.D.N.Y. 1980).[14] As the United States District Court for the Southern District of New York noted, "[t]he cases uniformly suggest Section 7 was enacted in order to nip antitrust violations in the bud, and to reach potential anticompetitive conduct that was not covered under the Sherman Act." *Reading Int'l, Inc. v. Oaktree Capital Mgmt, LLC*, 317 F. Supp 2d 301, 314-315 (S.D.N.Y. 2003).

V. <u>THE RESTRUCTURINGS ARE LIKELY TO SUBSTANTIALLY LESSEN COMPETITION.</u>

When this Court initially dismissed Plaintiffs' First Supplemental Class Action Complaint, it allowed Plaintiffs to replead to demonstrate harm to competition by either demonstrating that an "independent MasterCard" could harm the Class and competition or that the Restructurings would allow the banks to remain in control of the networks. (Nov. 25, 2008 Op. at 21-28.) Plaintiffs alleged both categories of competitive harm. Plaintiffs allege that the creation of "independent" networks harms competition by creating purported "single entities"

[14] This case was originally brought under Section 1, but the Court's reasoning that the formation of the joint venture lessened competition is equally applicable to analysis under Section 7. *See Columbia Pictures*, 507 F. Supp. at 421.

with market power, which were designed to allow New Visa and New MasterCard to establish rules and uniform schedules of default interchange fees, which previously could have occurred only through collusion among cartels of banks. Plaintiffs also alleged that the Restructurings erect barriers to entry, which have the effect of insulating Defendants' rules and fees from competition. These harms are not dependent upon any finding that the banks continue to control the "new" networks. Moreover, Plaintiffs demonstrate how the Restructurings perpetuate bank control over the "new" networks by cementing in place the anticompetitive market structure that the banks had created through collusion and exclusionary conduct. Each of the harms that is described in the supplemental complaints cause the continuation and escalation of the supracompetitive levels of interchange fees that existed before the Restructurings.

A. The Restructurings Created Single Entities With Market Power In The Relevant Markets.

Visa argues that Plaintiffs' antitrust injury is not caused by the Restructuring itself, but by Visa's post-IPO actions. (Visa Br. at 18-19 (quoting *Geneva Pharms. Tech. Corp. v. Barr Labs. Inc.*, 386 F.3d 485, 511 (2d Cir. 2004).)[15] MasterCard makes a similar argument. (MasterCard Br. at 15.) But these arguments ignore the fact that the Clayton Act is a "prophylactic measure" that is more concerned with market structure than with conduct. *See Reading Int'l*, 317 F. Supp. 2d at 315; *H.J. Heinz*, 246 F.3d at 715; Areeda & Hovenkamp, *supra*, § 944b. And if Visa's argument were correct, no merger challenge could ever survive Rule 12 because, in any merger

[15] In *Geneva.*, the defendant corporation acquired a subsidiary in which it already held 75% ownership. 386 F.3d at 510. Contrary to Defendants' characterization, the court did not fault the plaintiff's Section 7 allegations for challenging the merger itself rather than the post-merger firm's conduct. Rather, the court held that there was no antitrust harm because the challenged merger simply involved "remov[ing] a layer of internal corporate control," meaning that "the acquisition itself had no effect on the degree of concentration or competition in the [relevant] market." *Id.* at 511. *Geneva* stands in stark contrast to the present case, in which Visa's IPO and Ownership and Control Restrictions *created* a single entity, with market power, that intends to charge supracompetitive prices. (SSC ¶¶ 138-139.) Contrary to Visa's assertion, *Geneva* does not stand for the proposition that Section 7 of the Clayton Act would apply only to Visa's post-IPO pricing decisions, not to the merger itself. *Id.*

case, the competitive harm occurs as a result of the post-merger single entity acting in its best interest to charge as high of a price as its market powers allows. Thus, as in any Section 7 case, the relevant question is whether the effect of the transaction "may be substantially to lessen competition, or to tend to create a monopoly." *Geneva*, 386 F.3d at 510 (quoting 15 U.S.C. § 18). When a merger challenge is decided *after* the merger has been consummated, the fact of post-merger price increases is persuasive evidence of anticompetitive effects. *In the Matter of Evanston Northwestern Healthcare Corporation*, Opinion of the Commission at 16-18, Docket Number 9315 (F.T.C. Aug. 2007), *available at* http://www.ftc.gov/os/adjpro/d9315/070806opinion.pdf.

The Restructurings harmed competition because but for the Restructurings, the Networks' supracompetitive interchange fees would be subject to elimination through enforcement of antitrust laws prohibiting collusive activity. (ASC ¶¶ 115, 122, 131, 133-134, 147-148, 154, 160-162; SSC ¶¶ 103, 108, 111, 135-136, 141, 147-149.) Defendants' pursuit of a structural solution to enable them to continue imposing supracompetitive fees is exactly the strategy that the *Addyston Pipe* defendants and the *Northern Securities* defendants pursued over a century ago. *See generally N. Sec. Co. v. United States*, 193 U.S. 197 (1904). Furthermore, since the IPOs, Visa and MasterCard have both increased the levels of interchange fees and continued to enforce their anticompetitive rules and restrictions, with no decrease in merchant acceptance. (SSC ¶¶ 139, 167-169, 187, 191, 201, 210, 218; ASC ¶¶ 151, 220-222, 238, 242, 251; SCACAC ¶ 171.) Contrary to Defendants' arguments, the antitrust laws do not bless this conduct simply because it may be pursued by a "rational" and "profit maximizing" single entity. *See H.J. Heinz*, 246 F.3d at 715; Areeda & Hovenkamp, *supra*, § 944b. Thus, New Visa and New MasterCard have already utilized their market power to profitably elevate interchange fees.

B. The Fifteen Percent Ownership Limitations Constitute Barriers to Entry

Courts have recognized that an acquisition may pose a likelihood of substantially lessening competition when it creates or increases barriers to entry in the relevant market. *See Sullivan v. NFL*, 34 F.3d 1091, 1096-97 (1st Cir. 1994); *Bon-Ton Stores, Inc. v. May Dep't Stores Co.*, 881 F. Supp. 860, 877 (W.D.N.Y 1994). For example, in *Bon-Ton v. May*, a court issued a preliminary injunction against a department-store chain's acquisition of eight stores in Rochester-area malls. *Id*. at 878-79. The court reasoned that the acquisition was anticompetitive because it gave the acquirer two of the only available mall locations, in which the plaintiff could enter the Rochester market. *Id*. at 878. Even though an entrant could conceivably enter at a location other than a mall, the court noted that entering in a mall was the most effective means of entering the market, and therefore that preventing competitors' access to mall slots effectively prevented entry. *Id*.

Plaintiffs have alleged sufficient facts to establish that the networks' Restructurings harm competition by creating barriers to entry into the payment-card market through the acquisition of New Visa or New MasterCard. First, Plaintiffs alleged that the banks that sat on the Old Visa and Old MasterCard boards were concerned that the New Networks would be acquired by a merchant or another entity that did not have their best interests at heart. (ASC ¶¶ 143-45; SSC ¶ 123.) Secondly, Plaintiffs illustrated that, in light of the New Networks' market capitalizations and testimony of Visa's former CEO regarding the cost of *de novo* entry,[16] it may well be easier for a competitor to enter the market by acquiring Visa or MasterCard than by building its own network from the ground up. (SSC ¶ 176.) Thus, by protecting the most effective means of entry into the payment card market, the 15-percent ownership limitations that the restructurings

[16] The precise figure has been omitted from this brief to protect Visa's designation of this testimony as highly confidential.

impose threaten to substantially lessen competition by protecting the interchange fees of the New Networks from competition by a non-issuer-focused entity.

C. **The Restructurings Preserve The Member Banks' Control Over The Networks' Fee-Setting Practices.**

Congress intended to give Section 7 of the Clayton Act a broad reach, to apply to "the entire range of corporate amalgamations, from pure stock acquisitions, to pure assets acquisitions" to everything in between. *United States v. Philadelphia Nat'l Bank*, 375 U.S. 341, 342 (1963). Under this broad standard, an acquisition runs afoul of Section 7 when it transfers "a sufficient part of the bundle of legal rights and privileges to give the transfer economic significance" in a manner that is likely to lessen competition. *United States v. Columbia Pictures Corp.*, 189 F. Supp. 153, 182 (S.D.N.Y. 1960); *see also United States v. Dairy Farmers of Am.*, 426 F.3d 850, 858 (6th Cir. 2005).

Because the key inquiry in a Section 7 case is on the transaction's effect on competition, Section 7 does not require that "control" exist in the corporate sense in order for a transaction to threaten competitive harm. *See United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 329 (1961). Accordingly, the Supreme Court held that the potential for competitive harm remained in place when du Pont, whose acquisition of General Motors stock that the Court previously held to be anticompetitive, retained nonvoting shares in GM and had a "special relationship" with GM by way of its prior stock ownership. *Id.* at 332. And in *McTamney v. Stolt*, a court concluded that a plaintiff had stated a Section 7 claim when it challenged an unconsummated acquisition that gave the would-be acquiring company the ability to control the target's payment of creditors, which according to the plaintiff, was used to drive the target out of business. *McTamney v. Stolt Tankers & Terminals (Holdings), S.A.*, 678 F. Supp. 118, 120-21 (E.D. Pa. 1987). In a more recent case, the Sixth Circuit held that fact issues existed in the

government's Section 7 claim against a firm that had acquired nonvoting shares in two rival milk processors, equivalent to a 50 percent equity stake in each rival. The court set forth the history of the industry, in which each processor had recent, "lucrative" joint ventures with the acquirer, and the two processors had previously engaged in bid rigging. *Dairy Farmers*, 426 F.3d at 854-55, 862. In light of this history, the court concluded that the acquisition gave the processors an incentive to "'keep [their common shareholder] happy'." *Id*. at 854.

1. The MasterCard Restructuring Provides The Member Banks With A Vehicle To Control New MasterCard.

Taken as true, Plaintiffs' allegations establish that the MasterCard Restructuring provides the banks with the tools and the incentive to influence New MasterCard's decision-making process. Citing to MasterCard documents and deposition testimony, Plaintiffs allege throughout the Amended Supplemental Complaint that MasterCard intended for its IPO to perpetuate the anticompetitive market structure that its member banks had created through collusive activity. (*See, e.g.*, ASC ¶ 155.) The Restructuring provides the banks with several means to accomplish their goals. First, just as they had done before the MasterCard IPO, the banks continue to pressure MasterCard to increase interchange fees and MasterCard has an incentive to "keep [the banks] happy" because under the market structure that the banks had established in the Restructuring, MasterCard can compete only by luring more banks to issue its cards. *See Dairy Farmers*, 426 F.3d at 854; (ASC ¶ 149f). Second, Plaintiffs have alleged that, if the new "independent" MasterCard board attempted to discontinue imposing interchange fees on every transaction, the Class M shares that the banks acquired in the IPO allow the banks to threaten to block this change. (*Id*. ¶ 171.) Third, the banks still retain a 41 percent equity stake in the New MasterCard and can control up to one-quarter of the New MasterCard board, which provides the banks with additional influence over the affairs of New MasterCard. (*Id*. ¶ 125); *see also du*

Pont, 353 U.S. at 586 (holding that a supplier's acquisition of minority share in large customer, with which it shared a board chairman violated Section 7 of the Clayton Act). Finally, by intentionally impoverishing New MasterCard by eliminating MasterCard's right to assess its member banks to fund litigation liabilities, the member banks assured that New MasterCard could not take actions contrary to the interests of the Member Banks or to otherwise resolve this litigation — including agreeing to the reduction or elimination of interchange fees — without the agreement of the member banks.

Relying solely on MasterCard's Form S-1 filing, Defendants argue that the Class M rights would not allow the banks to prevent New MasterCard from eliminating or greatly reducing interchange fees. (MC Br. at 11-12.) But while a defendant may refer to public documents on a Rule 12 motion, it may not use those documents to refute the truth of the allegations in the complaint. *See Subaru Distribs. Corp.*, 425 F.3d at 122. In this case, Plaintiffs' allegation that MasterCard's member banks view interchange setting as a "core" function of the MasterCard network are supported by references to MasterCard's 2007 annual report, which includes the imposition of interchange fees as a component of MasterCard's role as a processor of payment card transactions. (ASC ¶ 140.) The banks and MasterCard have also consistently taken the position that interchange fees are necessary to the functioning of a payment card network, which is further evidence that the banks would attempt to use their Class M rights to preserve MasterCard's uniform schedules of default interchange fees. (*Id.* ¶ 139.)

Regarding the stock-ownership restrictions, MasterCard argues that Plaintiffs cannot state a claim under Section 7 because they failed to plead "facts showing that the stock ownership restrictions *actually do* enable the banks to control MasterCard *after* the IPO." (MC Br. at 13) (emphasis in original.) But Defendants' demand that Plaintiffs plead actual anticompetitive

effects is not consistent with the standard under Section 7 cases, in which a plaintiff need only allege that the harm caused by a transaction poses a substantial likelihood of lessening competition. *See Procter & Gamble Co.*, 386 U.S. 568, 577 (1967); *H.J. Heinz Co.*, 246 F.3d at 713.

2. The Visa Restructuring Allows The Banks To Continue To Control Visa's Competitive Behavior.

The Second Supplemental Complaint sufficiently alleges that the Visa Restructuring provides the banks with the tools and the incentive to influence New Visa's decision-making process. As with MasterCard, Plaintiffs allege that the Visa Restructuring was intended to preserve the issuer-focused market structure created by that the banks had created and to provide the banks with a new forum to pressure Visa to increase interchange fees. (*See, e.g.,* SSC ¶¶ 79-80, 111.) Even putting aside the banks' continuing day-to-day influence over Visa, the banks retain six out of 17 seats on the New Visa board, which allows the banks to pressure New Visa to maintain the anticompetitive practices that they had initiated – such as the requirement that an interchange fee be imposed on all transactions. *See du Pont*, 353 U.S. at 586; (SSC ¶ 130.)

In their motion to dismiss the Second Supplemental Complaint, Defendants improperly attempt to compartmentalize Plaintiffs' allegations and attack each restriction outside of the context the other restrictions and the history of the payment-card market. (*See* Visa Br. at 12-17;) *see Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 699 (1962) (holding that restraints alleged by plaintiffs must be considered *in toto*). For example, Defendants argue that corporate-ownership and change-in-control limitations are "commonplace" and cannot plausibly form the basis for an antitrust claim. (Visa Br. at 13.) In support of their argument, Defendants cite corporate-law authority that approves of anti-takeover measures to prevent a corporate board from losing control over the corporation. (*See id.*) And in the conventional

corporate context, when anti-takeover measures are adopted by independent, individual board members those measures may well be competitively innocuous.

But defendants' antitrust track record in the payment-card market and Plaintiffs' numerous, specific allegations revealing the intent of the member banks, demonstrate that the networks' Restructurings are far from "commonplace" transactions.[17] As in *Dairy Farmers* and *du Pont*, Visa's member banks — which were the owners and board members of Old Visa — were recently adjudicated to have engaged in anticompetitive activity. *Dairy Farmers*, 426 F.3d at 854-55; *du Pont*, 353 U.S. at 606-07. Plaintiffs cite real testimony and real documents showing that Visa's member banks sought to restructure Visa in a way that would seek to minimize antitrust risk but maintain enough control to guarantee that New Visa would continue to impose the same rules and fees that would be illegal for a joint venture of banks to impose. (*See* SSC ¶¶ 122-134.)

Contrary to the normal corporate scenario, in which individual board members may wish to protect their directorships against a hostile takeover, the control restrictions and veto rights described above were implemented to hobble any "independent" New Visa board and to protect and perpetrate an anticompetitive market structure. (SSC ¶ 122-34.) Nor can Defendants ignore the fact that the vast majority of Visa Class B and C shareholders – and each of the Bank Defendants named in the Second Supplemental Complaint – is a member of MasterCard (and *vice versa*). Thus, the veto rights vested in the Visa banks effectively become a tool for MasterCard's member banks to prevent the emergence of competition that may threaten their

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[17] At least one commentator has noted that MasterCard's IPO was designed at least partly to reduce antitrust risk, which is "unusual for an IPO." Victor Fleischer, *The MasterCard IPO: Protecting the Priceless Brand*, 12 HARV. NEGOTIATION L. REV. 137, 137 (2007).

stream of interchange fees from merchants and *vice versa*. *See McTamney*, 678, F. Supp. at 120-21.

Finally, Defendants tout the "procompetitive" benefits of a "supplier making independent business decisions to satisfy its customers." (Visa Br. at 16.) Again, while this blanket statement may be true in the abstract, it does not apply in this case because the New Networks' "customers" *i.e.*, its Member Banks, previously conspired to create an anticompetitive market structure and then restructured themselves in a manner that leaves that market structure intact. (*See, e.g.,* ASC ¶ 273e; SSC ¶¶ 40, 238e.) And by attempting to divorce the New Networks from their collusive pasts, Defendants' argument also distracts from the core question under Section 7 of the Clayton Act, that is whether an acquisition results in a market structure that may be substantially likely to lessen competition. 15 U.S.C. § 18; Areeda & Hovenkamp*, supra* § 944b.

VI. THE ELIMINATION OF THE SPECIAL ASSESSMENT RIGHT IS A FRAUDULENT CONVEYANCE

Plaintiffs' twenty-fifth and twenty-sixth claims for relief in the Amended Supplemental Complaint allege an unlawful fraudulent conveyance of MasterCard's right of special assessment under sections 275 and 276 of the New York Debtor and Creditor Law ("NYDCL"). (ASC ¶¶ 303-324.) Defendants move to dismiss Plaintiffs' fraudulent conveyance claims on three grounds: (1) that Plaintiffs lack standing to bring fraudulent conveyance claims; (2) that they have not adequately alleged actual fraud; and (3) that they have not adequately alleged constructive fraud. (MC Br. at 16-18 & n.11, 22 & n.14.)

A. Plaintiffs Were Legally Harmed by the Fraudulent Conveyance.

Defendants argue that Plaintiffs cannot maintain their fraudulent-conveyance claims because Plaintiffs are not "legally harmed" by the conveyance. (*Id*. at 16-17 & n.11.) (citing *In re Murphy*, 331 B.R. 107, 124-25 (Bankr. S.D.N.Y. 2005)). But in this case, Plaintiffs –

MasterCard's creditors – were prejudiced by MasterCard's conveyance of the right of special assessment because MasterCard did not obtain fair consideration for the release of its valuable special assessment right. *See Lippe v. Bairnco Corp.*, 99 Fed. Appx. 274, 281 (2d Cir. 2004). Defendants' argument also misapprehends Plaintiffs' fraudulent-conveyance claims by arguing that Plaintiffs are not prejudiced because they can recover "directly" from the banks. (*See* MC Br. at 17.) Plaintiffs' claims seek to void MasterCard's conveyance of its special assessment right to protect their ability to obtain the full value of a judgment against MasterCard (not the Bank Defendants). (ASC ¶ 202.) And the Second Circuit rejected the argument, advanced by Defendants, that a creditor is not prejudiced when alternative collection opportunities are available to it. *See HBE Leasing Corp. v. Frank*, 48 F.3d 623, 637 n.10 (2d Cir. 1995).

B. Plaintiffs Have Stated A Claim For Actual Fraudulent Conveyance Under Section 276.

1. Plaintiffs' Section 276 Allegations Satisfy Rule 9(b) by pleading actual Fraud with Particularity

Because actual fraudulent intent an element of a cause of action under Section 276, a complaint "must state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b). "A defendant must be given sufficient notice of the time, place, and content of the alleged fraud because a defendant would be unable to prepare a defense properly without such notice." *Official Committee of Asbestos Claimants of G-I Holdings, Inc. v. Heyman*, 277 B.R. 20, 36 (Bankr. S.D.N.Y. 2002)

As to allegations of fraudulent intent, Rule 9(b) provides that "[m]alice, intent, knowledge, and other conditions of mind of a person may be averred generally." *SIPC v. Stratton Oakmont*, 234 B.R. 293, 315 (Bankr. S.D.N.Y. 1999). Thus, direct proof of the transferor's fraudulent intent is unnecessary and "[a]ctual intent' . . . may be gleaned from the circumstances surrounding the alleged fraudulent transaction." *Id.* at 316 (citing *United States v. McCombs*, 30

F.3d 310, 328 (2d Cir. 1994)). "The Second Circuit has adopted certain 'badges of fraud' or presumptions as circumstantial evidence of actual intent." *Id*. at 315. These badges include:

> (1) the lack or inadequacy of consideration; (2) the family, friendship or close associate relationship between the parties; (3) the retention of possession, benefit or use of the property in question; (4) the financial condition of the party sought to be charged both before and after the transaction in question; (5) the existence or cumulative effect of a pattern or series of transactions or course of conduct after the incurring of debt, onset of financial difficulties, or pendency or threat of suits by creditors; and (6) the general chronology of the events and transactions under inquiry.

Id. at 315-16 (citing *In re Kaiser*, 722 F.2d 1574, 1582 (2d Cir. 1983)).

2. Plaintiffs Pleaded Actual Fraudulent Intent

Despite being informed by Boston Consulting Group that it faced potential litigation damages of $200 billion and a potential loss of interchange revenue of $100 billion, MasterCard directed Houlihan Lokey to not consider contingent liabilities associated with this Action in assessing the Company's capital adequacy after a redemption of the member banks' shares.[18] (ASC ¶¶ 5, 184-85.) Such conduct constitutes actual fraudulent intent. MasterCard's directive would have been completely unnecessary unless its directors believed that the antitrust threat was material and certain. (*Id*. ¶¶ 179, 184-85.) Plaintiffs repeatedly allege the gravity with which MasterCard's directors assessed a potential damage award. (*Id*. ¶¶ 180-81, 187.) The plain reality is that MasterCard's released of its right of assessment and permitted the banks' redemption even though the Board and MasterCard knew it was facing near certain antitrust liability of a magnitude MasterCard could not pay. (*Id*.)

[18] Defendants raise a number of fact issues regarding Houlihan Lokey's opinion. (*See* MC Br. at 22, n.14.) Whether Houlihan Lokey used suitable capital adequacy tests or applied them correctly and other issues of fact are "more appropriately raised in a motion for summary judgment, pursuant to Fed. R. Civ. P. 56, or at trial." *Sullivan*, 373 F. Supp. 2d at 304.

3. Even if Plaintiffs Did Not Plead Actual Fraudulent Intent, They Adequately Pleaded Badges of Fraud.

Although Plaintiffs make ample, specific allegations that support the inference that Bank Defendants, as transferees, acted with actual fraudulent intent, such allegations are not required because actual fraud requires intent to defraud only on the part of transferor, in this case, MasterCard. *See Stratton Oakmont*, 234 B.R. at 318. Whether the Transferee Defendants had the actual intent to hinder, delay, or defraud is an issue to be raised by them as an affirmative defense and thus cannot be resolved on a Rule 12(b)(6) motion. *Id*.

Plaintiffs have stated a section 276 claim by pleading the "approximate date of the transfer," "the interest involved," "the party making the transfer . . . as well as the recipient," and sufficient allegations of actual fraudulent intent. *See Sullivan v. Kodsi*, 373 F. Supp. 2d 302, 306 (S.D.N.Y. 2005). Although Defendants move to dismiss Plaintiffs' section 276 claim on the ground that Plaintiffs' allegations of fraud are conclusory, their argument focuses entirely on the sufficiency of Plaintiffs' allegations of actual fraudulent intent. (MC Br. at 18 & n.13.) Yet, the pleadings give adequate particularized notice with which to prepare a defense: Plaintiffs allege the date of the transaction (*see, e.g*., ASC ¶¶1, 182-83, 196); the terms of the conveyance (*see, e.g.*, *id*. ¶¶ 125-26, 182-83); including the inadequate consideration received (*see, e.g*., *id*. ¶¶ 184, 190-98); and the parties to the conveyance (*see, e.g*., *id*. ¶ 9); *see also Sullivan*, 373 F. Supp. 2d at 306. Plaintiffs' allegations also support numerous badges of fraud, giving rise to a strong inference of actual fraudulent intent.

a. Grossly Inadequate Consideration.

Consideration greatly below the fair value of the property conveyed is a prime factor in the badges of fraud analysis. *See In re Bennett Funding Group, Inc*., 220 B.R. 743, 758 (Bankr. N.D.N.Y. 1997) (citations omitted). For example, one district court in this circuit has concluded

that $800,000 in consideration was "grossly inadequate" consideration for assets totaling over $5 million. *Hasset v. Goetzmann*, 10 F. Supp. 2d 181, 186, 188 (N.D.N.Y. 1998).

The special-assessment right gave MasterCard, in 2005, a virtually unlimited ability to make a capital call on its members for losses related to this litigation. (ASC ¶¶ 193, 201.) Given MasterCard's $200 billion estimate of its potential damages arising from an interchange litigation event, Plaintiffs allege the value of MasterCard's right of special assessment is potentially tens to hundreds of billions of dollars. (*Id*. ¶¶ 5, 184.)

MasterCard acknowledged that the "$1 billion pool [($650 million after taxes) was] **in consideration of** the U.S. shareholders being relieved of assessment obligations" and MasterCard also admits that the $650 million holdback was unrelated to any estimates of MasterCard's actual liabilities or the value of MasterCard's right of special assessment. (*Id*. ¶¶ 196 (quoting Murphy Ex. 21882), 126, 190, 198.)

MasterCard director Norman McLuskie, in a letter to Mr. Selander, expressed concern that the $650 million holdback was inadequate, writing:

> While I appreciate the desire of the US Member Banks to draw a line under their exposure, I understand the damages figures could be significantly in excess of $1 billion. If that is the case and the residual contingent liability above $1 billion passes to [MasterCard] then I would have thought that could have a major impact on the potential for a successful IPO and for the future viability of [MasterCard] itself if there were a sufficiently large claim.

(*Id*. ¶ 177.) Mr. McLuskie wrote to Mr. Selander to inform him that he and other directors might abstain from the redemption vote, noting that the litigation risks in the U.S. were extremely significant. (*Id*. ¶ 187.) Mr. Pratt, writing to Selander, said he questioned whether the holdback was "actually sufficient to cover liability." (*Id*. ¶ 180.) Even the Chairman of the Board, Mr. Falcones appealed to Mr. Selander to consider another way to restructure the IPO without a

redemption vote. (ASC ¶ 187.)[19]

b. Close Relationship Between MasterCard and the Member Banks.

A close relationship between the parties to the conveyance – such as the relationship between related corporations or between closely-held corporations and their shareholders – is another classic indicium of fraud. *See United States v. 58th St. Plaza Theatre, Inc.*, 287 F. Supp. 475, 498 (S.D.N.Y. 1968); *Bulkmatic Transp. Co. v. Pappas*, No. 99 Civ. 12070 (RMB)(JCF), 2001 WL 882039, at *12 (S.D.N.Y. May 11, 2001). MasterCard and its Member Banks, especially the largest of its Member Banks, including the Bank Defendants, have a close relationship and played a central role in securing the release of MasterCard's special assessment right. (ASC ¶¶ 204, 206.)

Before MasterCard's Restructuring, Bank Defendants were all represented on at least one of MasterCard's boards of directors. (SCACAC ¶¶ 57-58, 62, 63, 68, 75.) Indeed, prior to the restructuring, MasterCard's bylaws ***required*** a close relationship between MasterCard and its directors; the bylaws mandated that each director "'be an officer of a member institution of MasterCard International Incorporated or an individual otherwise uniquely qualified to provide guidance as the Corporation's affairs.'" (ASC ¶ 48.) Moreover, the Bank Defendants were all represented on MasterCard's Global Board when MasterCard voted to redeem the Member Bank's shares and release of the right of special assessment. MasterCard Incorporated Form S-1 Registration Statement (hereinafter "S-1") at 87-91 (Sept. 15, 2005).[20]

The unusually close relationship between MasterCard and the Bank Defendants as well as the those banks' central role in obtaining the special assessment release is also illustrated by the

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[19] As noted above, this also gave MasterCard Member Banks another tool by which to control New MasterCard.

[20] A true and correct copy of the S-1 is attached to the accompanying Declaration of Ryan W. Marth as Exhibit A. The Court may consider public filings without converting this motion to dismiss into a motion for summary judgment. *See* Report & Recommendation at 7 (citation omitted).

exchange between Citigroup and MasterCard where Citigroup took an extraordinary additional affirmative step to guarantee that it would not be assessed for its share of a future judgment against MasterCard. (ASC ¶ 207.) Citigroup executive Michael Schiffres and its General Counsel, Wendy Kleinbaum, contacted counsel for MasterCard to concoct an e-mail to be sent from MasterCard's General Counsel, Noah Hanft, to Ms. Kleinbaum, assuring Citigroup that New MasterCard would not attempt to reinstate its special assessment right after the IPO. (*Id.* ¶ 207.) "[T]hese circumstances [are] a clear indication of the defendants' joint purpose" to delay, hinder, or defraud Plaintiffs, MasterCard's creditors. *Marine Midland Bank v. Murkoff*, 120 A.D.2d 122 (N.Y. App. Div. 1986); *see also Stratton Oakmont*, 243 B.R. at 316-17 (section 276 claim stated when transferees knew of the tens of millions of outstanding customer claims against the transferor and that those claims would not be satisfied if the transferor conveyed substantial payments to transferees). Furthermore, the numerous and particularized allegations concerning the identity, knowledge, communications and conduct of the Transferee Defendants decimates their argument that the ASC is "silent as to the bank defendants named in the fraudulent conveyance counts." (MC Br. at 18 n.13.)

c. General Chronology of Events.

The "existence or cumulative effect of pattern or series of transactions" is a badge of fraud. *Stratton Oakmont*, 234 B.R. at 16. The chronological course of conduct of Old MasterCard and the member banks shows that Defendants were operating together to fraudulently strip New MasterCard of its right of special assessment.

As detailed in Section II.A. above, by early 2004 Old MasterCard and its member banks had been sued for illegally fixing interchange fees, which alerted Old MasterCard's management and board to a threat to the legality of interchange. Mr. Selander solicited input from the board

and summarized the board's feedback as follows: "the legal threat now presents a significant and material risk" and MasterCard needs to act to decrease exposure to this risk. (ASC ¶¶ 91-92.)

The timing of the conveyance during the pendency of this lawsuit creates a strong inference of an intent to defraud. *Sullivan*, 373 F. Supp. 2d at 306-07; *Heyman*, 277 B.R. at 37; *Hasset*, 10 F. Supp. 2d at 181. The Old MasterCard board resolutions that approved the essential structure of the Restructuring in July 2005 – less than a month after the first complaint in what was to become MDL No. 1720 was filed – included a resolution that the "'U.S. shareholders fund a $1 billion pool ***in consideration of*** the U.S. shareholders being relieved of assessment obligations.'" (ASC ¶ 196.) Thus, Defendants cannot seriously dispute that (a) the banks on the MasterCard board caused MasterCard to release the assessment right in response to this litigation or that (b) the holdback was a *quid pro quo* for the release of the assessment right.

d. Impairment of MasterCard's Capital Position

Another reliable indication of fraudulent intent is "the financial condition of the party sought to be charged both before and after the transaction in question." *Kaiser*, 722 F.2d at 1582; *see also Pen Pak Corp. v. LaSalle Nat'l Bank of Chicago*, 658 N.Y.S.2d 407, 408 (N.Y. App. Div. 1977).

As a result of its release of the special assessment right, Plaintiffs allege that New MasterCard is not adequately capitalized and would be ruined by a large litigation liability. (ASC ¶¶ 130, 178.) MasterCard's board of directors shared the same concern leading up to the redemption vote, when the banks agreed to pay themselves out of the IPO proceeds while forcing MasterCard to give up the right of special assessment. (*Id*. ¶¶ 125, 177, 180, 187.) Indeed, MasterCard took the extraordinary step of ***increasing*** director indemnification in the event that they were sued in connection with the redemption vote. (*Id*. ¶ 186.) As a result of the redemption of the Member Banks' shares in MasterCard, the Member Banks took the lion's share of the IPO

proceeds and left New MasterCard and its shareholders bereft of the ability to raise sufficient capital to cover its legal liabilities due to giving up the special assessment right. (*Id.* ¶ 183.) New MasterCard would now be forced to raise money through the capital markets, which would not be sufficient to fund a large judgment against MasterCard.[21] (*See id.* ¶ 192.) Rating agency Standard & Poor's understood the value of MasterCard's right of special assessment and downgraded MasterCard's credit rating because it gave up the assessment right. (*Id.* ¶ 195.)

The directors' concerns that the New MasterCard would be undercapitalized created a powerful incentive for MasterCard to downplay, hide, and obscure the loss in system value and litigation threat, which its advisors had estimated exceeded a hundred billion dollars. (ASC ¶ 178.) To placate the directors' worries, management caused counsel advising on the deal to assure the board that MasterCard could not estimate or predict the contingent liability (despite the fact that its consultant had already done so and the board of directors had acted on the basis of the quantification). (*Id.* ¶ 183.)

In addition to instructing Houlihan Lokey not to consider New MasterCard's contingent liability, Old MasterCard and its member banks also misled its underwriter Goldman Sachs about the certainty and magnitude of the antitrust threat when it told Goldman Sachs that it did not believe that its liabilities from this lawsuit were quantifiable or probable. In its public filings and during its road show for prospective investors, MasterCard refused to provide its internal estimates of its potential antitrust liabilities. (*Id.* ¶ 189.) Amazingly, Defendants claim that MasterCard's disclosures in public filings exonerate them from liability, citing dicta in *Lippe v. Bairnco Corp.*, 249 F. Supp. 2d 357 (S.D.N.Y. 2003); (MC Br. at 19.) The disclosures made in

[21] In his deposition, MasterCard CEO Robert Selander estimated the amount that MasterCard could raise in the capital markets. Mr. Selander's precise estimate is found in paragraph 192 of the sealed version of the amended supplemental complaint.

the public filings at issue in *Lippe* are distinguishable from the self-serving disclosures MasterCard made in connection with its IPO. In *Lippe*, after failing to obtain a "clean" opinion on its public filings from its auditor because it did not disclose estimates of its future litigation exposure, the defendant-transferor estimated and disclosed its litigation exposure in subsequent public filings. (*Id*. at 363-65.) Moreover, litigation counsel gave the auditor legal opinions that the litigation would not have a material effect on the company's financial condition. (*Id*. at 366.) In this case, MasterCard has not disclosed estimates of its exposure and apparently did not provide its auditor with any opinions as to its antitrust liability. *Lippe* counsels against deciding these fact issues at the 12(b)(6) stage.

e. Bank Defendants' retention of control over MasterCard.

Stripped to its core, the right of assessment is the right to control the practical outcome of interchange-based antitrust litigation against MasterCard. New York courts have noted that "[r]etention of control of the property after a conveyance is regarded as an indication that the conveyance was fraudulent." *Marine Midland Bank*, 508 N.Y.S. 2d at 22; *see also Kaiser*, 722 F.2d at 1582. The relevant fact on this point is that the banks have implemented corporate control mechanisms to retain *de facto* control over MasterCard, and to prevent New MasterCard from re-establishing the assessment right. (*See, e.g.,* ASC ¶ 149.)

Defendants argue that the banks' retention of control over MasterCard cannot be used to support Plaintiffs' Section 276 claim. (MC Br. at 20.) But "[f]raudulent acts are as varied as the fish in the sea." *In re Kaiser*, 722 F.2d at 1583. It therefore "behooves the [c]ourt to employ wide discretion, recognize the unique circumstances and employ flexible standards as opposed to fixed rules." *Gafco, Inc. v. H.D.S. Mercantile Corp.*, 263 N.Y.S.2d 109, 114 (Civ. Ct. N.Y. City 1965). The greatest "asset" to the banks is the constant flow of supracompetitive interchange fees that they receive from merchants. (*See* ASC ¶ 7.) In this case, the banks have maintained control over

the future flow of interchange by acquiring Class B and M shares, which empower the banks to oppose any change that New MasterCard's "independent" board may wish to make to its issuer-focused business model. (*See id*. ¶¶ 149, 163-73.) Thus, the banks have remained the primary beneficiaries of the interchange system, preemptively blocked any attempt by MasterCard to change that system, and through the release of the special assessment right have attempted to skirt their share of the liability for this conduct. Moreover, if MasterCard wanted to satisfy a multibillion dollar litigation judgment without the assessment right, it could receive only voluntary contributions from its member banks. In this way, the banks have made New MasterCard even more dependent upon them and guarantee that they will be able to influence any attempt by MasterCard to settle this litigation, which will determine the future structure of the payment-card industry. (*Id*. ¶ 149d.)

The control that the banks exerted over MasterCard is also apparent from the redemption itself. As director Norman McCluskie stated in January 2006, he "[a]bove all want[ed] to avoid the difficulties the Directors may have around their personal liability exposure in voting for the redemption getting in the way of us making the correct commercial decision with the full unanimous support of the Board." (ASC ¶ 187.) If the directors were truly acting in the best interests of MasterCard, there would have been absolutely no reason to either express such concern or seek such protection. McCluskie's statement further supports the strong inference that the Board was not acting in the best interests of MasterCard in the course of the IPO.

C. Plaintiffs Stated A Claim For Fraudulent Conveyance Under Section 275.

"Because intent to defraud is not an element of [section 275], such claims, as opposed to claims of actual fraud are not subject to Rule 9(b)'s heightened pleading requirements." *Mills v. Everest Reinsurance Co.,* 410 F. Supp. 2d. 243, 254 (S.D.N.Y. 2006). Instead, pleading a claim

under section 275 "requires only '. . . a short and plain statement of the claim showing the pleader is entitled to relief . . . .'" *Id.* (quoting Fed. R. Civ. P. 8(a)).

Defendants argue that Plaintiffs do not state a claim for constructive fraud under section 275 because Plaintiffs supposedly pleaded "no new facts . . . to demonstrate that MasterCard eliminated the special assessment rights at a time when it believed it would incur debts beyond its ability to pay." (MC Br. at 23-24.)

1. Old MasterCard Did Not Receive "Fair Consideration" for Releasing its Special-Assessment Right.

The term "fair consideration" as used in section 275, is defined in Section 272 of the NYDCL as: (1) "a fair equivalent" is exchanged "in good faith;" or (2) an "amount not disproportionately small as compared with the value of the property . . . obtained" is exchanged in "good faith." NYDCL § 272. Thus, fair consideration has two separate components— good faith and fair value both of which are fact questions. *In re Borriello*, 329 B.R. 367, 374 (Bankr. E.D.N.Y. 2005). "[W]hat constitutes fair consideration under [section 272] must be determined upon the facts and circumstances of each particular case." *McCombs*, 30 F.3d at 326 (citations omitted). Underscoring the fact-intensive nature of this inquiry, courts compare the value of the consideration to the value of the property conveyed when determining if fair value was obtained. *See, e.g., id.*, at 327. As stated in section II.B.3.a above, the $650 million holdback was grossly inadequate in relation to the value of the special-assessment right to MasterCard.

"The term 'good faith' does not merely mean the opposite of the phrase actual intent to defraud." *Southern Indus. v. Jeremias*, 411 N.Y.S.2d 945, 949 (N.Y. App. Div. 1978). In other words, "an absence of fraudulent intent does not mean the transaction was necessarily entered into in good faith." *Id.* Rather, "the lack of good faith imports a failure to deal honestly, fairly, and openly." *Id.*; *see also In re Checkmate Stereo & Electronics, Ltd.*, 9 B.R. 585, 617 (Bankr.

E.D.N.Y. 1981) ("Good faith may be lacking because of a transferee's knowledge of a transferor's unfavorable financial condition at the time of the transfer, . . . or because of a transferee's position as an insider with control over the corporation's finances."). Section 272 examines the good faith of the transferee not the transferor. *HBE Leasing*, 61 F.3d at 1059 n.5; *In re Brosnahan*, 324 B.R. 199 (Bankr. W.D.N.Y. 2005).

In this case, the Banks Defendants were not acting in good faith. Plaintiffs alleged that the Bank Defendants had knowledge of MasterCard's financial condition at the time of the transfer and that these banks had control over the corporation at the time of the conveyance due to their positions on MasterCard's board. (ASC ¶¶ 195-99.) Accordingly, Plaintiffs adequately alleged the Bank Defendants acted without good faith.

2. MasterCard Believed that It Would Incur Debts Beyond Its Ability to Pay When It Conveyed the Special Assessment Right.

The requisite intent or belief under section 275 can be inferred from allegations that the transferor had a "good indication" that it would not be able to pay its debts as they mature. *Grace Plaza of Great Neck, Inc. v. Heitzler*, 770 N.Y.S.2d 421, 423 (N.Y.. App. Div. 2003); *In re Norstan Apparel Shops, Inc*., 367 B.R. 68, 80 (Bankr. E.D.N.Y. 2007); *see also Shelly v. Doe*, 671 N.Y.S. 2d 803, 806 (N.Y. App. Div. 1998).

In this case, MasterCard knew that without the special assessment right, it would not be able to pay its debts to Plaintiffs when their claims mature. (ASC ¶¶ 177, 180, 187.) By MasterCard's own admission, the antitrust claims aimed at MasterCard's interchange practices posed a serious threat to its survival because of those claims' certainty of success and magnitude of damages. (*Id*. ¶¶ 4-5, 9, 78-81, 113.) The only question was when those claims would mature.

Defendants argue that Plaintiffs fail to make any new allegations to support their section 275 claim, and characterize Plaintiffs' allegations of the concerns MasterCard directors raised at

the time of the conveyance as "anecdotal concerns of several individuals." (MC Br. at 23.) Defendants again raise fact issues on the appropriateness of Old MasterCard's "determination that contingent liabilities arising from this lawsuit were not quantifiable." *(Id.)* But Plaintiffs allege more than "anecdotal concerns." Plaintiffs quote long-tenured board members – the ultimate decision makers at MasterCard – expressing concern that after the IPO MasterCard would not be able to satisfy litigation liabilities. (ASC ¶¶ 177, 180, 187.) Further, while Defendants now claim that these concerns were anecdotal, MasterCard at the time of the Redemption took the extraordinary step of ***increasing*** indemnification protection for the directors in the event they were sued in connection with their vote on the redemption. (*Id*. ¶ 186.)

Finally, Defendants argue that Plaintiffs have not stated a claim under section 275 because the "pendency of litigation against an alleged tortfeasor who transferred assets prior to trial is not sufficient to establish a §275 claim" because such claims are speculative. (MC Br. at 24) (citing *Shelly*, 173 Misc. 2d at 211-12). But the decision Defendants cite was *reversed* on appeal on the very principle they cite the case for. *Shelly*, 249 A.D.2d at 671. Moreover, it cannot be the law that all section 275 claims made when litigation is pending against the transferor fail as inherently speculative in view of different possible outcomes at trial. If that were the case, then section 275 would not expressly include in its coverage claims to be brought by "both present and future creditors." NYDCL § 275. Here, Plaintiffs' alleged facts that show MasterCard believed that it would incur legal liabilities beyond its ability to pay, as it estimated its damages from an interchange litigation event at $200 billion, and the only way MasterCard could satisfy such a large judgment was through an assessment of its members. Accordingly, Plaintiffs stated a claim for fraudulent conveyance under section 275.

CONCLUSION

When the Restructurings and their attendant restrictions are viewed *in toto*, in the context of the history of the payment-card market, there can be no doubt that the Restructurings were intended to perpetuate the market power and the anticompetitive practices of the networks and that they will actually have that effect. Similarly, the plaintiffs allege specific facts that Old MasterCard and its banks engaged in a fraudulent conveyance intended to both defraud the merchant plaintiffs and possibly render MasterCard insolvent, which further increases the control that the banks wield over MasterCard's settlement of this case and its business going forward. For these reasons and all the others specified above, Plaintiffs respectfully request that the Court deny Defendants' motions in their entirety.

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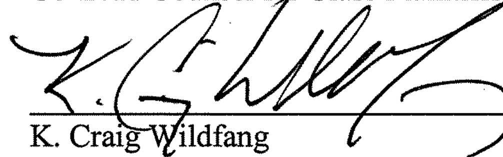
Respectfully submitted,

ROBINS, KAPLAN, MILLER & CIRESI LLP
K. Craig Wildfang, Esq.
Thomas J. Undlin, Esq.
Thomas B. Hatch, Esq.
Stacey P. Slaughter, Esq.
Ryan W. Marth, Esq.
2800 LaSalle Plaza
800 LaSalle Avenue South
Minneapolis, MN 55402
Tel: (612) 349-8500
Fax: (612) 349-4181

COUGHLIN STOIA GELLER
RUDMAN & ROBBINS LLP
Bonny E. Sweeney, Esq.
David Mitchell, Esq.
655 West Broadway
Suite 1900
San Diego, CA 92101
Tel: (619) 231-1058
Fax: (619) 231-7423

BERGER & MONTAGUE, P.C.
H. Laddie Montague, Esq.
Merrill G. Davidoff, Esq.
Bart Cohen, Esq.
1622 Locust Street
Philadelphia, PA 19103
Tel: (215) 875-3000
Fax: (215) 875-4604

Co-Lead Counsel for Class Plaintiffs



By: ______________________
K. Craig Wildfang