UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

IN RE PAYMENT CARD INTERCHANGE FEE AND MERCHANT DISCOUNT ANTITRUST LITIGATION **This Document Relates to:** **All Class Actions**	**MASTER FILE 05-MD-1720 (JG) (JO)** **ORAL ARGUMENT REQUESTED**

REPLY MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS THE FIRST AMENDED SUPPLEMENTAL CLASS ACTION COMPLAINT

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Defendants in the First Amended Supplemental Class Action Complaint (the "ASC") respectfully submit this reply memorandum of law in further support of their motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure.[1]

I. PRELIMINARY STATEMENT

In their opposition brief ("Pl. Opp."), plaintiffs still have not demonstrated how a MasterCard organizational change removing the very structural conspiracy that is the basis of plaintiffs' complaint could possibly harm competition or permit minority, non-voting shareholder banks to maintain control over the setting of interchange. Plaintiffs' fraudulent conveyance claims continue to depend on a showing that MasterCard hid its purported understanding that it was facing several hundred billion dollars in damages when it conveyed its special assessment rights pursuant to a publicly-disclosed IPO process — facts that plaintiffs still cannot allege despite years of discovery and the Court's roadmap of pleading defects.

II. ARGUMENT

A. Plaintiffs Have Failed to State a Claim Under Section 7 of The Clayton Act or Section 1 of The Sherman Act

In response to this Court's dismissal of their antitrust claims, plaintiffs merely re-assert that they have pleaded competitive harm as required under both Section 7 of the Clayton Act and Section 1 of the Sherman Act by alleging that (1) the IPO gave an independent MasterCard market power, thereby lessening competition or (2) the MasterCard member banks continue to control MasterCard post-IPO for the purpose of setting supracompetitive interchange fees. (Pl. Opp. at 23.) These same theories did not survive defendants' prior motion, and

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[1] Defendants are identified in Footnote 1 to Defendants' Memorandum Of Law In Support Of Motion To Dismiss The First Amended Supplemental Class Action Complaint ("Defs. Mem.").

plaintiffs here again fail plausibly to allege that the effect of MasterCard's IPO may be to substantially lessen competition.[2]

1. Plaintiffs Have Failed to Allege Anticompetitive Effect, Injury or Damages From the Creation of an "Independent" MasterCard

Previously, this Court specifically held that plaintiffs did not plead a sufficient basis to show that member banks controlled the independent, post-IPO MasterCard, and that alone was sufficient to require dismissal. For the reasons set forth below, as well as in Visa's reply memorandum,[3] plaintiffs have not pleaded any facts to overcome that defect previously identified by the Court.

Instead, plaintiffs emphasize their alternative theory that the IPO somehow infused MasterCard with sufficient market power to establish rules and raise interchange fees. (Pl. Opp. at 23-24.) These allegations were not sufficient to state a claim previously, and fare no better now.[4] Plaintiffs allege elsewhere that through its pre-IPO association structure MasterCard already had enough market power to raise prices and impose rules even *before* the

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[2] *In re Payment Card Interchange Fee and Merch. Disc. Antitrust Litig.*, No. 05-MD-1720, 2008 WL 5082872, at *10 (E.D.N.Y. Nov. 25, 2008) ("Nov. 25, 2008 Op.").

[3] *See* Reply Memorandum in Support of Motion To Dismiss the Second Supplemental Class Action Complaint ("Visa Reply Mem.") at 3-7. Defendants hereby adopt and incorporate the reasoning set forth in Visa's reply memorandum insofar as it applies to the ASC.

[4] Plaintiffs previously made these allegations and submitted such arguments to the Court, which apparently did not consider them to be of sufficient importance to address in its prior opinion. (*See* Visa Reply Mem. at 1-2, 7-8.) Nor does the Court need to reach these arguments now. Although plaintiffs contend that the Court permitted them either to re-plead their "independent MasterCard" theory or their allegations of bank control over MasterCard (Pl. Opp. at 23-24), in fact the Court only granted plaintiffs leave to re-plead allegations that "the Banks will retain control of the post-IPO MasterCard in ways that may have an anticompetitive effect." (Nov. 25, 2008 Op. at 22.) This Court held that plaintiffs' failure to allege anticompetitive effects through purported bank control alone was sufficient to warrant a dismissal; thus, as discussed *infra*, plaintiffs' continued inability to plead facts supporting that theory alone justifies dismissal of the ASC with prejudice.

IPO. (Defs. Mem. at 15; ASC ¶¶ 222-28, 236-38.) Plaintiffs do not plausibly allege that the change in structure allowed MasterCard to raise prices more than it could before the IPO. Thus, while plaintiffs allege that the IPO altered the legal structure of MasterCard, they have alleged no facts to establish that this plausibly threatened any additional competitive harm as required under Section 7.[5]

Mere changes in corporate organizational structures that do not result in threatened competitive effects cannot be the basis for a Section 7 claim. For example, in *Geneva Pharm. Tech. Corp. v. Barr Laboratories, Inc.*, 386 F.3d 485, 510-11 (2d Cir. 2004), a defendant that owned 75% of a second defendant's stock purchased the remaining 25%. Plaintiffs claimed that this change in ownership structure would "impede competition and monopolize" the relevant market in violation of Section 7. *Id.* at 510. Plaintiffs also alleged, however, that even before the stock purchase, the first defendant had market power in the relevant market; accordingly, the Second Circuit held "that the acquisition itself had no effect on the degree of concentration or competition in the [relevant] market." *Id.* at 511. Contrary to plaintiffs' suggestion (Pl. Opp. at 24 n.15), *Geneva* squarely bars plaintiffs' Section 7 claim because plaintiffs here also fail to

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[5] Plaintiffs also assert that given its alleged market power, MasterCard's post-IPO Board can unilaterally determine interchange fees. Yet, as the Court has previously recognized, MasterCard's Board has, at all relevant times, had the right to set interchange fees. This right, like MasterCard's alleged market power, was not "acquire[d] . . . by virtue of the IPO." (Nov. 25, 2008 Op. at 9.) For this same reason, plaintiffs' contention that the post-IPO MasterCard raised interchange fees has no significance even if accepted as true. Plaintiffs allege that MasterCard continuously raised interchange fees pre-IPO as well (ASC ¶¶ 220-22), and allege no facts that can show that any post-IPO adjustment in interchange was made because of the IPO itself.

allege plausibly that the changes in MasterCard's ownership structure caused any material change in MasterCard's purported market power.[6]

Plaintiffs' theory is legally defective for another basic reason: it would turn the antitrust laws on their head by placing MasterCard in an untenable "Catch-22" situation. Under plaintiffs' theory, the pre-IPO MasterCard is alleged to be a "structural conspiracy" wherein interchange fees (or any other allegedly similar fees) to merchants are inherently illegal "prices" because they are collectively set by the member banks that owned MasterCard. As a result, plaintiffs contend that pre-IPO MasterCard allegedly could not lawfully charge these prices to the merchants. The only effective remedy under plaintiffs' theory would be to alter the structure of MasterCard to eliminate the "collective" element of the pricing, which according to the ASC was the purpose of the IPO. But that is the Catch-22: Plaintiffs then attack even this remedy — *i.e.*, divesting the banks of control — as impermissible under the antitrust laws because it allegedly results in increased prices to merchants. As a result, the only acceptable outcome for plaintiffs would be an independent MasterCard that cannot charge merchants *any* interchange or other fee for its services or, alternatively, judicial price regulation of MasterCard to keep prices at some level that plaintiffs deem appropriate.[7] Antitrust law does not allow for such a result.

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[6] Further, although plaintiffs contend that this new structure represents the anticompetitive strategy pursued by defendants in *United States v. Addyston Pipe & Steel Co.*, 175 U.S. 211 (1899), and *Northern Securities Co. v. United States*, 193 U.S. 197 (1904), in fact just the opposite is true. In both *Addyston Pipe* and *Northern Securities* defendants previously acting as a cartel simply merged into one consolidated corporation, thereby eliminating competition. Here, in contrast, the MasterCard IPO divested prior bank owners of much of their interest in MasterCard by selling a majority of stock to the public.

[7] It is only compared to these outcomes — *i.e.*, a world in which MasterCard cannot charge merchants at all or a world of price regulation — that plaintiffs can argue that MasterCard's post-IPO prices to merchants are higher. Compared to the world alleged by plaintiffs in which MasterCard already had the ability to raise prices, there is no additional competitive harm after the IPO.

Moreover, in addition to this Catch-22, plaintiffs have alleged no effect on competition, injury or damages to the merchants resulting from the IPO. As described in defendants' opening brief, plaintiffs allege that both pre- and post-IPO MasterCard would set interchange at supra-competitive levels. (Defs. Mem. at 15-16.) Because plaintiffs nowhere plead any change in MasterCard market power or competitive conditions after the IPO (*see* ASC ¶¶ 222-28, 236-38), they cannot assert any basis for a finding of threatened competitive harm or actual antitrust injury.[8]

2. Plaintiffs' Allegations That the IPO Preserves Bank Control of Default Interchange Fees are Insufficient

Plaintiffs also seek to bypass this Court's prior rejection of their bank control allegations by asserting that the banks nonetheless have the "tools and incentive[s]" to "influence" MasterCard. (Pl. Opp. at 28.) Plaintiffs, however, offer no supporting factual allegations to show that such tools threaten to harm competition.

First, issuing banks do not control MasterCard simply by being customers that MasterCard would prefer to "keep happy." (Pl. Opp. at 28.) Ultimately, as this Court has already recognized, the decisions of MasterCard's Board must serve the company's best interests, which entails balancing the interests of the participants on the card issuing and merchant sides of the network platform in order to maximize its profits. Any allegation that the banks continue to influence MasterCard amounts to nothing more than a recognition of the influence that any significant customer has over a business. (*See* ASC ¶¶ 143, 149(b), (d)-(f); Pl. Opp. at 24, 28.) Second, as discussed in detail in Visa's reply memorandum (at 4-5), each of the

[8] Plaintiffs also assert that MasterCard is able to maintain its supracompetitive interchange because its stock restriction preventing any one party from owning more than 15% of MasterCard's common stock is an anticompetitive barrier to entry. Yet, as set forth in Visa's reply memorandum (at 5-7), this Court has already rejected plaintiffs' challenge to this 15% provision, which in any event does not support a Section 7 violation.

cases cited by plaintiffs are inapposite, since the Section 7 violations at issue in those cases stem from facts showing a degree of third-party control not present here.

Nor do plaintiffs adequately allege a factual basis warranting a finding that MasterCard banks exercise some sort of undefined informal control over interchange. Implicitly conceding that the banks' Class M share veto rights do not actually provide banks with an ability to veto changes in interchange levels (*see* Defs. Mem. at 11-12), plaintiffs' contention that the banks nonetheless can "threaten" to use such rights is toothless.[9] Further, although plaintiffs assert that the banks retain a 41% stake in MasterCard and a minority Board position, plaintiffs do not explain why these allegations — already rejected by the Court as a basis of control — matter.[10]

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[9] Plaintiffs cannot dispute that the public disclosures of MasterCard show that bank shares in MasterCard are dwindling, with bank Class B outstanding shares listed at approximately 24% of total outstanding Class A and Class B shares in MasterCard's publicly filed Form 10-Q statement for the first quarter of 2009. (*See* MasterCard Incorporated, March 31, 2009 Form 10-Q, at 3 (filed May 1, 2009), a true and correct copy of which is attached to the accompanying Reply Declaration of Gary R. Carney ("Carney Reply Dec.") at Exhibit A.) Once the Class B bank shares fall below 15% of the combined Class A and B outstanding shares, the Class M veto rights will be extinguished. (*See* MasterCard Incorporated, Amendment No. 8 to Form S-1 Registration Statement (form S-1/A), at 138-39 (filed May 23, 2006) (Carney Reply Dec., Exhibit B).)

[10] *Subaru Distribs. Corp. v. Subaru of Am., Inc.*, 425 F.3d 119 (2d Cir. 2005), does not lend any support to plaintiffs' position. *Subaru* holds that when considering a motion to dismiss a complaint to which numerous contracts are attached, the court "should resolve any ***contractual*** ambiguities in favor of the plaintiff." *Subaru*, 425 F.3d at 122 (emphasis added). Plaintiffs do not point to any ambiguities here, and nowhere does *Subaru* say that a public filing properly reviewed by a court on a motion to dismiss cannot discredit allegations in the complaint. (*See* Defs. Mem. at 11 n.8.)

B. Plaintiffs Have Not Stated a Fraudulent Conveyance Claim

1. Plaintiffs Have Not Pleaded Facts to Support a Violation of Section 276

Plaintiffs for the first time assert that MasterCard acted with actual fraudulent intent because it supposedly already knew it faced massive legal exposure when it directed Houlihan Lokey to ignore contingent liabilities in its IPO valuation process. (Pl. Opp. at 34.) But plaintiffs fail to plead any factual allegations with "particularity" under the strict applicable standard of Fed. R. Civ. P. 9(b) to support their naked assertion that MasterCard believed it faced such exposure from this lawsuit. This gap is fatal.

As discussed in defendants' opening brief, plaintiffs predicate MasterCard's fraudulent intent upon an estimate of lost future interchange revenues by the banks (assuming liability) — not probable damages to MasterCard — made by the Boston Consulting Group ("BCG"). (Defs. Mem. at 21; Pl. Opp. at 34.) But despite having enormous discovery, plaintiffs nowhere allege facts showing that MasterCard commissioned, understood or adopted any damages estimate by BCG or any other third party. To the contrary, the allegations can establish only that MasterCard believed the damages were not quantifiable, a fact it publicly disclosed. (*See* Defs. Mem. at 19.) It never hid the fact of the lawsuit or the potential for liability. (*See* ASC ¶ 189) (acknowledging that MasterCard informed potential investors of the contingent liability).)[11]

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[11] As MasterCard pointed out in its opening brief, the fact that Houlihan Lokey did not assess contingent liabilities is not sufficient grounds on which to rest an allegation of fraud absent other allegations that failing to do so was somehow improper. (Defs. Mem. at 22, n.14.) Plaintiffs respond only that this is a fact issue (Pl. Opp. at 34, n.18), but do not offer any factual allegations or legal support that either tee up the factual issue or rebut MasterCard's argument.

Having failed to allege a basis for showing actual fraud, plaintiffs attempt to rely upon several purported "badges of fraud" to support an inference of actual fraud. But nowhere do plaintiffs address MasterCard's fundamental point that its public disclosure of the challenged conveyance, the legitimate purpose for MasterCard's IPO, and its implementation of the restructuring in the usual course of business all confirm that no inference of fraud is warranted. (*See* Defs. Mem. at 19-20.)[12]

Nor do the "badges of fraud" identified by plaintiffs withstand scrutiny. First, as discussed above, plaintiffs have not pleaded a factual basis that could establish that MasterCard gave up its right of assessment for grossly inadequate consideration. Plaintiffs identify no facts demonstrating that MasterCard believed it had a damages exposure of between $100-200 billion. Plaintiffs once again identify communications by several Board members raising the question of litigation exposure. (Pl. Opp. at 36-37.) But plaintiffs do not address defendants' prior response that anecdotal concerns by a handful of Board members do not suffice to establish that MasterCard management, and ultimately a majority of the Board of Directors, itself believed that it faced massive liability from this lawsuit. (Defs. Mem. at 23-24.) Rather, *plaintiffs' own allegations* show that MasterCard, acting through its management and Board, and after considering all input, concluded that the contingent liability resulting from this lawsuit was not quantifiable, and reported to the public that the contingent liability could not be accurately estimated. (ASC ¶¶ 186, 189.) After years of discovery, plaintiffs have not alleged a shred of

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[12] Plaintiffs attempt to distinguish *Lippe v. Bairnco Corp.*, 249 F. Supp. 2d 357 (S.D.N.Y. 2003), on the grounds that the public disclosures in that case were based on actual litigation exposure estimates. (Pl. Opp. 40-41; *Lippe*, 249 F. Supp. 2d at 363.) But in fact the defendant in that case could not estimate litigation exposure for many years. Nonetheless, the Court found that the public disclosure of the challenged transactions alleged to be fraudulent conveyances weighed heavily against a finding of fraud. *Lippe*, 249 F. Supp. 2d at 364-65, 384.

evidence supporting their claim that MasterCard management and the Board did not reach that conclusion in good faith.[13]

Second, the chronology of events alleged in the pleading demonstrates only that MasterCard, facing continuous attacks as a purported "structural conspiracy," took steps to change its structure so as to eliminate the basis of any such claims. These actions do not constitute a "badge of fraud," particularly when the process was thorough and publicly disclosed, as it was here. As stated in *Lippe* and *In re Park S. Sec. LLC*, 326 B.R. 505, 518 (Bankr. S.D.N.Y. 2005) — cases not rebutted by plaintiffs — "there [is] nothing inappropriate about a company's management looking for lawful ways to reduce the adverse impact of . . . litigation." *Lippe*, 249 F. Supp. 2d at 383.

2. Plaintiffs Have Not Pleaded Facts to Demonstrate a Section 275 Violation

As discussed above, plaintiffs have failed sufficiently to allege that MasterCard believed it faced ruinous exposure and therefore did not receive adequate consideration for the relinquishment of its right to assess banks. Thus, plaintiffs have failed to rectify the deficiency in their pleading identified first by Magistrate Judge Orenstein. (*See* Report and Recommendation at 36 ("Neither the Plaintiffs' prediction of the 'likely' results of a victory on their antitrust claims nor the corresponding estimate of third parties says anything about what *MasterCard* intended or believed in releasing the right of assessment.") (emphasis in original).)

Moreover, the value of the special assessment right depended, at a minimum, on a variety of unknown factors including the probabilities that MasterCard would have the need or

[13] In support of their assertion that MasterCard should have valued its exposure in this case differently, plaintiffs cite only to one inapposite Northern District of New York case, *Hasset v. Goetzmann*, 10 F. Supp. 2d 181, 188 (N.D.N.Y. 1998). *Hasset* involves the transfer of assets known to be worth $5 million for assets worth only $800,000. *Id.* Here, MasterCard believed and publicly stated it could not quantify the contingent liabilities.

desire to assess the banks (something it did not do in *In re Visa Check* or in any other case (ASC ¶ 191)), the portion of the liability assessed and the banks' willingness or ability to pay. Other than relying upon their own inflated estimates of the worth of their case, plaintiffs have not — and cannot — specifically allege facts demonstrating that MasterCard lacked good faith in valuing this special assessment right.[14] In short, plaintiffs have not alleged a factual basis for a Section 275 claim.

CONCLUSION

For the forgoing reasons, defendants respectfully request that this Court enter an order dismissing the First Amended Supplemental Class Action Complaint in its entirety with prejudice.

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[14] Furthermore, contrary to plaintiffs' assertions, defendants did not claim that "all Section 275 claims made when litigation is pending against the transferor fail as inherently speculative . . . ." (Pl. Opp. at 45.) Rather, defendants cited *Shelly v. Doe*, 173 Misc. 2d 200, 211-12 (N.Y. Co. 1997), for the proposition that pending litigation alone is not sufficient to establish a debtor's knowledge of impending insolvency. The appellate decision in *Shelly* does not alter this proposition, as the court there found that plaintiff pleaded that defendant believed he faced insolvency not only because of the pending litigation, but because defendant had testified at trial that he believed he would become insolvent. *Shelly v. Doe*, 249 A.D.2d 756, 757-58 (N.Y. App. Div. 1998). This is in sharp contrast to plaintiffs' allegations here.

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