UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

IN RE

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

PAYMENT CARD INTERCHANGE FEE
AND MERCHANT-DISCOUNT
ANTITRUST LITIGATION

This Document Relates To: All Class Actions

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CLASS PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS CLASS PLAINTIFFS' FIRST SUPPLEMENTAL CLASS ACTION COMPLAINT

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PRELIMINARY STATEMENT

Throughout its forty year history MasterCard has been operated as a joint venture of competing banks. The antitrust laws strictly regulate agreements among competitors but are more lenient in their treatment of single-firm conduct. When competing firms combine to create "single entities" – through merger, acquisition, or otherwise – the antitrust merger laws serve a vital role to guarantee that the firms that result from these combinations cannot harm competition by virtue of their market power.

Sensing impending liability in MDL 1720 for their collusive setting of Interchange Fees and related anticompetitive conduct, MasterCard and its Member Banks executed an Initial Public Offering ("IPO"), in an attempt to transform MasterCard into a "single entity," immune from Section 1 of the Sherman Act. Class Plaintiffs therefore bring this Supplemental Complaint to challenge the creation of this "New MasterCard"[1] with the market power to harm competition.

Simply put, MasterCard and its Member Banks will either succeed in their transparent attempt to obtain immunity from Section 1 of the Sherman Act or they will fail. If, as Class Plaintiffs suspect, they fail,[2] merchants can continue to seek relief from MasterCard's supracompetitive fees under Section 1 of the Sherman Act. If they succeed in creating a single entity immune from Section 1, they will perpetuate the market power that allows them to set supracompetitive fees, but their fee-setting will be outside the reach of Section 1. Fortunately for Class Plaintiffs and merchants across the country the antitrust merger laws regulate transactions like the MasterCard IPO that create single

1 Capitalized terms have the meanings given them in Class Plaintiffs' First Consolidated Amended Class Action Complaint, and in the Class Plaintiffs' First Supplemental Class Action Complaint.

2 This would occur if, for example, MasterCard's Member Banks continue to set Interchange Fees among themselves behind the façade of a publicly traded corporation.

entities with market power. It is under these laws – Section 7 of the Clayton Act and the Sherman Act's prohibition on "combinations. . .in restraint of trade," – that Class Plaintiffs seek relief from the supracompetitive fees they have been forced to pay, and will continue to be forced to pay after the MasterCard IPO.[3]

Class Plaintiffs are also challenging a number of agreements antecedent to the IPO that insulate this New MasterCard and its member banks from competition. These agreements enable MasterCard and its Member Banks to avoid having to compete more aggressively for merchant acceptance, thereby protecting the banks and their interests in Visa from fee-based competition. And in a further attempt to escape price-fixing liability, MasterCard's Member Banks agreed that, as part of the IPO, MasterCard would relinquish its right to assess the banks for extraordinary litigation liabilities – a right it had used to fund previous payment-card litigation. This agreement limits the banks' exposure at the expense of subjecting MasterCard to insolvency. Thus, Class Plaintiffs as major creditors of MasterCard and its Member Banks, challenge this agreement as a fraudulent conveyance under New York law.

STATEMENT OF FACTS

Before the IPO, MasterCard existed as a consortium of Member Banks. (Suppl. Compl. ¶ 12.) These banks compete with each other on several aspects of their business, including the fees they charge and benefits they provide to consumers and the fees they charge to merchants for accepting their cards. *Id.* And in a properly functioning market, all of the fees that merchants paid to accept payment-card transactions would be subject

3 Mergers and acquisitions subject to Section 7 are prohibited if their effect "may be substantially to lessen competition, or to tend to create a monopoly." Mergers and acquisitions subject to Section 1 are prohibited if they constitute a "contract, combination . . ., or conspiracy in restraint of trade." U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* § 0.1&2 ("*Merger Guidelines*").

to the forces of supply and demand and would remain at competitive levels. (Suppl. Compl. ¶ at 59.) By collectively agreeing to charge merchants a uniform schedule of default Interchange Fees, however, MasterCard and its Member Banks are able to assert their collective market power to elevate Interchange Fees, and thereby merchant discount fees, to supracompetitive levels. (Suppl. Compl. ¶ 88.) But even in this collusive environment, MasterCard claims that its Interchange Fees are "defaults," from which any issuing bank can deviate. *See* MasterCard Mem. Supp. Mot. Sum. J. at 5, *Kendall v. Visa U.S.A., Inc.*, No. C04-4276 (JSW) (N.D. Cal. June 3, 2005).[4]

It is precisely this collusive structure that threatens MasterCard and its Member Banks with antitrust liability for many of their practices toward merchants and competitors.[5] The reason that MasterCard and its Member Banks have attracted so much scrutiny is simple: competitors that collectively have market power impose serious harm on competition when they conspire to fix prices. Faced with the risk of antitrust liability, MasterCard and its Member Banks now attempt to remove what they phrase as the "technical barrier" – Section 1 of the Sherman Act – that prevents its members from collectively exercising their market power to extract supracompetitive fees from merchants. (Banks Br. at 1, 15.) But by seeking to remove this "technical barrier," MasterCard essentially admits that it is attempting to create a "single entity" that will unilaterally exercise the same market power that it and its members could not legally exercise collectively. *Id.* Even if it could successfully remove itself from Section 1, the

4 Of course, the fact that members of a price-fixing cartel have the option of "cheating" on the agreement does not immunize the cartel members from Section 1 liability. *Premier Elec. Constr. Co. v. Nat'l Elec. Contractors Assn., Inc.*, 814 F.2d 358, 370 (7th Cir. 1987) (Easterbrook, J.)

5 *See* (1st Consol. Am. Cl. Action Compl. ¶¶ 93, 131-34); *In re Currency Conversion Fee Antitrust Litig.*, 361 F. Supp. 2d 237, 243 (S.D.N.Y. 2005).

creation of a "single entity" New MasterCard with the power to set prices unchecked by market forces is anticompetitive and actionable under antitrust merger laws.

MasterCard attempts to accomplish this transition through a complex IPO and antecedent agreements ("the Agreements") that purport to turn MasterCard from a collaboration of competitors into a partly publicly traded company. Under the terms of the IPO, MasterCard acquired the common stock that its Member Banks previously held for $2.2 billion. (Suppl. Compl. ¶ 2.) MasterCard paid for this acquisition by selling to the public 61,520,912 shares of Class A, voting common stock. *Id.* The public's stake in the New MasterCard was limited to 49 percent of the equity stake in the organization, however. (Suppl. Compl. ¶ 80.) The banks preserved their equity interest by agreeing to turn 100 million shares of their common stock into class B non-voting stock. For the first four years after the IPO, this stock may be transferred only among Member Banks. (Suppl. Compl. ¶ 82.) After this four-year period, the banks' ownership level is maintained by converting publicly held Class A shares into Class B shares in the event that Class B shares are sold to non-bank investors. *Id.*

At the same time as MasterCard offered some of the previously-bank-owned shares to the public, it and its Member Banks executed a series of agreements (the "Ownership and Control Restrictions") to preserve the banks' control over MasterCard and, by extension, the General Purpose Card Network Services market. (Suppl. Compl. ¶ 6(d).) Through these restrictions, the banks preserve their control in a number of ways:

- The Member Banks may elect 3 MasterCard board members, up to 25 percent of the board;
- The Member Banks gain veto power over the sale of all or substantially all of MasterCard's assets;

- The Member Banks gain veto power over a merger or consolidation of MasterCard;
- The Member Banks may prevent a discontinuation of MasterCard's core business; and
- The Member Banks may prevent any entity from acquiring greater than a 15 percent equity share in the New MasterCard.

(Suppl. Compl. ¶¶ 81, 83).[6]

The transactions described above will accomplish through a Section 1 "combination" the supracompetitive Interchange Fees that MasterCard and its Member Banks cannot legally set through collusion. *See N. Sec. Co. v. United States*, 193 U.S. 197, 328 (1904). MasterCard's public statements before the IPO indicate that it intends to set uniform Interchange Fees after the IPO, just as its Member Banks had previously done collectively. (Suppl. Compl. ¶ 75.) Unlike the pre-IPO MasterCard, however, the New MasterCard may have the ability to set mandatory instead of default fees. In any case, this New MasterCard will assume the market power that its Member Banks once exercised collectively. In the past, this market power enabled the MasterCard Member Banks to collectively raise Interchange Fees without losing significant merchant acceptance. (Suppl. Compl. ¶ 36); *see also United States v. Visa U.S.A., Inc.*, 344 F.3d

6 At least one scholar has noted the unusual structure of the MasterCard IPO and the continuing control of New MasterCard by the Member Banks:

> "The dual-class voting structure is unusual because the insiders (the member banks) retain more economic exposure than voting rights, flipping the usual dual-class voting structure upside-down. This element of the structure is a magnificent example of what I call "regulatory cost engineering": driving a wedge between the economics of a deal and its treatment for legal or regulatory purposed. *The member banks retain effective control of the company, and they retain much of the economics of the firm. But they give away enough formal voting power to reduce their antitrust liability going forward*"

(emphasis added). Victor Fleischer, *The MasterCard IPO: Protecting the Priceless Brand*, Harv. Negotiation L. Rev. (forthcoming 2007) (manuscript at 2-3, Univ. of Colo. Law School Research Paper Services No. 06-25 (Draft of August 11, 2006), *available at* http://ssrn.com/abstract=888923). (A copy is Exhibit 1 to Declaration of Ryan W. Marth. The author also observes, "The deal is not really about raising money at all." Rather it is about avoiding antitrust liability. *Id.* at 4.

229, 240 (2d Cir. 2003). This conduct was undertaken with the risk of antitrust liability, however. Now, after the IPO, MasterCard will continue to exercise its market power over merchants but will do so free from the prospect of "defection" from its Interchange Fees and, according to MasterCard, free from the proscriptions of Section 1.

Plaintiffs cannot know without discovery the precise method by which the New MasterCard will set Interchange Fees. Based on MasterCard's public statements, however, MasterCard will be able to take advantage of its fee-setting market power in one of a few ways. First, it may continue to allow Member Banks to collectively set default Interchange Fees. (Suppl. Compl. ¶ 93.) Secondly, it may take over the Interchange-Fee setting function from the banks and act as a joint-selling agent for the banks' services in the relevant market. (Suppl. Compl. ¶ 91.) Lastly, it may take over the issuing and acquiring functions of the Member Banks. [7] (Suppl. Compl. ¶ 95.) As part of this function, the New MasterCard may have the ability to set mandatory rather than default Interchange Fees. From the perspective of merchants and the antitrust laws, however, the form is unimportant – the New MasterCard will be able to set Interchange Fees at the supracompetitive level that its market power permits.

While the IPO cements the market power that MasterCard and its Member Banks enjoy, the Agreements antecedent to the IPO insulate the Defendants' market power from competitive pressures to lower Interchange Fees. These restrictions allow MasterCard's

7 Consider whether, if MasterCard found it profitable to issue payment cards itself instead of or in addition to licensing its trademark to banks, would the Member Banks' Class M shares allow them to block this emergence of competition. (Suppl. Compl. ¶ 84); Kenneth A. Posner, *MasterCard: Litigation and Other Risks may be Less Severe than Market Expects* at 24 (Morgan Stanley June 22, 2006) (Issuing cards "would bring [MasterCard] into direct competition with its member banks, large and small, which would likely resent the perceived intrusion on their own turf. Anticipating this strategy, the member banks have arranged veto rights over a wide range of corporate actions, including the merger of MasterCard with any competitor of MasterCard, any member of MasterCard, or any financial institution that is eligible to become a member.").

Member Banks to block even transactions that would be advantageous for MasterCard and its shareholders. (Suppl. Compl. ¶¶ 82-84.) If, for example, a single investor wished to purchase MasterCard and operate it as a low-fee competitor to Visa, the 15 percent ownership limitation would prevent that from happening, regardless of the price that was offered.[8] (Suppl. Compl. ¶¶ 81, 84.) This example illustrates how the Ownership and Control Restrictions are not merely commonplace corporate governance rules, but rather a mechanism to protect the banks' dominance in the General Purpose Card Network Services market. And because nearly all of MasterCard's Member Banks – including all of the Bank Defendants – are also members of the competing Visa Network, the banks protect not only their interest in supracompetitive MasterCard merchant fees but also their interest in supracompetitive Visa merchant fees. (Suppl. Compl. ¶ 106.)

The end result of the IPO and the Ownership and Control restrictions is a single entity with market power in the market for General Purpose Card Network Services – the creation of such entities is precisely the harm that the antitrust merger laws are designed to prevent. *See Brown Shoe Co. v. United States*, 370 U.S. 294, 317 (1962) (citing legislative history of amendments to Clayton Act);[9] *see also United States v. Rockford Mem'l Hosp.*, 898 F.2d 1278, 1285 (7th Cir. 1990) (Posner, J.) (noting that few competitors and entry barriers increase firms' propensity to collude, one of the concerns

8 Contrary to Defendants' characterization of Plaintiffs supplemental complaint, that investor need not be a merchant or a joint-venture of merchants. It could be any individual, firm, or group of firms that wished to enter the General Purpose Card Network Services market to undercut the supracompetitive fees that Defendants charge to merchants.

9 Although the holding in *Brown Shoe* has been criticized, its account of the legislative history behind the 1950 amendments to the Clayton Act remains widely cited to this day. *See, e.g., FTC v. H.J. Heinz Co.*, 246 F.3d 708, 713 (D.C. Cir. 2001); Areeda & Hovenkamp, Antitrust Law § 903a.

of the antitrust laws). Plaintiffs have alleged and intend to prove that the IPO and Agreements will harm competition at least in the following ways:

- The New MasterCard will be able to set mandatory Interchange Fees at a level that reflects its market power and merchants' inability to discontinue accepting MasterCard payment cards. (Suppl. Compl. ¶¶ 117, 120.)
- The IPO permanently eliminates the fee-based competition for merchant acceptance that would have existed but for the anticompetitive practices that Plaintiffs are challenging in MDL 1720. (Suppl. Compl. ¶¶ 88, 122.)
- The IPO purports to remove exercises of MasterCard's market power from the scope of Section 1 of the Sherman Act. (Suppl. Compl. ¶¶ 88, 122.)
- The Ownership and Control Restrictions decrease the likelihood of entry into the General Purpose Card Network Services market by eliminating the possibility of a low-fee competitor acquiring MasterCard. (Suppl. Compl. ¶¶ 105-06.)
- The transformation to a New MasterCard will facilitate express and tacit collusion in the relevant market. (Suppl. Compl. ¶ 96.)

I. PLEADING STANDARDS ON A RULE 12(b)(6) MOTION TO DISMISS

On a Rule 12(b)(6) motion to dismiss, all of the Plaintiffs' allegations are taken as true and all reasonable inferences are drawn therefrom. *Global Network Communications, Inc. v. City of New York*, 458 F.3d 150, 154 (2d Cir. 2006). And a complaint may not be dismissed under this rule unless "it appears beyond doubt, even when the complaint is liberally construed, that 'the plaintiff can prove no set of facts in support of his claim that would entitle him to relief.'" *Id.* (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)). Because the proof of an antitrust violation often rests in the hands of a defendant, dismissals at the pleading stage in antitrust cases are especially disfavored. *In re European Rail Pass Antitrust Litig.*, 166 F. Supp. 2d 836, 839 (S.D.N.Y. 2001); *see also Poller v. Columbia Broad. Sys., Inc.*, 368 U.S. 464, 472-74 (1962). Thus, in antitrust cases, as in other cases, "a short plain statement of a claim for relief which gives notice to the opposing party is all that is necessary" to survive a Rule 12(b)(6) motion to dismiss. *In re European Rail Pass*, 166 F. Supp. 2d at 840.

On a motion to dismiss, "consideration is limited to the factual allegations in plaintiffs' amended complaint…, to documents attached to the complaint as an exhibit or incorporated in it by reference, to matters of which judicial notice may be taken, or to documents either in plaintiffs' possession or of which plaintiffs had knowledge and relied on in bringing suit." *Muhammad v. New York City Transit Authority*, __ F. Supp. 2d __, 2006 WL 2714064, at *3 (E.D.N.Y. Sept. 20, 2006) (quoting *Brass v. Am. Film Techs., Inc.*, 987 F.2d 142, 150 (2d Cir. 1993)). If the plaintiff merely refers to documents without explicitly incorporating or attaching them, those documents may not be considered without converting the motion to dismiss to one for summary judgment. *Cosmas v. Hassett*, 886 F.2d 8, 15 (2d Cir. 1989) (holding that SEC documents that were cited were not incorporated by reference); *Lijoi v. Cont'l Cas. Co.*, 414 F. Supp. 2d 228, 244 (E.D.N.Y. 2006).

Class Plaintiffs are challenging the IPO and other agreements that were hatched in private. MasterCard's SEC filings are public reports of those agreements but do not reflect the entirety of the conduct Class Plaintiffs challenge. Defendants' submission of these materials with their motion converts this motion into a motion under Rule 56. *See* Declaration of Adav Noti (submitted with Defendants' motions); Fed. R. Civ. P. 12(b) and 12(c). This entitles Plaintiffs to discovery before the Court may rule on the motion.

II. THE ANTITRUST MERGER LAWS APPLY TO THE IPO

Defendants argue that the IPO and Agreements are merely corporate restructuring maneuvers to which the antitrust laws do not apply. (*See* Banks' Br. at 1, 19) This characterization conflicts, however, with MasterCard's pre-IPO public statements that the IPO was intended to lessen MasterCard's antitrust woes by turning it from a joint venture of competitors into a single entity. (Suppl. Compl. ¶ 78.) It also overlooks the antitrust laws' traditional concern with market structure and the creation of firms with market power. *FTC 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)).

A review of early antitrust enforcement illustrates exactly why the antitrust merger laws should apply to and condemn the transactions challenged in the Supplemental Complaint. In early decisions, courts took a harsh view of cartel activity. *See United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899). At the same time, the Supreme Court refused to apply the Sherman Act even to a merger that created a monopoly. *See United States v. E.C. Knight*, 156 U.S. 1, 9 (1895). Because of this dichotomous enforcement, companies such as the *Addyston Pipe* defendants found they could simply merge to avoid the antitrust laws. Areeda & Hovenkamp, *Antitrust Law*, ¶ 902a2.[10] Recognizing the loophole it had created, the Supreme Court then became more aggressive in merger cases, ruling that the transfer by two competitors of stock to a holding company was an unlawful combination under Section 1. *N. Sec. Co. v. United States*, 193 U.S. 197, 360 (1904).

While many years have passed since *Northern Securities*, the policy lessons contained in these early cases continue to guide antitrust enforcement. As Defendants trumpet in their briefs, the antitrust laws treat single-firm conduct more leniently than

10 The *Addyston Pipe* defendants merged to form the United States Cast Iron Pipe and Foundry Co., which controlled 75 percent of the domestic pipe-manufacturing capacity. Areeda & Hovenkamp, *supra*, ¶ 902a2 n.22. In fact, the leading antitrust treatise cites historical evidence that lax merger enforcement may have led to the merger wave of the early 1900s. *Id.* ¶ 902a2.

concerted conduct. (Bank Defs. Br. at 15) (citing *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 767-68 (1984)). The law makes this distinction because it presumes that vigorous competition among economically rational single firms will encourage those firms to increase efficiency to the benefit of consumers. (Bank Defs. Br. at 15); *Copperweld*, 467 U.S. at 768-69. But the rationale for leniency toward single-firm conduct — to encourage aggressive competition — does not apply when that single firm has acquired market power through a combination or merger of competitors. *See R.C. Bigelow, Inc. v. Unilever N.V.*, 867 F.2d 102, 108 (1989) (citing *Brown Shoe*, 370 U.S. at 343). If a firm has market power, it is able to elevate and maintain prices either unilaterally or by coordinating with competitors.

The record indicates that MasterCard is attempting to create a single entity where one did not exist before. (Suppl. Compl. ¶¶ 4, 78.) And this single entity will possess market power and be able to exercise that market power unilaterally, whereas the Member Banks could previously exercise that power only through collusion subject to Section 1. (Suppl. Compl. ¶¶ 88, 91.) Thus, assuming the New MasterCard sets Interchange Fees at a level that is "rational" for a firm with its market power, those fees will be set at a supracompetitive level. *Id.* The merchant-plaintiffs have been harmed by paying those elevated fees and will continue to be harmed in the future. (*See* Suppl. Compl. ¶ 114(b)). These merchants can therefore properly challenge these transactions under the antitrust laws governing mergers and acquisitions.

III. THE IPO AND AGREEMENTS ARE ACTIONABLE UNDER SECTION 7 OF THE CLAYTON ACT

The MasterCard IPO is an acquisition that implicates Section 7 of the Clayton Act. Despite their adamant protests to the contrary, both MasterCard and the Bank

Defendants are "acquirers" within the meaning of Section 7. (MasterCard Br. at 4-6; Banks' Br. at 11-12.) Furthermore, Class Plaintiffs demand injunctive relief in their amended complaint, including the unwinding of the MasterCard IPO. (Suppl. Compl. Prayer for Rel. C-D.) To effect this relief, the Court legally may – and in fact must – maintain jurisdiction over the Bank Defendants and MasterCard under Section 7. *United States v. Coca-Cola Bottling Co. of Los Angeles*, 575 F.2d 222, 229 (9th Cir. 1978).

A. MasterCard Has Acquired The Assets And Stock Of The Member Banks.

1. *The IPO is a stock acquisition to which Section 7 applies.*

Section 7 of the Clayton Act governs acquisitions of "the whole or any part of the stock or other share capital…*of* another person." (emphasis added). MasterCard argues that Section 7 does not apply to it because it acquired MasterCard stock rather than another company's stock. (MasterCard Br. at 4-5.) This argument contradicts both the plain meaning of the text and sound antitrust policy.

MasterCard's argument attempts to change the text of Section 7 from "*of* another person" to "*in* another person." *See Id.* The dictionary definitions of those two prepositions reveal this slight of hand.[11] The word "of," refers to origin, "[i]ndicating the thing, place, or person from which or whom something originates, comes, or is acquired or sought." OXFORD ENGLISH DICTIONARY ONLINE (Oxford Univ. Press 2006), *available at http://www.oed.com*. "In," by contrast, expresses "inclusion, situation, position, existence, or action…." *Id.* Because MasterCard "acquired or sought" stock from the

[11] Courts in this circuit commonly consult dictionary definitions to determine the plain meaning of statutory terms. *See, e.g., In re Ishihara Chem. Co., Ltd.*, 121 F. Supp. 2d 209, 218 (E.D.N.Y. 2000), *rev'd on other grounds*, 251 F.3d 120 (2d Cir. 2001) (citing *United States v. SKW Metals & Alloys, Inc.*, 195 F.3d 83, 90 (2d Cir. 1999))..

Member Banks, it acquired that stock "of" them. That the stock was "included in" MasterCard is immaterial to this inquiry and does not support dismissal.

The policy behind merger enforcement — to protect competition and prevent the concentration of market power — further supports applying Section 7 to this transaction. *See H.J. Heinz* 246 F.3d at 713. In a famous Supreme Court case, this policy justified the application of Section 7 to a transaction in which two defendants formed a new corporation and then divided that corporation's stock between themselves. *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 167-68 (1964). Even though the newly formed corporation had not previously "engaged in commerce," the formation of that company was governed by Section 7 because it ended competition between the defendants. *Id.* at 168.

By executing the IPO, MasterCard is consolidating stock previously held by thousands of banks. (Suppl. Compl. ¶¶ 86, 117.) In doing so, MasterCard also acquired the fee-setting authority that, in an unrestrained market, would have belonged individually to each of the Member Banks. (Suppl. Compl. ¶ 91.) This acquisition therefore prevents competition among Member Banks in the setting of Interchange Fees and allows MasterCard to maintain Interchange Fees at a supracompetitive level. (Suppl. Compl. ¶¶ 114(a)-(b), 117); *see also Penn-Olin*, 378 U.S. at 168. Thus, allowing MasterCard to escape Section 7 merely because it acquired MasterCard stock would create a loophole to engage in exactly the kind of consolidation that Section 7 was intended to prevent.[12]

2. *MasterCard Acquired Assets of the Member Banks.*

MasterCard's claim that it "did not acquire the. . . assets of another" relies on a narrow interpretation of "assets" and "acquire" that is not supported by federal precedent. (MasterCard Br. at 4.) In the context of the Clayton Act, these terms are interpreted broadly and "may mean anything of value." *United States v. Columbia Pictures Corp.*, 189 F. Supp. 153, 182 (S.D.N.Y. 1960). The form of an acquisition is immaterial, so long as there has been a "transfer of a sufficient part of the bundle of rights. . . to give the transfer economic significance." *McTamney v. Stolt Tankers & Terminals*, 678 F. Supp. 118, 120 (E.D. Pa. 1987). Thus, if one firm acquires economic decision-making ability that previously belonged to another, it has acquired an "asset" for purposes of Section 7. *See id.* In the case of *McTamney*, an "asset acquisition" was found based on the fact that two companies acquired the ability to control a third company's payment of creditors. *Id.* (citing *Nelson v. Pacific Southwest Airlines*, 399 F. Supp. 1025, 1028 (C.D. Cal. 1975)).[13] Similarly, courts recognize that the setting of prices is an asset because it is one of the most important competitive decisions that businesses make. *See Nelson*, 399 F. Supp. at

12 The loophole suggested by MasterCard would seriously undermine merger enforcement by enabling parties to structure transactions to fit into this loophole. *See Merger Guidelines* at 0.1 ("The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise. Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time.")

13 This proper interpretation of Section 7 led the District of Utah to apply a Section 7 merger analysis to a decision by Sears (the owner of Discover card) to join the Visa Network even though that decision did not "fit neatly into a merger analysis." *SCFC ILC, Inc. v. Visa U.S.A., Inc.*, 819 F. Supp. 956, 992 (D. Utah 1993), *rev'd in part on other grounds*, 36 F.3d 958, 960 (10th Cir. 1994). After a bench trial, the court found that merchant-discount-fee competition would be stifled by Sears joining Visa, but concluded that no violation had occurred because that harm was outweighed by benefits to competition. *Id.* at 997.

1028. *McTamney* and *Nelson* are in agreement with several federal court decisions that have found asset acquisitions based on the consolidation of decision-making authority.[14]

Taking the allegations in the Supplemental Complaint as true, MasterCard acquired a valuable asset — decision-making power over the setting of Interchange Fees among its Member Banks — that allows it to exercise market power in the relevant market.[15] (Suppl. Compl. ¶¶ 86, 91.); *see also McTamney*, 678 F. Supp. at 120. In the payment-card industry, as in other industries, fee-setting is a valuable function. *See Nelson*, 399 F. Supp. at 1028. Absent Defendants' collusion, Member Banks would be free to compete for merchant acceptance based on the level of fees they charge to merchants. (*See* Suppl. Compl. ¶ 59.) The banks' success or failure would depend partly on the prices they set. Because the fee setting function is so integral to banks' competitiveness, MasterCard has acquired an extremely valuable asset.[16] *See Columbia Pictures*, 189 F. Supp. at 182.

B. **The Bank Defendants Have Acquired Stock.**

The Bank Defendants' argument that, because they are not "net acquirers" of stock, they are not regulated by Section 7, is not supported in the plain text of the

14 These decisions include findings of acquisitions when companies reached a sales agreement, *United States v. ITT Cont'l Baking Co.*, 485 F.2d 16, 20 (10th Cir. 1973), *rev'd on other grounds*, 420 U.S. 223 (1975), gained a right of first refusal, *Mr. Frank, Inc. v. Waste Mgmt., Inc.*, 591 F. Supp. 859, 866-67 (N.D. Ill. 1984), entered into an operating lease, *United States v. Archer-Daniels-Midland Co.*, 584 F. Supp. 1134, 1138-39 (S.D. Iowa 1984), or executed an exclusive license, *Columbia Pictures*, 189 F. Supp. at 181-82.

15 Among the Member Banks' assets that New MasterCard acquired as a result of the Agreements is control over the valuable MasterCard brand and trademark. Although the MasterCard brand and trademark were nominally "owned" by MasterCard before the IPO, actual decision-making control over the use of the brand and trademark resided in the Member Banks who owned and controlled MasterCard. Post-IPO, however, New MasterCard — at least theoretically — has unfettered control over the use of the MasterCard brand and trademark. Trademarks and similar intellectual property are plainly "assets" within the cope of Section 7. *See e.g. United States v. Lever Bros.*, 216 F. Supp. 887, 889 (S.D.N.Y. 1963) (trademarks); *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1205 (2d Cir. 1981).

16 The full extent of MasterCard's acquisitions is not apparent from public information. Therefore, the effect of the acquisition on competition cannot be determined until discovery has been completed.

statute.[17] (Banks' Br. at 11-12.) As noted above, Section 7 broadly prohibits acquisitions of "the whole or any part of the stock or other share capital," if the effect of the acquisition "may be substantially to lessen competition." The Bank Defendants cite to no cases that support their narrowing interpretation. (Banks Br. at 11-12.)

The Supplemental Complaint alleges – and the Bank Defendants admit – that they have acquired Class M and Class B stock in the New MasterCard. (Suppl. Compl. ¶¶ 13, 81; Banks' Br. at 7-8.) This alone brings the transaction within the plain meaning of Section 7. The connection of the Member Banks' stock acquisition to the harm that Class Plaintiffs allege truly ends this inquiry. As fully set forth in Section V. below, Class Plaintiffs allege the banks' acquisition of these shares gives them substantial and practical control over the New MasterCard, which allows them to block any acquisition or change in MasterCard's structure that would threaten the banks' supracompetitive Interchange Fees. (Suppl. Compl. ¶¶ 100-06.) By preventing competition from a lower-fee competitor, the banks' acquisition of control harms Class Plaintiffs by maintaining the Interchange Fees of MasterCard and its Member Banks at supracompetitive levels. (Suppl. Compl. ¶ 106.)

C. <u>The Section 7 Claim Against The Banks Should Not Be Dismissed Because Class Plaintiffs Seek Injunctive Relief.</u>

Finally, the Section 7 claims against the Bank Defendants should not be dismissed because this Court's jurisdiction over the Banks is necessary to effectuate injunctive

17 The Bank Defendants correctly note that their acquisition of assets is not subject to Section 7. (Banks' Br. at 12-13.) Their acquisition of stock in the New MasterCard, on the other hand, is actionable under Section 7. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 321 (1963) ("[T]he specific exception for acquiring corporations not subject to the FTC's jurisdiction excludes from the coverage of § 7 only assets acquisitions by such corporations when not accomplished by merger."). And even if this Court accepted the banks' argument that Section 7 does not cover their stock acquisition, dismissal would not be proper because their conduct would still be actionable as a "combination" under Section 1 of the Sherman Act. (Suppl. Compl. 18th Cl. for Rel.) *See Rockford Mem'l*, 898 F.2d at 1281 (reversing § 7 judgment but upholding liability on identical facts under § 1 of the Sherman Act).

relief. Section 7 of the Clayton Act calls upon the broad equitable jurisdiction of federal courts to restrain violations of the Act. 15 U.S.C. § 25. This equitable jurisdiction "authorize[s] relief against such parties if necessary to eliminate the effects of an acquisition offensive to [Section 7]." *Coca-Cola*, 575 F.2d at 229; *see also United States v. Visa*, 163 F. Supp. 2d 322, 406-07 (S.D.N.Y. 2001) (maintaining jurisdiction over nonparty (Visa International) to guarantee that proper relief could be fashioned). Thus, even if this Court accepted the banks' technical defense to Section 7 that they were not acquirers, the Court nonetheless should maintain the Section 7 cause of action against them in order to remedy a violation of Section 7. For this reason, federal courts have noted that maintaining equity jurisdiction over a seller is proper.[18]

In order to effectuate the equitable remedy that Plaintiffs seek, the Court must be able to unwind the IPO. (Suppl. Compl. Pr. for Rel. A, B, C.) Class Plaintiffs allege that the consolidation of the price-setting power of the Member Banks will allow the New MasterCard to raise or maintain Interchange Fees. (Suppl. Compl. ¶¶ 115-17.) Without this consolidation or the anticompetitive collusion that Class Plaintiffs allege in their Consolidated Complaint, the New MasterCard and the Member Banks could not set supracompetitive Interchange Fees. (Suppl. Compl. ¶¶ 59, 117.) Thus, in order to shape an equitable solution to this problem, this Court should maintain jurisdiction over Bank Defendants and deny their motion to dismiss the Section 7 claims.

18 *See United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 608 (1957) ("It seems appropriate that [third parties] be retained as parties pending determination by the District Court of the relief to be granted"); *Community Publishers v. Donrey Corp.*, 892 F. Supp. 1146, 1174 n.23 (W.D. Ark. 1995); *Arbitron Co. v. Tropicana Prod. Sales, Inc.*, No. 91 Civ. 3697 (PKL), 1993 WL 138964, at *4 (S.D.N.Y. Apr. 28, 1993) (implying that plaintiff may have succeeded in stating a claim under Section 7 against seller if it had joined the seller and sought rescission of the sale). To be certain, the Supreme Court later stated that the sellers in the *DuPont* case could renew their objections to the district court's equity jurisdiction over them, but the Court never decided the issue. *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 334-35 (1961).

IV. <u>CLASS PLAINTIFFS HAVE ADEQUATELY PLED THAT THE EFFECT OF THE IPO AND AGREEMENTS "MAY BE TO SUBSTANTIALLY LESSEN COMPETITION"</u>

Bank Defendants erroneously assert that Section 7 of the Clayton Act applies a more lenient standard of anticompetitive effects than Section 1 of the Sherman Act. (Banks' Br. at 10.) The Southern District of New York has noted that there is "no substantive difference" between the merger standards under the two sections because both examine the "probable effects of an agreement." *Vantico Holdings, S.A. v. Apollo Mgmt. LP*, 247 F. Supp. 2d 437, 458 (S.D.N.Y. 2003) (citing *Rockford Mem'l*, 898 F.2d at 1281-83). While the standards under the two sections once were divergent, that distinction has disappeared as modern courts have moved away from early Clayton Act cases condemning mergers with even single-digit market shares. *Rockford Mem'l*, 898 F.2d at 1281-83 (referencing *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966)). In modern Section 7 cases, courts have examined whether transactions are likely to "hurt consumers," which essentially mimics the Section 1 inquiry. *Id.* at 1282-83. Thus, under either section, the proper standard is whether the transaction is "likely to reduce competition substantially." *Id.* at 1283.

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*, 26 F.3d at 713 (citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962)). Thus, in order to state a claim under Section 7, a Plaintiff must allege a "reasonable probability" of anticompetitive effects materializing from a transaction. *Id.* (citing Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust* § 9.1, at 511 (2000)). Plaintiffs have met this burden by alleging that the IPO creates a New

MasterCard with market power in the relevant market, thereby permanently eliminating Interchange Fee competition among its Member Banks. (Suppl. Compl. ¶ 122.)

A. <u>The New MasterCard Will Have Market Power In The Market For General Purpose Card Network Services.</u>

"Merger enforcement, like other areas of antitrust, is directed at market power." Sullivan & Grimes, *supra*, § 9.1, at 511. But unlike other areas of the law, merger enforcement is focused on market structure rather than conduct. *H.J. Heinz*, 26 F.3d at 715; Areeda & Hovenkamp, *supra*, § 944b. The concern in modern antitrust cases is the same as in the early days of enforcement — when an acquisition is likely to increase concentration or creates a firm with market power, prices will increase and output will decrease. *H.J. Heinz*, 246 F.3d at 715. The problem of single-firm market power is even more acute in markets with a demonstrated history of collusion. *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 905 (7th Cir. 1989) (Posner, J.); *see also* Areeda & Hovenkamp, *supra*, ¶ 944b. In these poorly performing markets, an acquisition can harm competition by making it easier for firms to reach agreements and decrease the likelihood that a firm will "cheat" on a cartel. *See Elders Grain*, 868 F.2d at 906. Even if collusion-prone markets are not functioning properly before an acquisition, the acquisition may further harm competition by decreasing the chances that cartel activity is detected or that firms "defect" from the cartel behavior. *See id.* at 905. Thus, especially in collusion-prone markets, the merger laws have a vital role in preventing the weakening of competition in its incipiency. *H.J. Heinz*, 246 F.3d at 713, 715.

Plaintiffs' allegations and historical evidence in the relevant market make clear that the New MasterCard will have market power in the General Purpose Card Network Services market. (Suppl. Compl. ¶¶ 35-36.) Both this Court in *In re Visa Check,* and

Judge Jones in *United States. v. Visa*, determined that MasterCard has market power. *In re Visa Check*, 1712568, at *4 (E.D.N.Y. Apr. 1, 2003) (denying summary judgment for MasterCard); *United States v. Visa*, 163 F. Supp. 2d at 340-41. And the demonstrated history of collusion in the General Purpose Card Network Services market further supports the inference that the IPO will harm competition. (*See* Cl. Pls. 1st Am. Consol. Cl. Action Compl. ¶¶ 177-92.) If New MasterCard sets mandatory as opposed to default Interchange Fees, the Member Banks – acting as members of Visa – will be relieved of the possibility that individual banks could undercut the default rate for MasterCard transactions. The loss of this pressure would encourage Visa and its Member Banks to maintain their supracompetitive fees.

Defendants will certainly argue that MasterCard's market power has not increased as a result of the IPO and therefore is competitively neutral. (*See* Banks' Br. at 15.) This argument ignores a crucial difference between pre-IPO and post-IPO market power, however. Before the IPO, MasterCard and its Member Banks were able to exercise market power only because they colluded on the setting of Interchange Fees. (*See* Suppl. Compl. ¶ 59.) This collusion could be stopped at any time by Section 1 of the Sherman Act, which prohibits restrictions among competitors even in the context of a joint venture. *See Bd. of Regents of Univ. of Okla. v. NCAA*, 468 U.S. 85, 120 (1984). After the IPO, however, every fee-setting decision by the "single entity" MasterCard is an exercise of market power that MasterCard argues is outside the scope of Section 1. *See H.J. Heinz*, 246 F.3d at 713. And while it may not be illegal for a single entity with lawfully acquired market power to charge supracompetitive prices, the Sherman and Clayton Acts function as roadblocks to acquisitions that give companies that power.

B. **The IPO Permanently Eliminates Fee-Based Competition Among MasterCard Member Banks.**

The Clayton Act recognizes that the prevention of potential or suppressed competition can constitute a "substantially lessen[] competition." *Penn-Olin*, 378 U.S. at 173. For example, the Southern District of New York issued an injunction against a group of motion-picture studios that sought to form a joint venture to sell their films to cable-television operators, even though the studios had not previously competed in the cable market. *United States v. Columbia Pictures Indus., Inc.*, 507 F. Supp. 412, 434 (S.D.N.Y. 1980).[19] The court reasoned that transaction would be anticompetitive because "competitors, especially those dominating a market, generally may not transfer to a joint venture their most competitive commercial functions." *Id.* at 430 (internal quotes and citations omitted). Similarly, the antitrust laws would prevent the merger even of firms that operated as a cartel before the merger. Areeda & Hovenkamp, *supra*, ¶ 907. That merger would be anticompetitive because it would make the parties' exercise of market power permanent. This is true even though, as a matter of economics, the price charged by the cartel and the merged firm might be the same. *Id.*

In MDL 1720, Plaintiffs are seeking to end MasterCard's 40-year-long practice of collectively setting Interchange Fees among its Member Banks. (Suppl. Compl. Prayer for Relief B). Plaintiffs allege that, but for the collective setting of Interchange Fees, competition among MasterCard Member Banks would drive down Interchange Fees in the relevant market. (Cl. Pls.' 1st Am. Consol. Cl. Action Compl. ¶ 255(f).) The IPO essentially converts this collusive structure to one in which MasterCard's Member Banks

19 Even though this case was brought under Section 1 of the Sherman Act, the court's reasoning that the formation of the joint venture lessened competition is equally applicable to the Section 7 context. *See Columbia Pictures*, 507 F. Supp. at 421.

agree to delegate pricing, one of "their competitive commercial functions," to MasterCard. (*See* Suppl. Compl. ¶ 91); *Columbia Pictures*, 507 F. Supp. at 430. This delegation of the pricing function harms competition because it permanently prevents fee-based competition among banks from emerging. (*See* Suppl. Compl. ¶ 91); *Columbia Pictures*, 507 F. Supp. at 430; Areeda & Hovenkamp, *supra*, ¶ 907.

V. THE OWNERSHIP AND CONTROL RESTRICTIONS ARE UNREASONABLE RESTRAINTS ON TRADE

An organization's restrictions on ownership, sale, or control are often scrutinized under Section 1 because they affect the incentives of participants in that organization and others in the market. *United States v. Visa*, 344 F.3d 229, 240 (2d Cir. 2003); *N. Am. Soccer League v. NFL*, 670 F.2d 1249, 1259 (2d Cir. 1982) ("*NASL*"). This is especially true in the context of joint ventures and associations, in which joint-venture parents often attempt to enact restrictions that protect themselves from competition within or outside the association. *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 612 (1973). Such restrictions may harm competition from their inception. Thus, courts have enjoined the formation of entities that contain such restrictions, even before those restrictions were put into practice. *See Columbia Pictures*, 507 F. Supp. at 420 (noting studios' prohibition on sales outside of joint venture).

Federal precedents shed light on the types of restrictions that Section 1 condemns. For instance, the Second Circuit condemned as unreasonable an NFL prohibition on team owners also holding stakes in teams playing in other sports leagues. *See NASL*, 670 F.2d at 1261. The court found this agreement weakened an upstart soccer league (*NASL*) because it restricted *NASL*'s access to the type of ownership capital that was needed for the league to compete. *Id.* at 1259. By reducing *NASL*'s access to ownership expertise, the court found that competition for fan support and TV revenues between the two leagues and their teams were harmed. *Id.* at 1260. The First Circuit rejected another NFL-ownership restriction that prohibited owners from selling shares of teams to the public. *Sullivan v. NFL*, 34 F.3d 1091, 1096-97 (1st Cir. 1994). According to the court, this ban was anticompetitive because it insulated team owners from competition by publicly owned teams, that could have been more effective competitors. *Id.* at 1100. Importantly, in each of these cases, the restrictions among association members were found to harm both competition among members and competition for their consumers. *Id.* at 1101-02 (citing expert testimony that public ownership could produce superior teams); *NASL*, 670 F.2d at 1254 (noting competition between *NASL* and NFL teams).

Plaintiffs have alleged harm to themselves, and to competition, that flows from the restrictions placed on the ownership and control of the New MasterCard. Like the restrictions in *Sullivan*, both the 15 percent limitation and the banks' veto power have the effect of barring a firm from entering the General Purpose Card Network Services market by acquiring an interest in MasterCard and operating the Network as a more-effective, low-fee competitor.[20] (Suppl. Compl. ¶¶ 100-06); *Sullivan*, 34 F.3d at 1100. These are not, as Defendants suggest, a commonplace, competitively neutral restraint on corporate control. (Banks Br. at 19.) Rather, they are restraints among competitors that restrict the behavior of an association (MasterCard) to which they all belong. *See Topco*, 405 U.S. at 612; *NASL*, 670 F.2d at 1259 (noting suppression of competition between NFL and *NASL*). And just as in the NFL cases, the Ownership and Control Restrictions are in the

20 The Defendants make much of Class Plaintiffs' suggestion that a joint venture of merchants may want to acquire MasterCard. This is merely one suggestion of an entity that would have an interest in competing as a low-cost competitor to Visa and MasterCard. From the perspective of competition, however, it makes no difference whether the party seeking to acquire MasterCard is a merchant or merely a private investor.

banks' interest, but not necessarily in the interest of New MasterCard, and definitely not in the interest of merchants.[21] (*See* Suppl. Compl. ¶ 92.)

The fact that the Ownership and Control Restrictions have not yet prevented entry does not justify dismissal on the pleadings. (*See* Banks' Br. at 16-17.) Courts recognize that the creation of barriers to entry is anticompetitive, even if there are no firms prepared to enter the market at the time of the acquisition. *Bon-Ton Stores, Inc. v. May Dep't Stores Co.*, 881 F. Supp. 860, 878 (W.D.N.Y. 1994); *see also Tasty Baking Co. v. Ralston Purina, Inc.*, 653 F. Supp. 1250, 1255, 1273-76 (E.D. Pa. 1987). And acquisitions are often prevented at their inception based upon the probability that they will facilitate collusion among firms in the post-acquisition market – even if collusion has not yet occurred. *H.J. Heinz*, 246 F.3d at 715. Thus, even if the Ownership and Control restrictions have yet to prevent an actual buyer from acquiring MasterCard, their creation is anticompetitive because it protects the supracompetitive fees that exist in the relevant market. (Suppl. Compl. ¶ 106.) In addition, Class Plaintiffs allege that, by discouraging entry and elevating prices, the Ownership and Control Restrictions immediately harm competition. These restrictions are therefore properly asserted at this stage.

VI. <u>THE ELIMINATION OF THE ASSESSMENT RIGHT WAS A FRAUDULENT CONVEYANCE</u>

The New York Debtor and Creditor Law, § 270 *et seq.* (McKinney 2001) ("NYDCL"), governs fraudulent-conveyance claims, and contains several sections that set forth distinct types of fraudulent-conveyance claims. Under any of these sections, a

[21] For example, if an investor offered to buy MasterCard at an adequate premium to its stock price, it may be in the best interest of MasterCard and its public shareholders to accept the offer. But if this suitor planned to lower Interchange Fees, the sale would not be in the banks' interest because it would threaten the interchange-fee revenue that MasterCard (and Visa) Member Banks enjoy. Thus, the Ownership and Control Restrictions serve only to protect the interests of the banks as competitors (rather than as investors).

plaintiff must: (1) be a creditor of the defendant; and (2) must allege that the defendant has made a "conveyance" to another party. In addition to alleging these two elements, a plaintiff must meet the requirements of one of the applicable sections. *See* NYDCL §§ 270 *et seq.*

Two of these sections, NYDCL §§ 275-76, apply in this case and mandate that Class Plaintiffs' fraudulent conveyance claims not be dismissed. Section 275 invalidates conveyances "incurred without fair consideration" when the conveying party "intends or believes" that it will incur debts beyond its ability to pay. Section 276 invalidates all transactions — regardless of the defendant's solvency — undertaken with actual intent to defraud present or future creditors.[22]

A. **Class Plaintiffs Have Pled A Fraudulent Conveyance Claim With Particularity.**

Under NYDCL § 276, and Fed. R. Civ. P. 9(b), a plaintiff must allege fraud with particularity. *In re Actrade Fin. Techs., Ltd.*, 337 B.R. 791, 809 (Bankr. S.D.N.Y. 2005). When proof of fraud rests in the hands of the defendants, however, courts take a pragmatic approach to this pleading standard. *Sullivan v. Kodsi*, 373 F. Supp. 2d 302, 306 (S.D.N.Y. 2005). For example, when the plaintiff cannot know the details of a transaction because the defendant is an insider and "has the particulars of the fraud. . .peculiarly within [its] knowledge," the plaintiff may rely on more generalized pleadings. *Bulkmatic Transport Co., Inc. v. Pappas*, 99 Civ. 12070 (RMB)(JCF), 2001 U.S. Dist. LEXIS 6894, at *37 (S.D.N.Y. May 11, 2001) (internal citations omitted).

22 Defendants spend significant effort characterizing Class Plaintiffs' claim as a claim under § 273-a, and attempting to dismiss that claim. (MasterCard Br. at 8-11.) Because that section applies only when a judgment has been obtained, however, Class Plaintiffs are not asserting a claim under that section.

Although the details of MasterCard's final IPO and Agreements are public, the circumstances behind those Agreements — such as the Defendants' motivation for removing the special-assessment right — were hidden behind closed doors. Given these circumstances, Class Plaintiffs have met their pleading burden under Rule 9 and the NYDCL.[23] The Supplemental Complaint repeats MasterCard's admission that its release of the special-assessment may threaten it with insolvency. (Suppl. Compl. ¶ 109.) And while Class Plaintiffs cannot know at this stage the precise value of the special-assessment right, the Supplemental Complaint states that MasterCard's $25 billion of potential legal liabilities could easily exceed its $5 billion value. (Suppl. Compl. ¶ 111, 112; *see also* Cl. Pls. 1st Am. Consol. Cl. Action Compl. ¶ 225(g).) Defendants' fraudulent intent is also apparent in ¶ 109, which implies the Member Banks' intent to remove their obligations to MasterCard without paying an adequate sum in return.

B. <u>The New York Debtor And Creditor Law Provides Class Plaintiffs With A Remedy For Defendants' Fraudulent Conveyance.</u>

Class Plaintiffs are covered by the NYDCL because they are "creditors" that are harmed by a "conveyance" made without adequate consideration. A "creditor" for purposes of NYDCL is "a person having any claim, whether matured or unmatured." NYDCL § 270; *Lippe v. Bairnco Corp.*, 225 B.R. 846, 856 (S.D.N.Y. 1998). NYDCL defines "conveyance" as "every payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property, and also the creation of any lien or

23 If the Court finds that Class Plaintiffs did not plead with particularity, the appropriate remedy would be dismissal with leave to amend, as "[c]omplaints dismissed under Rule 9(b) are 'almost always' dismissed with leave to amend." *Luce v. Edelstein*, 802 F.2d 49, 56 (2d Cir. 1986) (citations removed) (reversing dismissal of fraud claim without leave to amend); *see also Atlanta Shipping Corp., Inc. v. Chem. Bank*, 818 F.2d 240, 251 (2d Cir. 1986) (affirming lower order that plaintiff replead § 276 claim with particularity).

incumbrance." NYDCL § 270.[24] Defendants do not dispute that Class Plaintiffs are creditors and that a conveyance has occurred.

C. MasterCard's Release Of Its Special-assessment Right Is A Constructive Fraud In Violation Of NYDCL § 275.

Section 275 invalidates any transfer made (1) without fair consideration, (2) by a person who "intends or believes that he will incur debts beyond his ability to pay as they mature." Such a conveyance is fraudulent as to both present and future creditors. *Id.*

1. *MasterCard did not Receive "Fair Consideration" for releasing its special-assessment right.*

A debtor conveys property for "fair consideration" if: (1) it provides adequate consideration as defined by the facts of each case, or (2) conveys the asset in good faith "in an amount not disproportionately small as compared with the value of the property. . .obtained." NYDCL § 272; *Petersen v. Vallenzano*, 849 F. Supp. 228, 231 (S.D.N.Y. 1994).[25] The allegations of the Supplemental Complaint support the conclusion that fair consideration was lacking under both of these prongs.

a. MasterCard did not Receive the Fair Equivalent of its Assessed Right in Consideration.

Adequacy of consideration depends on the particular facts and circumstances of each case and is present if an asset is transferred for something of "fair equivalent" value. *In re Sharp Int'l Corp.*, 302 B.R. 760, 779 (Bankr. E.D.N.Y. 2003), *aff'd,* 403 F.3d 43 (2d Cir. 2005); *Gelbard v. Esses*, 465 N.Y.S.2d 264, 268 (N.Y. App. Div. 1983).

24 The broad reference to conveying "intangible property" in § 270, has been held to include transfer of an account receivable, *In re Am. Preferred Prescription*, 1997 Bankr. LEXIS 387, at *69 (Bankr. E.D.N.Y. 1997), an extension of indebtedness, *Clarkson Co. v. Shaheen*, 533 F. Supp. 905, 930 (S.D.N.Y. 1982), and release of a leasehold interest, 348-352 *West 27th Street Corp. v. Dropkin*, 36 N.Y.S.2d 740, 743 (N.Y. 1942).

25 Section 272, defines "fair consideration" as: (1) When in exchange for such property, or obligation, as a fair equivalent therefore, and in good faith, property is conveyed or an antecedent debt is satisfied, or (2) When such property, or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property, or obligation obtained.

Underscoring the fact-intensive nature of this inquiry, courts have noted that "it is necessary to compare the value of the consideration to the value of the property," when fair value is determined. *United States v. McCombs*, 928 F. Supp. 261, 272 (W.D.N.Y. 1995).

The Supplemental Complaint sufficiently alleges that MasterCard did not receive adequate consideration for its release of the right of special-assessment. The value of MasterCard's right to assess its Member Banks is apparent from its use of that right to fund is liabilities in *In re Visa Check/MasterMoney Antitrust Litigation* ("*In re Visa Check*"). In that case, MasterCard assessed the Member Banks in order to satisfy its obligation, which included $1.025 billion in compensatory relief. *In re Visa Check*, 297 F. Supp. 2d 503, 508 (E.D.N.Y. 2003). While the *In re Visa Check* settlement lends some specificity to the value of the special-assessment right, the true value is limited only by MasterCard's liabilities in major litigation, which could range into the tens of billions of dollars for current antitrust lawsuits. (Suppl. Compl. ¶ 111) (citing Bernstein Research, AXP | Quantifying the Legal Risk to MasterCard (May 17, 2006)). The value of the special-assessment right is underscored by the fact that, soon after MasterCard released this right, Standard & Poor's downgraded its credit rating. (Suppl. Comp. ¶ 109.)

While the precise amount that MasterCard received as consideration for releasing this right and the adequacy of that amount cannot be known without discovery, Class Plaintiffs have sufficiently alleged that the consideration was inadequate. Consideration was inadequate because the loss of this right could render MasterCard insolvent in the event that Plaintiffs prevail in MDL 1720 and other litigation. (Suppl. Compl. ¶ 111.) Had this truly been an arms-length transaction "in the usual course of business," (MasterCard Br. at 14) an independent "single entity" MasterCard would not have so easily agreed to releasing this special-assessment right. (Suppl. Compl. ¶¶ 109, 147.)

b. MasterCard and its Member Banks did not Undertake the Release in Good Faith.

"Fair consideration" was also lacking under § 272 because MasterCard and the Member Banks did not act in good faith. *See Farm Stores, Inc. v. Sch. Feeding Corp.*, 477 N.Y.S.2d 374, 378 (N.Y. App. Div. 1984) (voiding conveyance because not made in good faith, even though fair consideration was given). Good faith is absent if the conveyor has "intent to, or knowledge of the fact that the activities in question will hinder, delay, or defraud others." *Southern Indus., Inc., v. Jeremias*, 411 N.Y.S.2d 945, 949 (N.Y. App. Div. 1978).[26] Because the good-faith inquiry examines a debtor's knowledge of its debts, the same facts discussed in Section VI.B.2. below also support a conclusion of bad faith by MasterCard and its Member Banks. *McCombs*, 928 F. Supp. at 275 n12. (noting overlap between § 272 good-faith analysis and § 276 actual-fraud analysis).

2. *MasterCard believed that it was about to incur debts beyond its ability to pay when it conveyed the special-assessment right.*

MasterCard's estimated exposure in current antitrust lawsuits ranges into the tens of billions of dollars, while MasterCard values itself at only $5 billion. (Suppl. Compl. ¶ 111.) (Citing Bernstein Research, AXP | Quantifying the Legal Risk to MasterCard (May 17, 2006)). MasterCard also estimates that it faces settlement exposure of $15 billion as guarantor of the obligations of its members. MasterCard Incorporated, Amendment No. 8 to Form S-1 (Form S-1/A), at 23 ("S-1"). Nevertheless, MasterCard

26 Given the identical language, the § 272 good faith analysis overlaps with the § 276 actual fraud analysis (see below).

admits that it "ha[s] not established reserves for any of the legal proceedings in which [it is] currently involved," with the exception of currency conversion litigations and one of the chargeback litigations. S-1 at 16. MasterCard further acknowledges that an adverse result in a class-action antitrust lawsuit could render it insolvent, (Suppl. Compl. ¶ 111); S-1 at 17, and that the elimination of the special-assessment right increases this risk of insolvency. (Suppl. Compl. ¶109); S-1 at 24. Furthermore, the timing of the elimination of the assessment right is evidence that MasterCard believed that it would incur debts beyond its ability to repay. MasterCard admitted that the goal of the IPO and the Agreements was to "leave us less prone to challenges and provide us with additional defenses to the challenges we may face." (Suppl. Compl. ¶ 78); Amendment No. 4 to Registration Statement, at 67; *see also Brodsky*, 684 N.Y.S.2d at 247 (requisite intent found where transferor testified that "it was his intent that [the conveyance] would insulate him from anticipated legal liability."). These factors reveal MasterCard's subjective belief that it would incur debts beyond its ability to repay.

D. Defendants Violated NYDCL § 276 Because The Release Was Made With Actual Intent To Hinder, Delay, Or Defraud Judgment Creditors.

NYDCL § 276 provides that "[e]very conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors." NYDCL § 276. Under this section, "[o]nly an actual intent to hinder and delay need be established, not an actual intent to defraud." *Lippe v. Bairnco*, 249 F. Supp. 2d 357, 374 (S.D.N.Y. 2003) (citing *United States v. Carlin*, 948 F. Supp. 271, 277 (S.D.N.Y. 1996)). Where actual intent is present, NYDCL § 276 invalidates the conveyance even if the conveyor is solvent and received fair consideration. *Wall St. Assocs. v. Brodsky*, 684 N.Y.S.2d 244, 247 (N.Y. App. Div. 1999).

1. *Badges of fraud support an inference of fraudulent intent.*

Fraudulent intent is rarely susceptible to direct proof. *Salomon v. Kaiser*, 722 F.2d 1574, 1582 (2d Cir. 1983) ("*In re Kaiser*"). Therefore, courts allow the pleader to support its claim by means of "badges of fraud," *i.e.*, "circumstances so commonly associated with fraudulent transfers that their presence gives rise to an inference of intent." *Sharp Int'l Corp. v. State Bank & Trust Co.* (*In re Sharp Int'l Corp.*), 403 F.3d 43, 56 (2d. Cir. 2005) (quoting *Brodsky*, 684 N.Y.S.2d at 247). Some of the recognized badges of fraud include: (1) the lack or inadequacy of consideration, (2) a close relationship between the parties, (3) the effect of a series of transactions or course of conduct after the pendency or threat of suits by creditors, and (4) the general chronology of the events and transactions under inquiry. *In re Kaiser*, 722 F.2d at 1582-83. Class Plaintiffs have alleged – and intend to prove – that these badges of fraud characterize the elimination of MasterCard's special-assessment right. (Suppl. Compl. ¶ 149.)

a. Badge Number One: MasterCard did not receive adequate consideration for the special-assessment right.

As described above, MasterCard did not receive adequate consideration for the multi-billion dollar special-assessment right. (Suppl. Compl. ¶ 147.) Lack of adequate consideration is an established basis on which to infer actual fraud. *United States v. Carlin*, 948 F. Supp. 271, 277 (S.D.N.Y. 1996); *Shelly v. Doe*, 671 N.Y.S.2d 803, 805 (N.Y. App. Div. 1998). For the reasons set forth in Section VI.C.1 above, Class Plaintiffs have alleged sufficient facts to indicate that MasterCard did not receive adequate consideration for its release of the special-assessment right. This "badge," standing alone, supports a rebuttable presumption of fraudulent intent. *Carlin*, 948 F. Supp. at 277.

b. Badge Number Two: There was an extremely close relationship between MasterCard and the Member Banks.

Intent to defraud may be inferred "where the transfer is made to a related party (i.e., husband to wife, corporation to stockholder)." *United States v. 58th St. Plaza Theatre, Inc.*, 287 F. Supp. 475, 498 (S.D.N.Y. 1968). This type of close relationship has been found to exist between related corporations, such as two sister corporations owned by the same shareholder. *Bulkmatic*, 2001 U.S. Dist. LEXIS 6894, at *36. The close relationship between MasterCard and its Member Banks is exactly the type that can be labeled as a "badge of fraud." Before the IPO, the Member Banks controlled MasterCard through their roles as MasterCard's directors and shareholders. (Suppl. Compl. ¶¶ 44, 45.) Through their close relationship to MasterCard, the Member Banks were able to guarantee that the IPO and Agreements were executed in a manner that protected the banks' competitive interest, even to the detriment of MasterCard itself. (Suppl. Compl. ¶¶ 105-06.) Not surprisingly given these facts, Plaintiffs have alleged that the Member Banks abused their relationship to MasterCard by releasing their special-assessment right in order to escape their own legal obligations. (Suppl. Compl. ¶ 110.)

c. Badge Number Three: The effect of MasterCard's conduct after the pendency of this lawsuit was to hinder, delay, or defraud the Plaintiffs.

"Allegations that fraudulent transfers caused assets to be placed beyond the reach of creditors may suffice as a badge of fraud." *Nisselson v. Ford Motor Co.* (*In re Monahan Ford Corp. of Flushing*), 340 B.R. 1, 39 (Bankr. E.D.N.Y. 2006). As a result of the conveyance, MasterCard "will bear the expenses and liabilities associated with extraordinary events without recourse to [its] members through a right of assessment." S-1 at 24. The elimination of this right to assess the Member Banks came up only as a result of MDL 1720 and similar litigation, and was undertaken in a transparent attempt to insulate the banks from liability. (Supp. Compl. ¶ 111.) The obvious effect of MasterCard's release — and the intent behind it — was to shield MasterCard and its Member Banks from creditors. This attempt to avoid liability is properly labeled a badge of fraud. (Suppl. Compl. ¶ 110.)

d. Badge Number Four: The timing of the conveyance during the pendency of this lawsuit creates an inference of intent to defraud.

The timing of the conveyance also supports the inference that the release of the special-assessment right was fraudulent. MasterCard was the subject of many legal challenges at the time of the conveyance (Suppl. Compl. ¶ 78) and entered into the Agreements with the Member Banks in an attempt to evade liability. (Suppl. Compl. ¶ ¶ 91, 107.) When a conveyance is made "specifically to avoid having to pay judgments in pending suits" the timing of that conveyance becomes a badge of fraud. *Sullivan*, 373 F. at 306, 307.

2. *MasterCard's attempts to contradict the badges of fraud fail.*

MasterCard argues that: (1) it conducted the IPO in the "usual course of business and subject to the regulatory review of the [SEC]," (2) it "publicly disclosed the . . . elimination of the assessment right and its potential effect on MasterCard," and (3) it had "'legitimate business reasons' for entering into the Agreement, namely the 'competitive advantage' arising from changes to the corporate structure." (MasterCard Br. 14.) Each of these arguments fails.

First, MasterCard's argument that "the IPO involves the sale of stock to the public in the usual course of business" is irrelevant. The conveyance Class Plaintiffs challenge is the transfer of the special-assessment right to the banks, not the sale of stock to the public. The details behind this transfer and the intent of the parties in making the transfer cannot be determined without discovery.

Second, MasterCard's public disclosure of some of the terms of the Agreements does not suffice to validate the conveyance.[27] Even if MasterCard disclosed the fact of the release, it did not release the justification for it or the details of the consideration it received.

Third, MasterCard's so-called "competitive advantage" does not justify the elimination of the special-assessment right for inadequate consideration. MasterCard describes this competitive advantage as an enhanced ability "to defend [itself] against legal and regulatory challenges involving [its] ownership and governance." Amendment No. 4 to Registration Statement at 67. If MasterCard had truly wished to defend itself, however, why did it release the one asset that previously helped it fund over $1 billion in antitrust damages? (Suppl. Compl. ¶ 108); *In re Visa Check*, 297 F. Supp. 2d at 508.

CONCLUSION

Class Plaintiffs do not believe that MasterCard and its Member Banks have successfully created a "single entity" exempt from Section 1 of the Sherman Act. If they succeed in their attempt, however they will harm competition by perpetuating their market power and the collusive structure in the industry. And regardless of how

[27] *Lippe v. Bairnco*, cited by MasterCard for the proposition that public disclosure "weighs heavily against a finding of fraud," is distinguishable from this case on two significant factual issues: (1) the conveyance in *Lippe* was supported by demonstrably fair consideration; and (2) in *Lippe* there was only a weak relationship between the parties to the conveyance. 249 F. Supp. 2d at 382.

"rationally" this New MasterCard behaves, its creation will harm competition. Finally, because MasterCard is relinquishing its assessment right on its Member Banks, Class Plaintiffs and other parties that have been harmed by this anticompetitive conduct, may lose their ability to seek complete redress for their losses. Class Plaintiffs therefore respectfully ask that this Court deny Defendants' motions to dismiss so that they may complete discovery and determine the true competitive nature of the IPO and Agreements.

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

By:
For K. Craig Wildfang
Co-Lead Counsel for Plaintiffs

Robins, Kaplan, Miller & Ciresi L.L.P.
K. Craig Wildfang (kcwildfang@rkmc.com)
Thomas J. Undlin (tjundlin@rkmc.com)
Bethany D. Krueger (bdkrueger@rkmc.com)
Anne M. Lockner (amlockner@rkmc.com)
Kevin M. Magnuson (kmmagnuson@rkmc.com)
Ryan W. Marth (rwmarth@rkmc.com)
Bradley M. Orschel (bmorschel@rkmc.com)
2800 LaSalle Plaza
800 LaSalle Avenue South
Minneapolis, MN 55402
Tel. (612) 349-8500
Fax (612) 349-4181

Berger & Montague, P.C.
Bart Cohen (bcohen@bm.net)
Merrill G. Davidoff (mdavidoff@bm.net)
Michael J. Kane (mkane@bm.net)
H. Laddie Montague (hlmontague@bm.net)
1622 Locust Street
Philadelphia, PA 19103
Tel. (215) 875-3000
Fax (215) 875-4604

Lerach Coughlin Stoia Geller Rudman & Robbins LLP
Christopher M. Burke (chrisb@lerachlaw.com)
Bonny E. Sweeney (bonnys@lerachlaw.com)
655 West Broadway
Suite 1900
San Diego, CA 92101
Tel. (619) 231-1058
Fax (619) 231-7423

Samuel H. Rudman (srudman@lerachlaw.com)
200 Broadhollow Road
Suite 405
Melville, NY 11747
Tel. (619) 231-1058
Fax (619) 231-7423

Freedman, Boyd, Daniels, Hollander & Goldberg, P.A.
Joseph Goldberg (jg@fbdlaw.com)
20 First Plaza
Suite 700
Albuquerque, NM 87102
Tel. (505) 842-9960
Fax (505) 842-0761

Hulett, Harper, Stewart, LLP
Dennis Stewart (dstewart@hulettharper.com)
550 West C Street
Suite 1600
San Diego, CA 92101
Tel. (619) 338-1133
Fax (619) 338-1139