# EXHIBIT 3
# Part 1

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

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| IN RE PAYMENT CARD INTERCHANGE FEE AND MERCHANT DISCOUNT ANTITRUST LITIGATION<br><br>This document refers to: All Actions | MDL No. 1720<br><br>Case No. 1:05-md-1720-JG-JO |

**DECLARATION OF RYAN W. MARTH**

I, Ryan W. Marth, hereby declare under penalty of perjury, pursuant to 28 U.S.C. § 1746, that the following is true and correct:

1. I am a Principal in the law firm of Robins, Kaplan, Miller & Ciresi L.L.P., counsel for the Class in the above-captioned action.

2. I submit this Declaration in support of Class Plaintiffs' reply memorandum of law in further support of settlement final approval.

3. Attached hereto as Exhibit A is a true and correct copy of the transcript of Hearing Before Antitrust Task Force of Committee on the Judiciary House of Representative, July 19, 2007.

4. Attached hereto as Exhibit B is a true and correct copy of the Statement of W. Stephen Cannon on Behalf of the Merchants Payment Coalition, Inc. before the United States House of Representatives Committee on the Judiciary Antirust Task Force, Hearing on the Credit Card Fair Fee Act of 2008, May 15, 2008.

5. Attached hereto as Exhibit C is a true and correct copy of the Panel Discussion II: Consumer Issues at Fordham University School of Law 2008.

6. Attached hereto as Exhibit D is a true and correct of Visa International Operating Regulations Core Principal, 10.3 effective April 15, 2013.

7. Attached hereto as Exhibit E is a true and correct copy of MasterCard Rules, 9.3 dated June 14, 2013.

8. Attached here to as Exhibit F is a true and correct copy of the *In Re: Visa Check/MasterMoney Antitrust Litigation* Settlement Conference Hearing Transcript, 2003 WL 25728442 (E.D.N.Y.) dated September 25, 2003.

9. Attached hereto as Exhibit G is a true and correct copy of John M. Connor, *Private Recoveries in International Cartel Cases Worldwide – What do the Data Show?*, AAI Working Paper No. 12–03.

10. Attached hereto as Exhibit H is a true and correct transcript of a 2008 Panel Discussion on Consumer Issues at Fordham University School of Law, featuring the comments of Objecting Plaintiffs' counsel, Jeffrey I. Shinder.

11. Attached hereto as Exhibit I is a true and correct copy of Civil Minutes – General, DE 444, *In Re: Aftermarket Automotive Lighting Products Antitrust Litigation* No. 2:09-ml-2007-GW-PJW (C.D. Cal.) dated February 23, 2012.

12. Attached hereto as Exhibit J is a true and correct copy of the Notice of Class Action Settlement *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, MDL No. 1720 (JG)(JO).

13. Attached hereto as Exhibit K is a true and correct copy of *Expressions Hair Design v. Schneiderman*, No. 1:13-cv-03775 (S.D.N.Y.) hearing transcript dated June 4, 2013.

14. Attached hereto as Exhibit L is a true and correct copy of an excerpt from DE 27, Memorandum of Law in Support of Attorney General Schneiderman's Motion to

Dismiss and in Opposition to Plaintiffs' Motion for a Preliminary Injunction No. 1:13-cv-03775 (S.D.N.Y.) dated July 12, 2013.

15. Attached hereto as Exhibit M is a true and correct copy of Witness Statement of Mario De Armas on behalf of Wal-Mart Stores, Inc., *The Commissioner of Competition and Visa Canada Corporation, et al*., CT-2010-010, no. 234 (Canada Comp. Tribunal Mar. 6, 2012). Unlike in its objection in this case, Walmart argued in Canada that the no-surcharge rules "eliminate a significant source of leverage that Walmart Canada would otherwise have in negotiating with Visa and MasterCard." De Armas Wit. Stmt. ¶ 52.

16. Attached hereto as Exhibit N is a true and correct copy of Witness Statement of Charles Symons on behalf of IKEA (exhibits omitted) *The Commissioner of Competition and Visa Canada Corporation, et al*., CT-2010-010, no. 234 (Canada Comp. Tribunal Mar. 13, 2012). IKEA's positions in Canada also contradict its opposition to this settlement. In the *Commissioner and Visa* matter, IKEA argued that the no-surcharge rules were anticompetitive because they prevent IKEA from "send[ing] appropriate signals to customers" or "constrain[ing]…or reduc[ing] Card Acceptance Fees." Symons Wit. Stmt. ¶¶ 47-48. And unlike its testimony in the United States, where it highlighted the difficulty of surcharging, it argued in Canada that customers were used to paying surcharges because they willingly paid extra for services such as delivery or assembly that were not part of the standard IKEA product offering. *Id.* ¶ 53. IKEA also detailed its six-year history of surcharging in the United Kingdom where it successfully reduced its card-acceptance costs, steered consumers to cheaper forms of payment, and passed the savings along to customers (*Symons Wit. Stmt.* ¶¶ 54–57.) Contrary to the contentions of Prof. Hausman and other objectors, IKEA did not experience a loss of sales in the United Kingdom as a result of its surcharge policy. (*Id.* ¶ 59.)

17. Attached hereto as Exhibit O is a true and correct copy of a news article "Romney Vowing Dodd-Frank Repeal Hits JPMorgan Risky Trades," Bloomberg.com dated May 14, 2012.

18. Attached hereto as Exhibit P is a true and correct copy of excerpts from the deposition of Brian Emmert taken January 17, 2008.

19. Attached hereto as Exhibit Q is a true and correct copy of excerpts from the deposition of Gary Morton taken October 15, 2008.

20. Attached hereto as Exhibit R is a true and correct copy of excerpts from the deposition of Paul Gallo taken April 24, 2008.

21. Attached hereto as Exhibit S is a true and correct copy of a news article "Rift Widens over Visa, MasterCard Settlement," foxbusiness.com dated July 20, 2012.

22. Attached hereto as Exhibit T is a true and correct copy of a J.P. Morgan Computer Services & IT Consulting report of eight months of payment-card-purchase data.

23. Attached hereto as Exhibit U is a true and correct copy of a memorandum opinion in *NACS v. Board of Governors of the Federal Reserve System*, Civ. No. 11, 2013 U.S. Dist. LEXIS 107581 (July 23, 2013).

24. Attached hereto as Exhibit V is a true and correct copy of Expressions Hair Design, et al v. Schneiderman Complaint, 13-cv-3775 (S.D.N.Y.) dated June 4, 2013.

25. Attached hereto as Exhibit W is a true and correct copy of the City of Portland's FAQ's at www.portlandoregon.gov, last accessed August 16, 2013.

26. Attached hereto as Exhibit X is a true and correct copy of the City of Norman's webpages http://www.ci.norman.ok.us, last accessed August 16, 2013.

27. Attached hereto as Exhibit Y is a true and correct copy of Visa interchange rates.

28. Attached hereto as Exhibit Z is a true and correct copy of MasterCard interchange rates.

29. Attached hereto as Exhibit AA is a true and correct copy of news article "Why You May Soon See Higher Credit Card Fees," BankingMyWay.com, last viewed July 16, 2013.

30. Attached hereto as Exhibit BB is a true and correct copy of Brief of evidence of Professor Jerry Hausman, May 4, 2009 In the High Court of New Zealand civ-2006-485-2535.

31. Attached hereto as Exhibit CC is a true and correct copy of Evidence in reply of Professor Jerry Hausman, September 4, 2009 In the High Court of New Zealand civ-2006-485-2535.

32. Contrary to the contention of the Objecting Plaintiffs, Class Counsel did take discovery of the Defendants after the MasterCard and Visa IPOs. Document discovery did not close until September 2008, five months after the Visa IPO and nearly two-and-a-half years after the MasterCard IPO. And after the close of discovery, Class Counsel secured supplementation of the Defendants' document discovery, specifically relating to the interactions between the networks and the banks post-IPO. Class Counsel also conducted a two-day Rule 30(b)(6) deposition of each network on topics relating to each network's restructuring, including the banks' understanding of how the networks would operate after the IPOs. In addition to the Rule 30(b)(6) deposition, Class Counsel questioned top-level Visa, MasterCard, and bank executives about issuing relating to the IPOs and the relationships between the banks and the networks after the IPOs.

I declare under penalty of perjury that the foregoing is true and correct.

Dated: Minneapolis, Minnesota.
August 16, 2013

*s/ Ryan W. Marth*
Ryan W. Marth

84112883.1

# Exhibit A

[House Hearing, 110 Congress]
[From the U.S. Government Printing Office]

# CREDIT CARD INTERCHANGE FEES

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HEARING

BEFORE THE

ANTITRUST TASK FORCE

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

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JULY 19, 2007

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Serial No. 110-77

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Joseph Gibson, Minority Chief Counsel
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Antitrust Task Force

JOHN CONYERS, Jr., Michigan, Chairman

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Perry Apelbaum, Staff Director and Chief Counsel

Joseph Gibson, Minority Chief Counsel

C O N T E N T S

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JULY 19, 2007

APPENDIX

Material Submitted for the Hearing Record



CREDIT CARD INTERCHANGE FEES

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THURSDAY, JULY 19, 2007

House of Representatives,
Antitrust Task Force
Committee on the Judiciary,
Washington, DC.

The Task Force met, pursuant to notice, at 2:11 p.m., in Room 2141, Rayburn House Office Building, the Honorable John Conyers, Jr. (Chairman of the Antitrust Task Force) presiding.

Present: Representatives Conyers, Berman, Boucher, Lofgren, Delahunt, Waters, Cohen, Chabot, Keller, Cannon, Issa, and Smith.

Mr. Conyers. Good afternoon. The hearing of the Antitrust Task Force will come to order. We are delighted to have this stellar group of all-male witnesses.

The issue that brings us together today is about a fee that affects the American consumer. Most people are unaware it even exists and how much of it they are paying, and so we are going to learn today some of the truths about the hidden interchange fee. You see, every time you use a payment card at the mall, at the grocery store, on the Internet, the merchant is charged a fee, which gets divided up three ways, between the merchant's bank, the consumer's bank, and the credit card company. It covers processing fees, fraud protection, billing statements, and other costs.

Almost 90 percent of this fee is a so-called interchange fee, which is the payment made by the merchant's bank to the consumer's bank. The percentage of this amount is set by the credit card companies, generally Visa or MasterCard, and averages 1.75 percent of the total purchase. Last year, these fees totaled $36 billion, an increase of 117 percent since the year 2001. These fees are ultimately passed onto consumers in the form of higher prices for goods and services, whether they purchase these items by credit card, check or cash.

Merchants are increasingly concerned about these fees because, as the rates rise and credit cards become more and more ubiquitous--and they cite the lack of public awareness about interchange fees among consumers, inconsistent charging practices, and the possibility that Visa and MasterCard may be setting the interchange fees--dare I say it--collusively, instead of allowing competition to work.

Now, the payment card industry defends these fees, arguing that the credit card companies don't prohibit disclosure of interchange fees to consumers, the fees are a result of healthy competition and are vital to the entire system of payment cards. In this regard, we are trying to clear up a couple questions: Are interchange fees imposing unfair costs on the consumer? Are interchange fees increasing at too rapid a rate, and why? And, finally, are our friendly credit card companies engaged in anti-competitive behavior?

Now, I come to this hearing with as open a mind as I can, but I think the proof is on the credit card companies to give us some reassurance. And so I look forward to a frank discussion with all of you here today.

I am happy to recognize now my friend, Steve Chabot, the Ranking Member.

Mr. Chabot. Thank you, Mr. Chairman. I want to thank the Chairman, the distinguished gentleman from Michigan, for holding this important hearing today, examining the role that credit card interchange fees play in our economy. We have an expert panel of witnesses with us today, and I look forward to hearing their perspectives on this issue.

This hearing is yet another example of how technology has changed the way that we live, the way we work, we do business, and travel. Credit cards have brought consumers and merchants together in ways never thought possible. Coupled with the increased use of Internet, buying and selling has never been easier.

And recent statistics prove it: there are more than 14,000 card issuers in the United States today, with one billion cards in use. Think of that. We have about 300 million people in this country, yet we have a billion credit cards in use. In 2002, consumers bought more than $43 billion worth of goods on the Internet. That figure rose to $100 billion in 2004. Experts predict that, by 2009, U.S. consumers will spend more than $5 trillion using electronic payment systems.

Today's hearing is about the costs of doing business with credit cards. In our market economy, supply and demand sets the prices of goods and services, and the Sherman Act was enacted to protect consumers from anti-competitive behavior. Recently, concern has been expressed that the interchange payment system is anti-competitive; yet, it is no secret, especially with the statistics that I just read, that the number of Americans buying on credit has increased. Consumers continue to obtain and use credit and debit cards for their convenience, ease, and, in certain instances, their rewards programs.

However, this increase in consumer use has brought with it increased concern that merchants are paying disproportionately high transaction costs associated with credit and debit electronic payments. Businesses large and small want a more competitive and transparent system. In my district, I have received a number of letters from retailers and grocery stores and other merchants expressing concern about the impact that these fees have on businesses and their ability to provide goods and services.

I look forward to hearing from our witnesses today and to gaining a better understanding of the market for credit cards, the origins of the interchange fees, the role that these fees play in facilitating transactions, and learning whether Government intervention is appropriate. I said in the last three antitrust hearings that we have had in this particular Committee that we have held that Government intervention is not always the best remedy, and we must be careful not to do more harm than good. Of course, sometimes Government action is appropriate, and it is for us to determine, and this is one of those hearings that will help us to decide that particular issue. But I think most of us are trying to keep an open mind on this.

This hearing is a necessary first step in fulfilling our oversight responsibilities, and I again want to thank the Chairman for holding this hearing, and I want to also thank each of the members of the panel here for their attendance this afternoon. And we are hoping to learn a great deal.

I yield back.

Mr. Conyers. Thank you very much, Steve Chabot. We will incorporate all other opening statements in the record.

And I yield now to the distinguished gentleman from Virginia, Rick Boucher, to introduce one of our witnesses.

Mr. Boucher. Well, thank you very much, Mr. Chairman. And I commend you, also, for organizing today's hearing.

Unfortunately, after this introduction, I am going to need to depart, but I look forward to receiving the benefit of testimony provided here today and learning more about this very important matter.

I have the privilege this afternoon of introducing to the Committee a person who is not only a constituent of mine, but also a personal friend. His name is Steve Smith. He is the Chairman of the Food Marketing Institute, which includes 1,500 member companies, both food retailers and also food wholesalers. He is also the President and Chief Executive Officer of K-VA-T Food Stores, which operates more than 90 Food City grocery stores, 67 pharmacies, and 46 refueling stations in Virginia, Kentucky and Tennessee.

Of particular interest to me is the focus that Steve Smith, through his various stores, has placed on the need to acquire from local farms in our region locally grown produce and also locally produced meat. He has worked with my office to foster the market in our region for sheep and value-added beef farming, as well as fruits and vegetables purchased from local farms, benefiting our economy and also providing very fresh local produce for the benefit of my constituents.

So it is a privilege to welcome today one of our region's most successful businessmen, who I know will have enlightening testimony for the Committee. And I am pleased to introduce to the Committee Mr. Steve Smith.

And thank you very much, Mr. Chairman, for allowing this time.

Mr. Conyers. Mr. Smith, you have been introduced by one of our stars in the Congress, so I won't add anything to it, but except to tell you, you have got a heavy burden to prove here. We welcome you, though, nevertheless. Please feel free to proceed.

TESTIMONY STEVEN C. SMITH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, K-VA-T FOOD STORES, INC.

Mr. Smith. Well, thank you very much, Congressman Boucher, for that kind introduction.

And, Chairman Conyers and Members of the Committee, I am honored to appear before you today and present information of great concern to my company, to members of the Food Marketing Institute, and to the American consumers. I am here today to shed light on the best-kept secret, I think, of the credit card industry, and that is the hidden tax that has been thrust upon consumers due to the ever-increasing interchange fees that credit card companies charge retailers as a result of the collective pricing setting by Visa and by MasterCard and their respective card-issuing banks.

This collective price setting does not occur in isolation. Rather, it is part and parcel of a system that imposes collectively set rules that effectively require merchants to keep the cost of accepting cards secret from their customers. The rules also prevent merchants from refusing to accept particular types of credit and debit cards that impose higher fees, including premium and corporate cards. Further, we cannot make brand preference based on card or payment type. Thus, the card systems can--and do--increase their collectively set interchange fees without any fear of resistance by the cardholders who remain unaware of the increased costs that they are imposing and incurring.

The grocery industry is comprised of a variety of retailers, from big box retailers, nationally known, to small mom-and-pop retailers on the corner. Our industry serves probably the broadest cross-section of the retail industry that I can think of. And each of our consumers enjoy a very competitive marketplace that exemplifies what most Americans believe the free enterprise system to be. Because of this healthy competition, the profit margin in the grocery industry is generally in the 1 percent range. Now, I don't know of any other industry that operates in such a competitive, low-margin environment.

Now, when we first started accepting credit cards, our interchange rate was around 1 percent, about the same as our profit margin. The initial volume of card payments was low. And, quite frankly, our industry expected the rate charges would fall as transaction volume increased. This would be consistent with basic economic theory and our experience with various other aspects of our business. However, the exact opposite proved true.

As credit card usage has become more prevalent and interchange fee rates have climbed, our costs have increased exponentially, resulting in a 700 percent rise in total interchange fees over the last 10 years. Today's high rate of credit card usage, combined with the fact that credit card companies are allowed to collectively set interchange rates, leaves retailers faced with the ``take it or leave it'' system. The retailer's only practical option is to pay up and pass this uncontrollable expense onto our consumers. Because of these factors, the grocery industry now faces credit card interchange fees that can be over 2 percent of a sale, nearly double our industry's profit margin of 1 percent.

As FMI chairman, I represent over 26,000 retail food stores with combined annual volume of over $340 billion. These retailers have been put in the position of having to pass along to consumers over $4 billion annually in interchange fees. In the grocery industry, our very survival depends on customer attraction and retention amidst an intensely competitive marketplace.

Every entity of the retail world is faced with some form of competition, and this competition serves as a safeguard to ensure that our practices and prices remain in check. Yet the reverse is true of the credit card companies. Visa and MasterCard, accounting for over 80 percent of the industry transaction volume, each work collectively with their members to drive rates upward rather than maintaining a healthy balance. In their non-competitive market, normal pressures do not apply.

Visa regularly increases its collectively set interchange fee to encourage the issuance of cards, and MasterCard does the same. Meanwhile, the unsuspecting consumer is the conduit for the rise in fees, thanks in part to those collectively set rules that prevent merchants from responding competitively to the increased cost of particular cards.

Fair and rigorous competition is the foundation of our industry. We are not lobbying to deny credit card companies their reasonable profits. We only ask that we not be faced with costs imposed on us that have been set collectively by card systems and their member banks in an environment that is deliberately designed to deprive American merchants of any freedom of competitive action. Given Visa and MasterCard's market share, we simply don't have the ability to say no to the card systems' all-or-nothing proposition.

The conventional wisdom tells us that, as volume grows, prices should fall, but instead credit card companies have created much greater volume and raised fees and costs substantially. This is contrary to the basic concepts of the American free enterprise system, and the situation is the result of card systems controlling 80 percent of an industry collectively setting prices in violation of the antitrust laws.

And the great shame of it, my friends, is that the consumer bears the cost, and this fact has been effectively hidden from them. I don't know of any other industry which is allowed to blatantly abuse both the consumer and the retailer. Credit card companies should be required to operate in the same competitive environment as any other facet of business throughout our Nation.

Thank you very much, and I will be happy to answer questions at the appropriate time.

[The prepared statement of Mr. Smith follows:]

Prepared Statement of Steven C. Smith

Chairman Conyers and Members of the Committee, I am honored to appear before you today and present information of great concern to my company, K-VA-T Food Stores, Inc., the members of the Food Marketing Institute and American consumers.

I serve as President and CEO for K-VA-T Food Stores, Inc., a retail supermarket chain operating 95 stores under the Food City banner in Kentucky, Virginia and Tennessee. We are a family owned business, dating back to 1955. 16% of our company is owned by our associates through our Employee Stock Ownership Plan and we currently employ over 11,000 associates.

Also, I serve as Chairman of the Food Marketing Institute, commonly referred to as ``FMI.'' FMI is a national trade association that has 1,500 member companies made up of food retailers and wholesalers in the United States and around the world. FMI's members operate approximately 26,000 retail food stores with combined annual sales of $340 billion, representing three quarters of all retail food store sales in the United States. FMI's retail membership is composed of national and regional chains as well as independent grocery stores. Our international membership includes some 200 companies from 50 countries.

I am here today to shed light on the best kept secret of the credit card industry; that is, the great hidden tax that has been thrust upon consumers due to ever increasing interchange fees that credit card companies charge retailers as a result of collective price setting by Visa and by MasterCard and their respective card-issuing banks.

This collective price setting--which looks to me like price fixing under the antitrust laws--does not occur in isolation. Rather, it is part and parcel of a system that imposes collectively-set rules that effectively require merchants to keep the cost of accepting cards secret from their customers. The rules also prevent merchants from refusing to accept particular types of credit or debit cards that impose higher fees. Thus, the card systems can, and do, increase their collectively-set interchange fees without any fear of resistance by their card holders who remain unaware of the increased costs they are imposing and incurring.

My testimony today will focus on three topics: First, I would like to give you some understanding of the supermarket industry in today's marketplace; Second, the history of electronic payment transactions in our industry; and last, the effect of interchange fees on the retail industry today and the hidden ``tax'' burden it has laid upon the consumers.

The grocery industry is comprised of all types of businesses--from national ``big box'' chain stores to the traditional ``mom & pop'' store on the corner. It is my opinion that this industry serves a broader cross-section of the American public than any other retail industry. Each of those consumers enjoys a very competitive marketplace that exemplifies what most Americans believe their free enterprise system to be--specifically, each member of our industry has to fight, each and every day, to offer the consumer the best product at the fairest price in order to win them as a customer.

Because of this healthy competition, the profit margin in the grocery industry is generally in the 1% range; that is, our operators generally only make $1 of profit for $100 of sales. I like to say that we are a ``penny'' business--I know of no other industry that operates in such a competitive, low-margin environment.

Back in the early 1990's, supermarkets first began experimenting with credit and debit card acceptance. When we signed on to accept credit/debit cards, the issuing banks actually paid retailers to accept their cards and offered a variety of incentives to entice retailers to ``sign up'' and join the system.

Over time, our interchange fees were increased. And even though our profit margin was right around 1%, the same amount as our 1% introductory interchange fees, the initial volume of credit card payments was low. The industry fully expected that the rate charges would fall as transaction volume increased--this would be consistent with basic economic theory and our experience with various other aspects of our business. However, the exact opposite proved true.

Today consumer use of credit and debit cards is at an all time high, with 60-65% of all payments in our industry made with plastic. As the credit card payment method has become more and more prevalent, and interchange fee rates have increased, our interchange fee volume began to increase exponentially--resulting in a 700% increase in total interchange fees over the past 10 years. Today's high rate of credit card usage combined with the fact that credit card companies are allowed to collectively set interchange rates leaves retailers faced with a take it or leave it system--basically it comes down to a decision to either swallow hard and pay high fees that are set with no competitive influences or turn your back on the 65% of your revenue from customers who have been influenced by the card industry's advertising to believe they are social outcasts if they pay with actual cash. The retailer's only practical option is to ``pay up'' and be forced to pass this uncontrollable expense on to consumers.

Because of these factors, the grocery industry now faces credit card interchange fees that can be up to 2% or more of a sale. Please recall my earlier statement that our industry is a ``penny business'' or 1% of sales. Therefore, the effect is that fees set collectively by the credit card companies are now double the industry's profit margins.

As FMI Chairman, I represent 26,000 retail food stores with combined annual sales of $340 billion, or three quarters of all retail food store sales in the United States. These retailers have all been put in the position of having to pass-along the costs of these credit card interchange fees. As a result, consumers pay over $4 billion annually in FMI member stores and because the fees remain hidden, they don't even realize it!

To the ``injury'' of higher interchange fees, our members must add the ``insult'' of the anticompetitive, Visa and MasterCard Operating Rules. These rules prevent stores from setting minimum charges; require retailers to accept all cards, even premium rewards or corporate cards which carry a higher interchange fee and are not available to the majority of consumers; don't permit retailers to make preferences based on card type or even payment type; and prevent retailers from reviewing the rules of practice without obtaining a signed nondisclosure agreement.

In the grocery industry, our very survival depends upon customer attraction and retention amidst an intensely competitive marketplace. Every entity of the retail world is faced with some form of competition--from the contractors that build our stores and suppliers that provide our products to our utility companies. This competition serves as a safeguard to ensure that our practices and prices remain in check.

Yet the reverse is true of credit card companies. Visa and MasterCard, accounting for 80% of industry transaction volume, each work collectively with their members to drive rates upward rather than maintaining a healthy balance. In their non-competitive market, normal pressures do not apply. Visa regularly increases its collectively-set interchange fees to encourage the issuance of its cards and MasterCard does the same. Meanwhile, the unsuspecting consumer is the conduit for this rise in fees--thanks in part to those collectively-set rules that prevent merchants from responding competitively to the increased cost of particular types of cards. The only beneficiaries are those lucky few who qualify for the premium cards packed with rewards on airline miles, cash back, hotel rooms, etc. But even they often find that the greatly touted rewards programs lack the promised substance.

My company operates 95 stores in 3 states. We see credit cards from every state in the country and I have yet to find even one bank that chose to offer an interchange rate lower than those collectively set and agreed upon by Visa or MasterCard. Fair and rigorous competition is the foundation of our industry. We are not lobbying to deny credit card companies their reasonable profit. We only ask that we not be faced with costs imposed on us that have been set collectively by card systems and their member banks, in an environment that is deliberately and collectively designed to deprive America's merchants of any freedom of competitive action: given Visa and MasterCard's market share we simply don't have the ability to say ``no'' to the card systems' all-or-nothing proposition.

The conventional wisdom tells us that as volume grows prices should fall, but instead credit card companies have created much greater volume AND raised fees and costs substantially. This is contrary to the basic concepts of the American free enterprise system. This situation is the result of card systems controlling 80% of industry volume collectively setting prices in violation of the antitrust laws. And the great shame of it all is that the consumer bears the costs and this fact has been effectively hidden from them. I hope that you can work with representatives of FMI and other merchant groups to develop solutions to end the anticompetitive conduct of the major card systems. I know of no other industry which is allowed to blatantly abuse both the consumer and the retailer. Credit card companies should be required to operate in the same competitive environment as every other facet of business throughout our nation.

Thank you for the opportunity to testify.

Mr. Conyers. Thank you very much, Mr. Steven Smith.

Our next witness is the chairman of the Payment and Technology Committee of the Independent Community Bankers of America, known as ICBA. Mr. John Buhrmaster is the chairman of this ICBA committee, the only national trade association that exclusively represents community banks. He is the president also of the First National Bank in Scotia, New York, and has been recently appointed to the ICBA Bank as a director. He also served on the association's Hurricane Katrina disaster task force.

And we welcome you to this hearing.

TESTIMONY OF JOHN BUHRMASTER, PRESIDENT, FIRST NATIONAL BANK OF SCOTIA, NEW YORK

Mr. Buhrmaster. Thank you, Chairman Conyers and Ranking Member Chabot, Members of the Task Force. My name is John Buhrmaster, and I am president of First National Bank of

Scotia, a $270 million community bank located in Scotia, New York, upstate New York. I am pleased to be here today on behalf of the Independent Community Bankers of America and its nearly 5,000 member banks, just like myself.

Today, I would like to focus on two key aspects of the interchange debate: how interchange affects consumers in the market and the impact of interchange on competition.

It is important to realize that, for a community bank like mine, which is engaged in credit and debit card activities, both as an acquiring bank and a card issuer, our customers are both the consumers who trust us with their personal banking needs and our many local merchants. This might not seem obvious, but as consumers can shop around for a bank that best meets their financial needs, merchants setting up a credit card acceptance process can also shop around for a level of service, customer support, and a range of fees that best suits their business plan.

If a merchant opts to sign with First National, it is getting a tremendous value because of the interchange system. Small business in and around my community can set up a deal with my bank where they are paying competitive fees, can accept plastic, and are assured a consistent payment experience, backed by sophisticated fraud detection systems. This acceptance is very important to the economic base of my community.

The payment system in our country is not free. It did not materialize overnight and should be paid for by those choosing to take advantage of it. We don't want our merchants to pay high fees, but interchange is a cost of doing business for them and is a cost to the acquiring side of my bank's business.

My aunt runs a winery in the Finger Lakes of New York. In setting up her business, she made the choice to accept credit cards. She told me that interchange is a good value for her business, because credit cards allow people to buy who might otherwise not. Sometimes they even purchase more if it is on a card, rather than if they are paying with cash. She views the interchange as a part of her overhead, and it helps her reach more consumers.

Contrary to popular belief, for many community banks, the services we are able to provide thanks to the existence of a negotiated interchange fee system are not huge profit centers. For me and many community bankers, the variety of products and the high level of personal service we are able to offer consumers is what makes the system most valuable, not the profit opportunity.

Some have also stated that the interchange system is not transparent and that these rates should be printed on payment card receipts. I have no problem telling the merchants the cost they incur to accept debit and credit cards, but printing interchange rates on customer receipts, beside adding an additional expense, would be the equivalent of my aunt telling her customers how much it cost the venue to pick the grapes.

The interchange system enhances competition and functions so well that thousands of small community banks are able to stand toe to toe on both the issuing and acquiring side of the business and offer services to consumers in direct competition to banks like Citigroup and Bank of America, while providing the type of consumer experience that only a community banker can give.

Our bank was founded in 1923, and I am the fourth generation of my family to serve as president. If we were forced to compete in an environment without the card networks negotiating interchange against the mega-banks with national footprints, our relatively small size would put us at a competitive disadvantage that would be difficult to overcome.

I also want to point out that the interchange rates we currently receive as an issuer and pay as an acquirer are on a level playing field with the largest banks in our country. Consumers and merchants are not always better served by something just because it is big, and that is where a community bank plays a vital role.

I believe that aspect is often overlooked in this debate, because it is so easy to focus on the largest issuers and acquirers. I also believe it is inaccurate and misleading to characterize interchange as a hidden tax on consumers. It is no more a hidden tax than is the cost of check processing or the cost of counting cash or the cost of making change. And if anything, interchange is more transparent than the cost of other services.

Interchange is a fee for a valuable service provided to the merchant. It is a fee that allows a bank like mine to support local businesses and give those businesses the ability to accept and to attract more customers with additional payment choices and allows those customers the flexibility of paying on credit. That is the benefit of a balanced market that works the way it is supposed to, with an intermediary like Visa or MasterCard standing in for us, successfully bringing together and meeting the payment needs of banks, merchants and consumers alike.

Again, thank you, Chairman Conyers and Ranking Member Chabot for the opportunity to testify on behalf of ICBA and community banks in this country. I look forward to your questions.

[The prepared statement of Mr. Buhrmaster follows:]

Prepared Statement of John Buhrmaster

Chairman Conyers, Ranking Member Chabot, Members of the Task Force, my name is John Buhrmaster and I am President of 1st National Bank of Scotia, a $270 million community bank located in Scotia, New York, and I am pleased to be here today on behalf of the Independent Community Bankers of America (ICBA).

On behalf of ICBA's nearly 5,000 member banks, I want to express our appreciation for the opportunity to testify on the important role credit and debit card interchange fees play in supporting community banks and our customers. While there are many aspects to the interchange debate, I would like to focus on two today: how interchange affects consumers in the market, and the impact of interchange on competition.

THE IMPACT OF INTERCHANGE ON CONSUMERS

For a community bank like mine, which is engaged in credit and debit card activities as both an acquiring bank--i.e. a member of Visa or MasterCard that maintains the merchant relationship and receives the card transactions from the merchant--and a card issuer, it is important to realize that not only are our customers the consumers who trust us with their personal banking needs, but also the many local merchants who have decided, after shopping around, that we can provide them with the best acquiring services to meet their needs.

Just as consumers should always shop around for a financial institution that best meets their banking needs, a merchant who is setting up a credit card acceptance process should shop around for a level of service, customer support, and range of fees that best fits their business plan. If a merchant opts to sign with 1st National, at the end of the day, it is getting tremendous value because of the interchange system that I, as an acquirer, am able to utilize. The merchant does not have to extend credit directly. It gets guaranteed funds in its account right away, the ability to accept credit and debit cards carried by millions of consumers, and doesn't have to worry about bounced checks. And also because of interchange, merchants, as well as cardholders and card issuers, all benefit from state-of-the-art fraud detection systems. These fraud-detection systems are even more important to smaller merchants who lack the deep pockets of their much larger competitors. The same applies to my bank as a small card issuer.

There was a time when, if you wanted to use credit for a purchase, you had to shop at a large department store that could afford an in-house credit program. Today, most consumers can use credit to shop at even the smallest merchant because most consumers carry a line of credit in the form of a credit card in their wallets. What small retailer could afford its own proprietary card nowadays? Because of my ability to issue cards and be a merchant acquirer, small businesses in and around my community can set up a deal where they are paying competitive fees, can accept plastic, are assured a consistent payment experience, and are protected against the fraud I described earlier. This acceptance is important to the viability of my local merchants and the economic base of my community.

Contrary to popular belief, for many community banks, the services I'm able to provide thanks to the existence of a negotiated interchange fee system are not huge profit centers. The real value lies in my basic ability to offer these products to consumers and merchants. Does it make me some money? Of course. But for me and many community bankers, the high level of personal service I am able to provide consumers is what makes this system valuable, not gigantic profits.

In my estimation, government intervention in the interchange system would most significantly harm my customers who, again, include both small merchants and consumers. In all likelihood, without the incentive of interchange, community banks like mine would not be able to offer the same services we do now, which means fewer choices for consumers and less competition for their business. In addition, if more banks stop offering interchange-fee-supported products and services, I think it's very likely the industry would consolidate into just a few very large issuers and acquirers, and costs of running the system that are currently covered by interchange would be passed on through the payments chain, with the final burden falling on your average consumer who uses a credit card. The payment system and infrastructure in our country is not free, did not materialize overnight, and should be paid for by those choosing to take advantage of it.

We don't want our merchants to pay high fees, but interchange is a cost to the acquiring side of my bank's business. It is a factor in determining the merchant fee (``discount'') I charge the merchants my bank supports. This merchant discount is a cost of doing business just as the wholesale cost of Concord grapes--a significant industry in my part of Upstate New York--is a cost of doing business to a winery. The merchant winemaker needs to know the cost of both the merchant discount and the wholesale cost of grapes. The regular statements I provide to my merchant customers gives them explicit figures on the cost to them of card acceptance, just as the bills winemakers receive from grape growers tell them the wholesale cost of grapes.

Also, as a card issuer, I could not afford to make those products available to consumers, giving them the opportunity build that relationship with their local bank, without interchange income. It is also likely that the remaining issuers would scale back reward programs and grace periods, turning credit cards into straight short-term lending products and not the transaction accounts they have evolved into for many people who take advantage of free airline tickets and merchandise.

Some have also made the assertion that the interchange system is not transparent, and that these rates should be printed on payment card receipts. I have no problem telling merchants the costs they incur to accept debit and credit cards. But printing interchange rates on customer receipts would be the equivalent of telling consumers how much it cost the vineyard to pick its grape harvest. The more relevant information for the consumer would be the wholesale cost of the grapes and the merchant discount paid. Right now, nothing prevents a merchant from voluntarily printing both on receipts; but doing so would add additional costs to the payment process.

THE IMPACT OF INTERCHANGE ON COMPETITION

On the issue of competition, our bank was founded in 1923, and I am the fourth generation Buhrmaster to serve as President of 1st National. I can tell you with confidence, if I didn't have a card network like Visa or MasterCard standing in for me to negotiate interchange rates against the mega-banks with national footprints, I--and maybe my father before me who served as President--would simply not have been able to compete for as long as we have. The financial services we provide to the people and businesses in our communities would have been gone long ago because we, quite simply, would not have been able to offer the competitive products and services to stay in business.

Put another way, our interchange system works so well that thousands of small community banks are able to stand toe-to-toe, on both the issuing and acquiring bank sides of the business, and offer services to consumers in direct competition to banks like Citigroup and JPMorgan Chase, while providing the type of customer service that only a community banker can give. If we were forced to compete in an environment without interchange, our relatively small size would put us at a significant competitive disadvantage in negotiating the rates we would receive. It is important to note that the interchange rates we currently receive as an issuer and pay as an acquirer, are the same rates paid by the largest banks in our country. Without our market-driven system, how would a small bank compete against the clout of mega-banks?

While big banks will always beat us in terms of economies of scale, they just can't offer the flexibility to customers that we do. A person can walk into one of our bank branches and set up all of their financial services in one place, including walking out with one of our credit or debit cards. They can have a relationship with one bank that knows them and their community, and they can do that thanks to interchange.

I'd also like to address what I believe is a very unfair characterization: that all interchange does is allow big institutions to take advantage of the little guys. Not only is that wrong, it's also opposite of reality. Interchange, as I described previously, offers many protections against things like losses from fraud. Yes, the big issuers and big banks do drive interchange pricing. But some large banks choose to have interchange as a main profit center, and are very good at creating efficiencies. But consumers, including folks who walk in off the street and merchants, are not always better served by something just because it's ``big,'' and that's where a community bank plays a vital role. I believe that aspect is often overlooked in this debate, because it's so easy to focus on the large issuers and large acquirers, ignoring the harm that could be done to the thousands of community banks should the interchange system be curtailed and not allowed to operate by the dictates of the market.

I also believe it is inaccurate and misleading to characterize interchange as a hidden tax on consumers. It is no more a hidden tax than is the cost of check processing or the cost of counting cash and making change. Interchange is a fee for a service that allows a bank like mine to offer additional services to local businesses, gives those businesses the ability to attract more customers with additional payment choices, and allows those customers the flexibility of paying on credit. That's the benefit of a two-sided market that works the way it's supposed to, with an intermediary like Visa or MasterCard standing in for us and successfully bringing together and meeting the various payment needs of banks, merchants and consumers. Were there not some value to be added to a business model by accepting the costs of participating in the credit and debit card interchange fee system, we would see rates of electronic payments on the decline. Of course we all know, that is not the case and the number of electronic payments continues to grow. Only thanks to interchange can complete strangers exchange plastic for large-dollar items within the parameters of a controlled, predictable system.

To conclude, ICBA strongly believes the credit and debit card interchange system in our country is working, and provides tremendous benefit to American consumers who are opting in greater numbers each day to use credit and debit cards. Merchants have many choices available to them with regards to the form of payments they wish to accept, just as consumers have many choices regarding the financial institution with which they choose to do business. I compete every day for the business of both merchants and consumers, and I do so in large part thanks to the availability of default interchange rates. Intervening in a functioning market will only harm the merchants and consumers currently benefiting from an efficient process.

Again, thank you Chairman Conyers and Ranking Member Chabot for the opportunity to testify on behalf of ICBA, and I look forward to any questions you may have.

Mr. Conyers. Thank you very much.

We now have the consumer advocate with the U.S. Public Interest Research Group, Ed Mierzwinski. He has been before the Congress and State legislatures. He has written extensively on consumer issues. He is frequently quoted. You may have seen him on TV even, or read about him in the New York Times. And now we have him before us today.

We welcome you, sir.

TESTIMONY OF EDMUND MIERZWINSKI,
CONSUMER PROGRAM DIRECTOR, U.S. PIRG

Mr. Mierzwinski. Thank you very much, Mr. Chairman. And we appreciate all your leadership on consumer issues over the years, as well.

I am Ed Mierzwinski, and I am consumer program director with U.S. PIRG. My testimony today is also on behalf of the Consumer Federation of America and Consumer Action, two leading consumer groups. After I submitted my testimony, Consumers Union also endorsed it, so some of the leading consumer groups all agree that interchange is a significant problem for the Congress to consider.

A prime purpose of our organization is to advocate for a fair and competitive marketplace. And, quite frankly, we believe that the financial services markets work best when there is vigorous competition and consumers are protected from anti-competitive practices. The work of your Committee is very important in this regard.

I have one simple message today: The deceptive and anti-competitive practices of the Visa and MasterCard payment networks have injured both consumers and merchants for many years. Interchange fees are, in fact, hidden taxes or charges paid by all Americans, whether they use credit cards, whether they use debit cards, whether they use checks, or whether they pay with cash. There may be some modest benefits to those cardholders who use cards and get some rewards, but I think those benefits are offset dramatically by the costs that all consumers pay, because, again, interchange is paid by all of us because of the way that the system works.

The consumers who don't use credit cards basically subsidize credit card usage by paying inflated products, prices inflated by the $36 billion of dollars of anti-competitive interchange fees paid each year. We present six main points. Again, all consumers, even those who pay with cash, pay more at the store and more at the pump because these interchange fees are passed along in higher costs of goods and services.

The significant increased interchange fees signal a broken marketplace. Visa and MasterCard have tremendous market power. Merchants have no choice but to accept their cards on their terms. It is not surprising that interchange fees have increased significantly, even though costs have gone down and are much higher in the U.S. than in any other country due to these anti-competitive practices. In a competitive market, prices would fall when costs fall.

Third, the card associations' rules prevent merchants from informing consumers about the costs of payment and limit the ability of merchants to direct consumers to the safest, lowest cost, and most efficient forms of payment. I never use a debit card myself. I use an ATM card, but not a debit card. Debit cards are risky when you use them in a signature-based transaction. The rules that protect you are not as good as the rules when they use a credit card, but merchants would prefer you to use an online transaction, the PIN-based debit, but the Visa and MasterCard rules prohibit them from doing so. There are a variety of unfair and deceptive practices that they use to drive you to the higher cost payment, and rewards is simply one of them.

Fourth, neither the card issuance nor the card network markets are competitive. Because of the lax merger policy of the Government regulators, the card issuance market is essentially an oligopoly. Interchange and consumer fees have increased as concentration has increased to enormous levels.

And, finally, I want to point out that interchange is only one problem of this oligopoly of the card networks. The issuing banks have become so concentrated that they are able to engage in a number of unfair practices to consumers. Owning a credit card company issuing credit cards is essentially a license to steal. The top 10 companies now control 90 percent of the market. Their contracts with consumers allow them to change the rules at any time for any reason, including no reason. And consumers are subjected to unfair mandatory arbitration if they want to change or dispute anything on their contract.

You might ask, why would I be talking to you about these practices at the Antitrust Task Force? Well, there are three reasons. First, the industry will suggest the limitless benefits of credit cards. I submit to you that the story of the benefits is far more ambiguous, and I submit to you that the purpose of rewards, for example, is simply to get either merchants to pay more in merchant interchange fees or to get consumers to rack up high-cost credit card debt. And the concentration of the market facilitates these deceptive and onerous practices. The ability of the dominant card issuers to maintain this tight oligopoly is contributed to by these unfair practices.

We urge the Committee to examine closely the competition issues that allow this oligopoly to treat customers so unfairly. In particular, we ask you to question whether DOJ, in approving virtually every recent credit card company merger with no conditions, has adequately reviewed the competition implications of the mergers.

And, finally, we believe these deceptive and anti-consumer practices demonstrate the lack of competition in the card network market. Visa and MasterCard have the ability to prevent many of these unfair practices; they choose not to. About the only rule we know of that they have enforced--and enforced in a bad way, as you will hear from the merchants--is preventing merchants from offering discounts for cash.

So we think that there is a lot of serious problems before the Committee. We are very pleased we have the opportunity to testify on behalf of consumers today. We look forward to your questions.

[The prepared statement of Mr. Mierzwinski follows:]

Prepared Statement of Edmund Mierzwinski

Mr. Conyers. Thank you very much.

Our next witness is counsel for O'Melveny and Myers, Mr. Timothy Muris, esquire. He has had a lot of experience here defending these companies, and he is a former chairman of the Federal Trade Commission. And he served also on the Advisory Panel on Federal Tax Reform.

So we welcome you to our Committee hearing and invite you to proceed, sir.

TESTIMONY OF TIMOTHY J. MURIS, OF COUNSEL, O'MELVENY & MYERS

Mr. Muris. Thank you much, Mr. Chairman.

May I submit for the record my written testimony and a law review article I recently wrote?

Mr. Conyers. Yes, all the testimony is incorporated in the record, including your law review article.

Mr. Muris. Thank you, sir.

I personally advise Visa on antitrust and consumer protection, but the views that I express today are my own. Let me make four points: First, payment cards benefit both consumers and merchants. Cards rank with the cell phone, microchip, and personal computer as one of the last century's great inventions. The simplicity of pulling a card from your wallet or purse, however, belies an extraordinarily complex technological infrastructure that supports these transactions. It cost billions of dollars to create and allow the transactions to occur securely, reliably and efficiently.

Second, payment cards are an example of a two-sided product connecting two groups of consumers. The challenge for any two-sided product is bringing both groups on board. Newspapers illustrate how most two-sided products set prices. This is today's Washington Post. Now, in a business sense, this is a vehicle to connect readers and advertisers. The readers, in fact, pay very little. The publishers get their money from the advertisers. If newspapers charged readers the direct cost of supply, they would lose many of them. Without enough readers, there wouldn't be enough advertisers. Without both sides of the market working, not as many consumers would enjoy their newspaper, and advertisers would lose benefits of this medium.

The economics of attracting the two distinct groups drives the pricing. The value of the two-sided product to one group is determined by its attractiveness to the other. The group with the low-cost substitutes--in this case, its readers, who can go a lot of other places for their news and information--gets the better deal. For payment cards--this is my Visa card--the consumer is king.

To compete with the two historically dominant forms of payment, cash and check, the payment cards are priced to provide value to the cardholders. The industry has followed this model from its inception. Originally, the merchant discount, the amount that the merchants paid, was 7 percent; today, the average discount on American Express is about 2.5 percent, while Visa and MasterCard, larger companies, charge about 2.1 percent. Discover charges about 1.5 percent.

Consumers and merchants clearly benefit. Walk into a McDonald's, and you can now swipe your card to purchase a meal. Nobody made McDonald's take the payment cards, but instead it found that the cards offered value for a price it was willing to pay.

My third point is that merchants are wrong to analogize interchange to cartel price-fixing. Unlike a cartel, a four-party payment card system cannot exist without interchange. A default rate reduces the cost of negotiating separate fees between the thousands of acquirers and issuers. Moreover, for MasterCard and Visa to succeed, merchants need to honor cards from each of the thousands of issuers. Knowing that all cards must be honored, an individual issuer could then insist on very high fees. Merchants would then be subject to higher costs and would be less willing to accept the network. A default interchange rate, which the payment networks set, avoids this problem.

The difference between the payment card systems in a cartel is stark. With cartel pricing, an end to the cartel lowers prices, raises output, and increased innovation. The end of interchange produces the opposite results and would lead to chaos. The merchants understand this. They don't want interchange to end; instead, they just want to pay less. While they argue against the card systems setting their respective interchange rates, this is exactly what they want the Federal Government to do.

This is not an antitrust remedy. One of the fundamental maxims of antitrust is that the market, not the Government, should set prices. Indeed, reasonableness is never a defense to price-fixing. Interchange began with Visa decades ago. Bank of America started a three-party payment system in California. Because banks could then not cross State lines, the bank tried to franchise its system outside of California with no takers. It spun off the system, renamed it Visa, and Visa then began interchange long before Visa had any significant market share.

My final point is that we are here primarily because merchants want to cap the rates they pay for payment cards. Such caps would inevitably increase card prices to consumers, just as if you reduced the amount advertisers paid for newspapers. The merchants' effort to regulate prices, therefore, poses a direct threat.

Despite what you have heard, most consumers know that merchants pay when consumers use their cards. If consumers understood the threats that the merchants' campaign poses to their wallets, the cards in their wallets, I suspect that we would see nothing less than a consumer revolt.

I understand the full fury of the aroused American consumer. While chairman of the FTC, we created the National Do-Not-Call Registry. I suspect that many Americans feel as strongly about their plastic as they do about their dinner hour.

Thank you very much, and I would be happy to respond to questions.

[The prepared statement of Mr. Muris follows:]

Prepared Statement of Timothy J. Muris

ATTACHMENT

Mr. Conyers. Very interesting.

Our last witness is Senior Vice President and General Counsel for the National Retail Federation, Mr. Mallory Duncan. His job is to coordinate strategic, legislative and regulatory initiatives involving customer data, privacy, bankruptcy, fair credit reporting, and truth in lending.

Well, you have got a big job there, my friend. He has been on a lot of boards of nonprofit organizations throughout his legal career, including the National Hospice Foundation. And we welcome you to this hearing.

TESTIMONY OF MALLORY DUNCAN, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, NATIONAL RETAIL FEDERATION

Mr. Duncan. Thank you very much. Thank you very much, Mr. Chairman. Thank you very much.

I am General Counsel of the National Retail Federation, and I am also Chairman of the Merchants Payment Coalition. I want to thank the Chairman and the Ranking Member for inviting me here today to speak on behalf of those two organizations.

The MPC represents virtually every type of retail operation, from corner stores to the Nation's largest retail chains. We want the Committee to appreciate what is going on here. This market is broken, and it needs to be fixed.

The card industry has told you the market is functioning fine and that this is so complicated, four-sided markets, that it would be best if you just ignored it and moved on. But in truth, this is a very simple scheme, privately regulated, not by the market, but by a set of card company rules that they won't make available to this or to any other Committee.

The banks that are members of Visa and MasterCard will tell you that the card business is competitive. On one side, that is true: The banks compete for customers. Each tries to get consumers to carry their brand of card, and the piles of credit card offers in your mailbox is a test of that.

But on the merchant's side, the opposite is true. For example, Visa and its banks get together and decide how much they are going to charge to process card payments. All issuing banks agree to charge the same fees, regardless of which bank's name is on the card. These otherwise competing banks, under Visa and MasterCard's banner, insist that merchants accept their cards, fees and rules on a take-it-or-leave-it basis, with no opportunity to negotiate. And even though the fees are outrageous and the rules harsh, no merchant can stand up against that kind of power.

We believe the two card associations each operate as an illegal price-fixing cartel in clear violation of Federal antitrust laws. Who are the banks among these cartels? Well, they are Citi, Chase and B of A, to name three. Their card divisions are each nearly the size of American Express. What business do these three banks have being in a price-fixing arrangement with each other, not to mention with thousands of other banks? If Kroger, Safeway and Publix agreed with every other grocer to set the price of milk at $10 a gallon, would anyone here believe that this to be a fine, functioning market, delivering value to consumers?

The banks also fix the rules, rules designed to support the cartel and hide its operations from the consumers who ultimately pay for these fees. Let me give you just one example. Retailers are very competitive. The average net profit after wages, taxes, rent and goods is about 2 percent. For grocery stores, it is just about 1 percent. The card company rules say that the regular price we offer to the public must be the credit card price, but a 1 percent or 2 percent profit margin isn't large enough to absorb 2 percent in interchange fees.

So a shopping cart of back-to-school clothes that we would willingly sell for $99 cash has to be priced at $101 because of their rules. But look what has happened: $101 has become the regular price for $99 worth of cash merchandise. And regardless of whether you pay with cash, check or food stamps, we all end up paying the credit card company price.

Now, by the way, merchants are not allowed to show the interchange fee on the receipts the way we would show a sales tax, for example, which essentially is what interchange is. Now, as you can see here, interchange fees are growing at about 17 percent a year, and we expect them to hit $40 billion in 2007. That is more than annual fees, cash advance fees, late fees, and over limit fees combined. It amounts to more than $300 in hidden fees per household each year.

Now, what does interchange pay for? Last year, Diamond Consulting independently studied interchange and discovered that only 13 percent goes to pay for processing transactions. Most of the remainder taxes consumer prices to provide profits for the cartel and rewards for a relative few.

Now, although we may disagree on the benefits, in his written testimony Mr. Buhrmaster accurately describes what is happening here. He essentially said the big banks set the rules, and they set them high, so high that even small or inefficient banks can make a profit, while the big banks make a killing. This is not the workings of a competitive market.

Now, if you look at this chart, you will see that the blue line is the rise in the retail sales over the last several years, and the red line is the rise in interchange. These rising fees have other consequences on other businesses. At Balliets, a highly regarded $7 million-a-year women's clothing store in Oklahoma, interchange fees rose to more than $80,000 last year, topping the $60,000 the owner spent on health insurance for his employees. In order to pay the card companies this year, he was forced to reduce the company health insurance contribution from 70 percent to 50 percent minimum required by his carrier. He tells us that next year, Balliets may actually be forced to stop offering health coverage to its employees if interchange fees continue to rise.

In conclusion, the collective setting of interchange fees represents an ongoing antitrust violation and is costing merchants and their consumers tens of billions of dollars annually. Competition authorities in the rest of the world has realized this and begun to address it, and the rates in those countries are lower. The U.S. rates are on the far right side of this chart; the other industrialized countries are to the left.

The credit card system is an important component of our economy, potentially benefiting consumers, merchants and banks alike, but it has become dramatically tilted in favor of the two cartels that control the market. There are several pending lawsuits, but the courts' remedies are limited. Courts can deliver damages, prohibit specific conduct, or become regulatory czars. Congress has much more nuance and flexible tools at its disposal.

We urge you to study this problem and work with all of the parties on a solution to this anti-competitive market. Thank you.

[The prepared statement of Mr. Duncan follows:]

Prepared Statement of Mallory Duncan

Mr. Conyers. Thank you, Attorney Duncan.

And I thank all the witnesses.

Mr. Duncan. Mr. Chairman, I also have comments from other members of the MPC I would like to submit for the record, if I may.

Mr. Conyers. I would be happy to receive them.

Mr. Duncan. Thank you.

Mr. Conyers. Well, men, we heard the preliminary opening statements in this case. And without rushing to any judgment, it doesn't look so good for the credit card companies. So let's see if we can find out a little bit more.

Now, Mr. Buhrmaster, with all respect to your aunt's winery business, she has not been found guilty of committing fraud in the Federal court system and holding back information like the credit card companies, so I would distinguish her conduct and her activities very much from the credit card companies.

Mr. Buhrmaster. Not to my knowledge, she hasn't.

Mr. Conyers. Well, that is good enough for me, and we will check the kind of quality of her products, too, while we are at it.

Mr. Buhrmaster. It is very good, I assure you.

Mr. Conyers. Okay.

Mr. Buhrmaster. Would you like me to respond?

Mr. Conyers. No. [Laughter.]

With regard to--this is a statement that could be the subject of another hearing that is quite separate. ``The market, not the Government, should set prices.'' That always grabs me by the collar, coming from a former Chairman of the Trade Commission.

First of all, we find out the market isn't setting the prices here. But even if it were, it wouldn't make me feel better. I mean, markets sometimes go really crazy, and we have to bring in the Government. That is what all these agencies are trying to do is bring down prices. Following the market can get you into very big trouble. But we are not even using the market, as it turns out.

So let me get to the main point of all this. What are we to do? Congressman Johnson, a Member of this Judiciary Committee, has introduced a bill which is supposed to--he has got some legislation that would--it is called the Arbitration Fairness Act, with respect to unfair use of mandatory arbitration, which is another little problem, where you can't go in and sue on your own, but you are caught. And, of course, that is always in the fine print in many instances.

So let's get to the solution part of it. Mr. Mierzwinski, after we investigate thoroughly, complained to the high heavens, tons of mail, constituents raising sin, so what do we do?

Mr. Mierzwinski. Well, Mr. Chairman, first, I want to thank you for bringing up Congressman Johnson's bill, which all the consumer groups support. Arbitration, of course, is a separate issue, but it is related to the problem consumers face with their credit card companies. All their unfair issuer practices, you can't do anything about them, and the Arbitration Fairness Act would solve that problem.

By the way, the only people the Congress has ever protected from arbitration are car dealers. They said, ``We are very small compared to car manufacturers,'' and so Congress did exempt them from mandatory arbitration. We think consumers deserve the same.

But on this particular issue, I think you are doing the exact right thing. The first step should be--sunlight is the best disinfectant, and the Committee is conducting its oversight role. I think there are some real questions about all of the mergers that have gone on in the issuer marketplace that have been just simply rubberstamped over at Justice.

And the issue here is being litigated with all the retailer lawsuits, but I think it is important that Congress takes a look at it. That would be the first step to solve this problem of unfair interchange fees and try to dig into further some of these problems with non-transparency that the card issuer--I am sorry, that the associations have, where nobody knows what their rules are, nobody can look at their rules unless they sign an NDA, et cetera, et cetera.

Mr. Conyers. Well, the credit card companies are being sued all over the place, but they have settled one antitrust suit case for $336 million, where they were accused of fixing credit card foreign currency and exchange rates, but there are other lawsuits going on, and that is why they declined to come here today, to be present at the hearings.

Steve Chabot?

Mr. Chabot. Thank you, Mr. Chairman.

My first question--and it is kind of a series of questions. I would invite perhaps one representative from the credit card companies and one representative from the retailer folks or consumer folks to respond. And we have only got 5 minutes, so it is kind of hard to do this.

But the first question would be this. If I am a business owner or retailer, and I want to be successful, how important is it to accept payments electronically? And what are my options for payment within the credit card industry? And would I negotiate these options with my bank or with the individual credit card companies? And what are my options if I choose to accept payments only in some form other than credit cards, like cash or check? And does acceptance of credit or debit cards impact my chances of success?

And whichever one wants to take it, either side is fine with me.

Mr. Buhrmaster. I would be happy to answer that question. I am an acquirer, and I have merchant customers. We have about 160 merchant customers, and these customers have made a choice to accept electronic payment cards. They don't have to, but they have made a business decision, because it makes sense for what they do.

When they make that decision, they will come to us--and they will probably go to another bank and maybe another payment processing company and ask us how much it is going to cost. They want to know what it is going to involve. What are the risks? What are the costs? And so forth.

We can sit down, if they can tell us what their average volume is and how many customers that they expect, the average ticket size--that is the average charge that is made--and we can come pretty close to giving them an estimate of what it is going to cost them to run this operation for themselves and what it will mean to their bottom line.

Those businesses that come to me and ask for payment services, they understand this is a cost of operating your business. They want to attract those customers that want to pay by card. In today's society, people want things now. Everybody wants it now, and the best way to have that is through electronic payments. In other words, that is how they can get things now, either on credits or using their debit card.

Mr. Chabot. Okay, thank you. And have you decided which one of the other three would like to--Mr. Smith?

Mr. Smith. Let me just address the first part. There is no negotiating with the credit card companies. It is a take-it-or-leave-it proposition. You don't negotiate your fees. If you choose not to take credit cards, which we are free to do, we are turning our back on about 60-plus percent of transactions. And, again, that is not something that is very inviting for the retailers to tell their consumers, ``No.''

I don't think any of us in the retail industry mind taking a credit card. What we want is a fair fee to be able to be charged to our retailers. We want them to compete for our business just as we compete for our consumers.

Mr. Muris made the analogy to cell phones and computers and credit cards being some of the greatest inventions. Look at what the cost of cell phones has done as volume has gone up. Look at the cost of computers as volume has gone up. But look at the analogy of credit cards: As volume has gone up, the fees have gone up, as well, when, in our opinion, they should be going down because of the additional usage.

So it is just not a free market enterprise system, and that is what we would like for it to be.

Mr. Chabot. Mr. Buhrmaster, did you want to follow up? And I would invite either one of the folks if you would like to----

Mr. Muris. Can I?

Mr. Buhrmaster. Please.

Mr. Muris. Merchants can do lots of things. Believe it or not, there are prominent merchants that don't accept certain kinds of credit cards. Costco is one of the most successful merchants in the world in Mr. Smith's line of business, and I can't use my Visa or MasterCard or Discover card there. I can't use Visa at Sam's Club. On the other end, if you go to Neiman Marcus, you can use only American Express. Lots of small restaurants I go to don't take cards.

Merchants can offer cash discounts. We heard a lot of things--and if someone gives me the chance, I would correct them for the record later--about restrictions on merchants. Merchants are allowed to discount for cash. They can advertise that fact. They can post big signs in the stores that they discount for cash. Merchants can steer customers--and many of them do, especially in the grocery business--to debit, which is cheaper. Discover is significantly cheaper.

There are thus lots of options for merchants. And, in fact, the contracts are not take-it-or-leave-it. Supermarkets have negotiated a better deal, in terms of interchange fees, than almost any other major group of merchants.

Mr. Chabot. I am just about out of time, so let me go back to the retailers. Mr. Duncan?

Mr. Duncan. Thank you. Just a couple of points. First of all, in terms of supermarkets negotiating a better deal, what happened there, actually, was they gave the supermarket industry--this is monopolist. What does a monopolist do? They segment the market. They went to supermarkets and said, ``We will give you 1 percent,'' and cards came in at 1 percent, and then they began introducing new cards with extra high rates, but they weren't part of the deal. So suddenly supermarkets are paying 2 percent for some of their transactions.

This is not fair dealing. They changed the terms on merchants the same way they change the terms on consumers.

Mr. Chabot. Thank you very much, Mr. Chairman. I see I am out of time. I yield back my time.

Mr. Conyers. Okay.

Mr. Howard Berman? No questions.

May I gain the attention of my friends at the other end? Do either of you have any questions that you would like to pose to the witnesses? Okay, you can think of some.

That is the way Bill Delahunt works. He is a very extemporaneous guy.

Mr. Delahunt. Spontaneous is the word, Mr. Chairman. And I thought Mr. Berman would, but if you care. He is listening.

Mr. Berman. I am meditating.

Mr. Delahunt. What would be the problem, for the sake of transparency, on some document--the sales slip, et cetera--list the exchange fee? What is the problem with that?

Mr. Muris. There is nothing now that prevents merchants from doing that. Consumers aren't interested, but if merchants want to go ahead and do that, they can. Merchants know what they pay, which is the merchant discount----

Mr. Delahunt. I am talking about the credit card----

Mr. Muris. No, that is what I am saying.

Mr. Delahunt. I am talking about--oh, the issuer you are talking about?

Mr. Muris. The issuer?

Mr. Delahunt. Yes.

Mr. Muris. I am sorry, the issuer----

Mr. Delahunt. I am talking about the credit card companies.

Mr. Muris. Yes, the issuer has a relationship with the consumer and discloses the fees that it pays to the consumer, if that is----

Mr. Delahunt. But would the issuer have a problem, given the dimensions of the customer base--and having the wherewithal, in terms of the software, just for sake of transparency, put down what the exchange fee was in that particular transaction?

Mr. Muris. But the issuer--the transaction is between the consumer and the merchant, not the issuer.

Mr. Delahunt. I understand that, sir. But for the issuer--

--
Mr. Muris. I am sorry, the issuer can't do what you are asking.
Mr. Delahunt. Can he, Mr. Duncan?
Mr. Duncan. Sure, certainly they could. I mean, look, they are the ones who have these prices, and they are the ones who develop these prices. If they wanted to disclose it, it would be a very simple thing for them to do. Frankly, it would be a lot easier for them to disclose it than for us to disclose it, because we don't know how much a transaction is going to cost us until after you----
Mr. Delahunt. That was the rationale opposing it. What is the problem?
Mr. Muris. Well, in fact, the interchange fees are disclosed, and they are available on the Visa and the MasterCard Web site, if that is your question.
Mr. Delahunt. Please, please, Mr. Muris, you know, on the Web site? I mean, some of us don't know how to access a Web site, let alone asking the consumer to do that--I mean, in the real world, people get a slip. It would be very convenient for them, for the consumer, to understand what the exchange fee was. And what is the problem for the issuer to do that?
Mr. Muris. There is nothing that prevents when consumers engage in a transaction the merchant from disclosing that. I believe consumers aren't interested in that information. Consumers are interested in the prices that they pay.
Mr. Delahunt. But the consumer, I dare say, would like to know, you know, if they are paying 1 percent or 2 percent or 3 percent more what it was. Why not, just for the sake of----
Mr. Muris. But consumers know what they pay to the credit card company. They know what they pay to the merchant. If the merchant, for whatever reason, wants to break it down----
Mr. Delahunt. They don't know what--please.
Mr. Muris. Sure, they know.
Mr. Delahunt. They know? They don't know what the figures are.
Mr. Berman. Would the gentleman yield?
Mr. Delahunt. Of course I yield.
Mr. Berman. I thought I heard one of you--I don't know if it was Mr. Duncan or Mr. Mierzwinski--say that, under the contract between the merchant and the issuer, that the merchant wasn't allowed----
Mr. Duncan. We have to advertise everything as the credit card price. There is----
Mr. Berman. Right.
Mr. Duncan. So the price to the consumer--we have to tell the consumer is the credit card price.
Mr. Muris. Mr. Duncan said that the companies, Visa and MasterCard, prevent the disclosure that you are asking for, and they don't. And, second, if the merchants want, they can offer a discount for cash and they can advertise it. There is nothing that prevents them from doing that. In fact, some merchants do.
Mr. Duncan. May I mention this discount for cash? I mean, that is thrown around as if it were a panacea. In fact, they have a series of rules that they disclose to us through the merchant banks as to how you can offer a discount for cash. Most merchants understand those rules to say that you can offer a discount for cash as long as the credit card price is the most prominent price and the discount for cash is the smaller price, and it has to be separately listed in each instance.
So that means, where do you see it? You won't see it in the Sears, with 100,000 different items. They are not going to put

200,000 prices on the merchandise. You will see it at a gas station, because they only have three products, regular, mid-level and premium. And so there it is conceivable you could put a lower price.

But even when you have that option, they are trying to stop us from doing it in gas stations. Just this last couple of months, Visa went to a gas station in San Francisco, no less, that was offering a 10-cent-a-gallon discount for cash. They had a sign up that said, ``Credit price, cash price,'' and Visa said, ``No way. No can do, because it looks like the credit price is not the regular price. You have got to call that''----

Mr. Delahunt. Reclaiming that time, I think that is easy to corroborate. I mean, and you are saying--or it has been said that, you know, we are trying to--that the retail industry wants Government to do what the marketplace should be doing.

I mean, clearly, there is an appropriate role for Government in certain circumstances. We have usury laws, you know? I mean, the reality is, we have got, you know, in some States, there are caps in terms of interest rates. Otherwise, you know, we could follow the rule, you know, let it go. I mean, the mafia would be in good shape. It wouldn't be interest; it would be called the vig under those circumstances. But maybe we are talking about the vig.

And I yield back.

Mr. Cannon. Mr. Chairman, I ask unanimous consent that the gentleman be granted an additional 2 minutes, because I am actually interested in hearing from Mr. Muris how it is obvious to the consumer, because it doesn't seem to me to be obvious----

Mr. Delahunt. I yield to the gentleman, if I get an extra 2 minutes.

Mr. Cannon. Then, Mr. Muris, you were insisting that it is obvious to the consumer. How is it obvious to the consumer?

Mr. Muris. I am saying what is obvious to the consumer is what the consumer cares about, which is the price that they pay. If Sears wanted to, however, Sears could post a gigantic sign that says, ``Minus X percent''--pick 2 percent--``Minus 2 percent for cash.'' They don't have to post it on every individual item.

Most Americans, sir, most Americans know that merchants have to pay for credit cards. There have been surveys that show that, consumers understand that. Consumers also understand that they get a good deal from the payment card companies. There is enormous competition, despite what we have heard today.

Mr. Cannon. Pardon me, but have there been any studies where you have asked consumers what they think they are paying for their credit card fees?

Mr. Muris. Yes. Credit card fees are disclosed. Okay, we are talking about two different things here. Consumers visit a merchant----

Mr. Cannon. Well, we only want to talk about one thing, and that is, what percentage of the final price that a consumer pays in a store does he think he is paying for the store and what does he think he is paying for you? Have there been any studies where you have asked consumers what they think the appropriate interchange fee that the merchant pays should be?

Mr. Muris. Yes. When consumers are asked, do they know about that the merchant is paying? They say, ``Yes.'' And when they are asked, are they okay with the arrangement, at various price arrangements----

Mr. Cannon. Are they ever asked how much they think they are paying?

Mr. Muris [continuing]. Most Americans are okay with that.

Mr. Cannon. Have you ever asked what Americans think they are paying when you ask those other questions? In other words, do we have any studies that indicate that Americans know what the fee actually is?

Mr. Muris. The fees that Americans pay for credit cards are disclosed. The prices that they pay in stores are disclosed. If the stores wanted to--as I have said----

Mr. Cannon. Pardon me. Pardon me. I guess it is my time, having had it yielded, I am asking a really simple question. I think most people know they pay a fee, but I don't think they know that it is anywhere near what it actually is. I am just wondering if you have done any studies that you can show us where you have asked people what they think an appropriate fee to pay for a credit card transaction would be?

Mr. Muris. There are studies that address that issue. I would be glad to submit them for the record. But there is a more important point here, which is--if Mr. Smith or Mr. Duncan, who worked with me at the FTC years ago--if they feel that consumers want to pay cash, they can tell consumers that, ``You will get a discount,'' and they can say it is 2 percent or whatever it is they want, paying for cash. Why isn't that a solution to the problem?

Mr. Cannon. You are here telling me what you think the most important issue is and not really answering the question. I am looking forward to the report to see what people think they are paying. I was actually quite startled.

Mr. Smith. Mr. Chairman?

Mr. Cannon. And yielding back--let me yield back to the gentleman from Massachusetts.

Mr. Conyers. The Chair is conflicted, because Mr. Smith was very agitated about trying to get in the conversation. So if we grant 1 minute more to Mr. Delahunt's time, maybe he can get in his two cents.

Mr. Delahunt. I yield to----

Mr. Conyers. Smith?

Mr. Delahunt [continuing]. Smith.

Mr. Smith. Well, Mr. Chairman, it won't take that long. We as a retailer do focus groups with our consumers on a periodic basis. And one of the questions we have asked our consumers, ``Do you know what you pay or what we pay in credit card fees or debit card fees?'' And I cannot--we have never hit double digits with people that even have an idea of what they pay. Most people think it is free. They think they get their credit card, they pay fees for the credit card, in a lot of cases, and they don't have an idea that the retailer pays a fee.

Now, some will say, ``Yes, I am sure you pay some fee.'' The vast majority of customers, when we do our focus groups, have not a clue that they are paying extra for their product because of credit card fees.

Mr. Conyers. Thank you very much.

The Chair recognizes the very patient gentleman from Florida, Mr. Ric Keller.

Mr. Keller. Well, thank you, Mr. Chairman.

And I have 23, 24 questions, and no way we are going to be able to get to it in my 5 minutes or before votes, so let me just give a brief opening statement to kind of lay out what my concerns are and try to get to as many questions as I can.

I remain very open-minded about this issue. On the one hand, I think the electronic payment system, dominated by Visa, MasterCard, and their participating banks, has provided a very positive convenience to consumers and merchants over the past

10 years.

On the other hand, I am quite concerned that, despite the dramatic increase of the volume of interchange fee business, we have seen that interchange fee rates have not fallen, as we might expect, but instead have increased, along with the volume of business. And these costs have been passed onto consumers.

Now, earlier today, I went down to the congressional liquor store on Capitol Hill to check out something. [Laughter.]

I feel I could use it now, but I saw that a six-pack of Coke is only $3.65, and that is the exact same price of a six-pack of Pepsi. I saw that a six-pack of Bud Light is only $5.29. It is the same price as Miller Lite, exactly. Pepsi keeps Coke honest. Miller Lite keeps Bud Light honest.

Why the heck isn't MasterCard keeping Visa honest? Why doesn't MasterCard say to the retailers and merchants, ``Hey, they may charge you 2 percent fees, but we are going to have 1 percent''? Why don't we see that competition? Is there collusion going on between MasterCard, Visa and their participating banks? Or could it just be that the cost of business for these organizations has gone up and they have to incur costs associated with fraud and other expenses?

The $64,000 question for me is: Can we find a way to hold down the increase in interchange fees without resorting to price controls? And I haven't heard the answer to that yet.

And I am just going to be honest with you. Both sides have very strong points and very weak points, and let me just tell you what I think they are, as I see it as a neutral observer.

In terms of the banks and the credit cards, they have made a strong point in saying that they have provided a valuable service with the electronic payment system offering convenience and a strong point in pointing out we shouldn't have price controls. That is not our way. On the other hand, they have no good explanation that I have heard for why we have seen these dramatic increases in interchange fees.

On the other hand, I look at the merchants and retailers, and they have a very good explanation of the problem and the unfairness of having these fees jacked up dramatically over the past 10 years. And in light of the fact that 60 percent of their customers are using MasterCard and Visa, they have you by the shirt. And on the other hand, the weakness here, you have not given us any good solutions at all. And so I would love to hear what the solutions are, outside of price controls.

Let me begin with you, Mr. Smith, and make sure I am walking through this process property, at least Food City. I go to your store, and I buy $100 worth of groceries at Food City with a Visa card issued by my bank. It is my understanding that Food City, in terms of the allocation money, would pay approximately $2.10 to its bank, called the merchant discount rate. Its bank would then keep a processing fee of about 35 cents, and then Food City's bank would pay an interchange fee of approximately $1.75 to my bank, the issuing bank. And then my bank would pay approximately 9.5 cents to Visa or MasterCard, so for a grand total of about $2.10.

Is that roughly how it works?

Mr. Smith. Mr. Keller, I am not sure I can tell you exactly how the transactions work. I can tell you that my bill is going to be over 2 percent of my transaction.

Mr. Keller. Two percent. All right, and I know you are concerned about that, because it used to be 1 percent about a decade ago, right?

Mr. Smith. Yes, sir.

Mr. Keller. Now, let me ask you this. If you take that same

$100 grocery example, and your customer instead uses of the credit card, uses a debit card, and he puts in PIN number, isn't it true that Food City would only have to pay about 25 cents, rather than the two dollars in fees associated with the credit card?

Mr. Smith. That is correct. It would be much, much less than the credit card.

Mr. Keller. Why don't you just put up a sign encouraging customers, ``Please use your Visa debit card, and put in your PIN number, instead of using your Visa credit card''?

Mr. Smith. We do encourage customers to use a PIN-based debit card, and a lot of our customers choose to do so. But by the same token, a lot of our customers choose to use a credit card for many different reasons. Maybe they don't have the money in the bank at that particular time. Maybe it is rewards or points that they have been enticed with to be able to use that credit card.

Mr. Keller. Do you offer a discount to those customers who use their Visa debit card with PIN numbers or who pay in cash?

Mr. Smith. We do not.

Mr. Keller. Are you legally allowed to if you wanted to?

Mr. Smith. It is my understanding that we are not allowed to do that. Now, I heard Mr. Muris say that we are allowed to. Maybe we will look into that. I stopped by--and I know nobody can see this--but I stopped by my local commissioner of revenue. I live in the commonwealth of Virginia. And this is a property tax payment form that is put out by the county. And they surcharge. If you use a Visa or a MasterCard to pay your property taxes--which I didn't realize people did, but they do--they actually allow them to surcharge. And it surcharges up to 3 percent.

But we can't surcharge. We cannot surcharge. If we can discount, that is news to me, but other entities, such as governments--I think the IRS does the same thing--surcharge consumers for using those credit cards.

Mr. Keller. Well, thank you. I have a ton more questions, but, Mr. Chairman, my time has expired.

Mr. Conyers. All right, you can put them in the record or send them to the witnesses to submit their responses if you would like, Mr. Keller.

The very distinguished gentlelady from California, Maxine Waters.

Ms. Waters. Thank you very much, Mr. Chairman.

Before I move forward with my questions, I think we should make sure the record reflects that the Congress of the United States does not own a liquor store. [Laughter.]

I can just see us bombarded with our citizens saying, ``Aha, there you go, you have got a gym and a liquor store.'' So the record reflect that that is some retail store that has adopted the name ``Congressional Liquor Store.''

Mr. Conyers. So reflected.

Ms. Waters. Thank you.

Secondly, for the study that Mr. Muris referred to, he wasn't very exact about the time of the study, what the study entailed. He said he would submit it to us, and I would like the Chair to ask that that be submitted by a time certain, within the next 10 days or so.

Mr. Conyers. Is that all right with you?

Mr. Muris. Yes, sir.

Ms. Waters. All right, thank you very much.

Now, to Mr. Duncan. I would like to explore with you this business about the interchange fees, and how they have increased, and how they do this. As a consumer, I know that credit card companies have the teaser rates that they get you in with and then they increase over a period of time. I also know that, once you become a customer, if you are late paying, they have a way of increasing your interest rates. They have a way of generating fees.

And then I discovered that fee generation is a whole business, that there are companies who do nothing but teach banks and financial institutions how to create more fees. And I think something I read some time ago indicated that some of our businesses are getting more money, more profit in fees than they are on the actual services.

So we know, as consumers and customers, how we have gotten caught up in the fee game and the fees that we have--explain to me, why do you think these fees have increased over a period of time, when everybody concedes that they should have been reduced? And what other ways and what other techniques are being used in order to get more money out of the merchants?

Mr. Duncan. Congresswoman, there is a number of answers to that question. I guess the simplest one is to say that a monopolist will do what a monopolist does. And Visa and MasterCard are essentially a duopoly, and so they will try to find ways of profit maximizing.

And not surprisingly, many of the same techniques they will use with consumers, such as teaser rates, they will also use with the merchant community. As someone mentioned a moment ago, they introduced a new category at a low rate and then flood the market with higher rate cards, which essentially drives that up.

They also have rules, and we haven't really focused on the rules today. But there are rules which the executive vice president of Visa says are the size of the New York City phonebook. That is 1,900 pages, roughly. They will only disclose a fraction of that, and yet we are expected to abide by them. And the fraction they expose, in the case of one company, you have to sign a gag order. NRF could go on the line and look at those rules, but then I couldn't talk to you about them and we couldn't solve this problem.

So they have a number of techniques, such as rate increases, that are governed by those rules, that cause prices to go up. I think, talking about the number of options, it is beyond the scope of the time we have here, but needless to say it is a profit-maximizing endeavor.

If I may, may I just respond to one thing that Mr. Keller raised, in terms of the pricing? You saw similar pricing between Visa and MasterCard. This market is broken; it needs transparency and genuine competition. But currently, Visa and MasterCard don't battle for merchants. They battle to get banks to issue their brand of cards. So this is the only market in which the competitors compete, by raising prices rather than lowering them.

Ms. Waters. Wow. I had another question, and I am so taken away--oh, I want to ask this. This Congress and most public policymakers wax eloquently about support for small business. As a matter of fact, if you polled the Members of Congress about their feelings and support for small business, that would rank very high in those public policy considerations that they work with, they deal with.

I want to know the impact of these interchange fees on small businesses. Are our small businesses being hurt? Are they being ripped off? Are they being caused to go out of business, not to be able to have the inventory that they need because they are being gouged?

Yes, sir?

Mr. Buhrmaster. Yes, thank you. I would like to respond to that.

I deal with small businesses every day. My bank was the number-one small business lender in New York state for a bank our size. Small businesses have a variety of costs of doing business. They have insurance; they have lawyers; they have accountants; they have waste removal.

When I look at a financial statement for a typical small business, you know, that accepts credit cards, what I am finding is, on average, insurance is more, it costs more for insurance, waste removal is fairly equivalent to the cost of your interchange fees, and legal and accounting is less. So it is a cost of doing business. It is built into their pricing structure overall.

I don't believe they are being gouged. I think they are getting a good service for it. You know, these are people that have to--these are merchants that have to reach the people. And right now, the most popular means of making payments is through credit cards.

And if you take a look at the national savings rate, it was negative the first time, it is because people are getting used to putting thing on their credit cards. And I don't think it is anything that is on Visa or MasterCard's advertisements that is doing it; I think it is people's desire for now.

Ms. Waters. Aside from the convenience for the customer and the merchant, what else does the merchant get for this fee?

Mr. Buhrmaster. For its fee?

Ms. Waters. For this interchange fee that they pay.

Mr. Buhrmaster. Well, first of all, the merchant has the fraud protection system, which is built into the system, that if someone comes in with a fraudulent card, if they don't have that system there, they might accept that for payment and end up taking the loss later. However, by running it through the system properly, if they do everything properly, they are covered, and that is a valuable thing. You can't have that with the check.

With cash, of course, cash is king, but not everybody carries cash anymore. I mean, if you poll everyone in this room, how many people really have a lot of cash in their wallets? Most of us rely on those cards that are in our wallet to go to McDonald's or to the beverage store.

Ms. Waters. Well, that is why the merchants are at the mercy of the issuers, because most people do rely on credit cards. I wish we did not have to, but you can't travel in this country, you can't get lodging in this country, you can't do anything without a credit card, so we are at the mercy of the credit card companies.

Yes, sir?

Mr. Smith. Congresswoman, if you assume this is the cost of doing business--which I wouldn't disagree with--it is an uncontrollable cost of doing business. It is one we can't negotiate. I can negotiate with the folks that are going to pick up my trash, and I can find the one that gives the best service and the best price. I can negotiate with a bank, if he is going to take my checks. I can negotiate prices on check processing. I can negotiate every one of my costs of doing business, but I cannot negotiate that cost of taking credit cards.

Ms. Waters. How would you recommend we could help you?

Mr. Smith. I wish I had a simple solution, because it is somewhat of a complex thing. I think that, when people compete, just as we compete in the retail grocery business, the consumer benefits. And that is what I hope that this group, along with Food Marketing Institute and some other participants in the Merchants Payment Coalition, can get together and come up with some very good solutions.

Ms. Waters. Yes, sir?

Mr. Mierzwinski. Representative, if I could just add one quick point, the market power of the two card associations forces merchants to accept their product on the terms that are offered. And the terms that are offered are very, very complex, as you have heard.

And I spoke to one small business woman--a doctor, actually, a solo practitioner--and she cannot find out until she gets her bills back from her third-party processor that some of the cards that she has accepted are these rewards cards with the much higher fees that she pays. They look like Visa cards to her, and they go through her machine just like Visa cards. They are all the same, but these new types of cards that are being offered are these rewards cards, these signature cards.

And I would submit that the fraud detection and everything else is a cost of the companies--are doing for any of the cards and that you are not getting better fraud detection. You are simply paying for more rewards, but you don't have any idea what you are paying. You have no choice in the matter, because of the market power of the company.

Ms. Waters. Yes, sir?

Mr. Muris. Ma'am, could I just make two points in response? One, I would like to submit for the record a letter from the Small Business and Entrepreneurship Council, which opposes what the merchants want to do, if I could submit that for the record.

Mr. Conyers. Without objection.

Ms. Waters. Before you--are you going to accept that for the record?

Mr. Conyers. I did. You don't want to?

Ms. Waters. Well, I wish I had been able to object to that.

Mr. Conyers. You didn't want to----

Ms. Waters. Because I want to see it. Because I can't imagine merchants sending a letter up here saying, ``Don't help us.''

Mr. Conyers. Well, we have accepted it for the record so you can examine it now.

Ms. Waters. All right.

Mr. Muris. And my second point is, in terms of small merchants, Visa and MasterCard are two of the greatest things that ever happened for the small merchants in America.

Ms. Waters. My time is up. Thank you.

Mr. Muris. If you don't want to hear the answer, that is fine.

Ms. Waters. No, no, no, I don't.

Mr. Conyers. I was afraid to tell her, her time was up. [Laughter.]

So now that she acknowledges it herself, I mean--the Chair is pleased to recognize the Ranking Member of the full Committee from Texas, Lamar Smith.

Mr. Smith of Texas. Thank you, Mr. Chairman. Mr. Chairman, I assume that the gentlewoman from California has, in fact, set the precedent and the standard for time allotted for questions?

Mr. Conyers. You may not make that assumption. [Laughter.]

Mr. Smith of Texas. Mr. Chairman, first of all, I would like to ask unanimous consent to have an opening statement made a part of the record.

Mr. Conyers. Without objection.

Mr. Smith of Texas. And I would like to also that I apologize to our witnesses for being slightly late today. I was over participating in a Conference Committee over on the Senate side on the 9/11 bill, and that was the first meeting and somewhat mandatory. And, unfortunately, I have got to return as soon as I finish my questions to that Conference Committee.

Mr. Muris, let me address my first couple of questions to you. And some of these questions are really follow-ups to questions related that you have been asked already. But how does Visa and Master Charge actually set their interchange rates? What factors go into those specific rates?

Mr. Muris. Well, they recognize that this is a two-sided market, and it is a two-sided market where the consumer is king. The consumers get tremendous value. They get the rewards cards.

Mr. Smith of Texas. How are the actual rates set? Say it is roughly 2 percent.

Mr. Muris. The rates have been set in part by competition. In fact, we have heard a lot of talk about rates going up. The merchant discount rates haven't gone up since the late 1990's, and they did go up. And one of the reasons--Mr. Keller asked what happened--one of the reasons was----

Mr. Smith of Texas. Actually, let me go back to my question. What factors do you consider in setting those rates?

Mr. Muris. That is what I am saying. Competition between Visa and MasterCard to get banks to dedicate themselves to them was one of the factors that caused the increase in rates in the late 1990's.

Mr. Smith of Texas. Is there an overhead factor? Is there an expense factor? Is there a cost factor?

Mr. Muris. But in a two-sided market it is frequent that one side gets subsidized. If I go on eBay, the seller pays it all and the buyer pays nothing. I mentioned newspapers when you weren't here. In newspapers, the readers are subsidized by the advertisers.

In payment cards, the cardholder gets a very good deal, and the merchants bear most of the costs. And that happens throughout in these so-called two-sided markets.

Mr. Smith of Texas. Okay. You have gotten some criticism today about anti-competitive behavior. How do you--if the fees are so similar, if you talk about an individual going into a store and buying the same merchandise with the Visa and the Master Charge, the fees are going to be pretty similar, why isn't that anti-competitive behavior?

Mr. Muris. Well, as Mr. Keller mentioned, in competitive markets, it is quite frequent that the prices are similar or even identical. But here prices, in fact, are different. American Express, which is a smaller company, has a higher merchant discount of 2.5 percent. Discover has a lower merchant discount.

The size of the merchant discounts, is related to the type of the card and with what happened--of the need to attract merchants, as compared to consumers. There are antitrust cases going on. Those cases do not involve American Express and Discover because they are single entities.

Through historical accident, because Bank of America could not have multi-state banking, we ended up with the system that we have now. MasterCard and Visa have, in fact, moved to a system that now will look much more like American Express and

Discover.

Mr. Smith of Texas. Mr. Duncan, why do you think the interchange fees are too high? And you have been asked several times today about a solution, and I heard one about arbitration and that a bill has been introduced to, I gather, compel arbitration. I assume you are opposed to price controls, but what other answers are there out there if, in fact, you can show that the fees are too high?

Mr. Duncan. Sure, let me start with just suggesting to you how fees are fixed. As Mr. Buhrmaster said in his testimony, and I think I referenced in my testimony, what happens is a group of big banks with Visa get together and they set the fee. They then take it back to the Visa, and Visa blesses it, and all of the banks then charge that fee.

Mr. Smith of Texas. Just because they have gotten together doesn't necessarily prove the fee is too high. Why is the fee too high?

Mr. Duncan. The fee is too high because it is set the way a fee would be set by a monopolist. In any other market, as we see growth, as we see computerization, as we see improvements, prices go down. After all, this was originally a fee for processing a transaction, and now we see that only 13 percent of it goes to processing.

Mr. Smith of Texas. And what would you propose as an alternative?

Mr. Duncan. There is a couple of parts to that. First of all, because this system is governed by a privately regulated set of rules, the first thing we have to have is some transparency. We have to be able to see the rules of the game to know how you are going to fix this thing.

Look back. A few years ago, we had Ma Bell, and you could get any phone you wanted as long as it was black, white or ivory, and you paid two dollars a minute for long-distance calls. The courts got involved, and there was tumult. Finally, Congress came around and said, ``You know, this is a problem that we have to fix. We have to look at it, study it, and come up with a solution.''

We have an analogous situation here. The courts are involved, but only Congress can come up with a nuanced response to make this work. It may be as simple, for example, as looking at the ``honor all cards'' rule, the rule that says, ``If I sign it to take this 1 percent traditional card, I have got to take this 3 percent business rewards card,'' and allowing a merchant to say, ``No, I don't want to take these business rewards cards or these high-flying extra cards.''

Mr. Smith of Texas. Okay.

Mr. Chairman, I would like to have an additional minute. And if granted, I am going to yield it to the gentleman from Florida, Mr. Keller.

Mr. Conyers. Very good.

Mr. Smith of Texas. Thank you.

Mr. Keller. Thank you.

Mr. Duncan, what is to keep Visa and MasterCard, since they have an 80 percent market share, for determining, ``You know, instead of having 2 percent interchange fees, we are going to have 3 percent or 4 percent''?

Mr. Duncan. Frankly, the only thing I think that stops that from happening is because they are monopolists, and monopolists will price maximize. It has been a number of years since economics, but there is a market-clearing competitive price, and there is a much higher price that monopolists charge if they can profit maximize.

Mr. Keller. Mr. Muris, would that be a good thing, if the interchange fees went up to 3 percent?

Mr. Muris. Well, if they had the power that Mr. Duncan says they have, obviously the fees wouldn't be where they are now. But it is important to understand that----

Mr. Keller. But isn't your position ``when interchange fees increase, cardholders benefit''?

Mr. Muris. Yes, but interchange fees are set in this process, this balancing process. It is clear that one of things----

Mr. Keller. So if the ATM fees go up, that is good for me?

Mr. Muris [continuing]. What happens with interchange is that cardholders received better cards. Most of us have four or five cards in our wallets, believe it or not. If interchange went down, like has happened in Australia, what happens is, annual fees become an issue. With annual fees, people would carry far fewer cards.

You might believe that people are wrong to carry four or five cards. I personally don't, but there is a direct relation between the size of the interchange fees and the quality of the cards.

Mr. Keller. Thank you. I think my time has expired. I yield back.

Mr. Mierzwinski. Mr. Chairman, could I just add one quick comment on the Australia? I mean, the consumer groups would be happy to submit for the record that we disagree with the card associations' interpretation of the Australia experience, and we think that actually, overall, consumers are paying lower fees, and there are more entrance in the market, and it is a much more competitive system.

Mr. Conyers. We would be pleased to accept any information in that regard.

The Chair recognizes Chris Cannon.

Mr. Cannon. Thank you, Mr. Chairman. I appreciate that.

And let me pick up from where I was with Mr. Smith. You were talking about some focus groups you had done. Do you have anything that you can share with us, any written reports on those focus groups or anything that would indicate something we could look at as a Committee?

Mr. Smith. No, no, sir, I don't here with me today. I could provide that with you in the future.

Mr. Cannon. If something is done already, I would appreciate that. That would be interesting.

Mr. Smith. Yes, sir.

Mr. Cannon. In that process, did you ask people what they thought fees currently are?

Mr. Smith. And I don't recall exactly the exact line of questioning, because obviously I wasn't doing the questioning, but the questions had to do with payment methods. Which payment methods do you prefer? Is it debit, credit, check, et cetera? And it kind of weaved back around to the question, you know, what fees do you think are associated? Do you think any fees are associated with these cards? And that is where we ascertained the information that most consumers do not think there are fees associated with cards.

Mr. Cannon. Did you then take it beyond that to say globally how much profit is built into those transaction fees for banks?

Mr. Smith. No, sir, because we were very careful not to disclose things we are not supposed to, according to the rules.

Mr. Cannon. Can you tell me about the rate you pay or the rates--for instance, does one size fit all or are there multiple rates that you end up paying as a merchant?

Mr. Smith. Well, actually, I have a rate sheet right in front of me here. We pay 64 different rates to credit card companies. I would be happy to share this. At this point, I am probably not allowed to.

Mr. Cannon. Well, I ask unanimous consent that that be included in the record.

Mr. Conyers. Without objection.

Mr. Cannon. Thank you.

Mr. Smith. I am not sure that I can do that in accordance and not be in violation of my Visa and MasterCard----

Mr. Muris. It is public information.

Mr. Smith. I would be happy to supply you with that. But there are 64 different rates that are on this sheet. And if you look at MasterCard's rate sheet, as I understand it--now, this is not just for our industry; this is for our stores--but theirs was 106 pages long for all of the industries that they do business with.

Mr. Cannon. But this sheet reflects your fees?

Mr. Smith. Sixty-four different rates.

Mr. Cannon. And they are different rates, and therefore, presumably, some ability to push people to use rates that are higher? Do you find that banks are--in other words, we have talked a lot about different kinds of cards. And some cards have extra fees because they are specialty cards, and a merchant ends up paying more, but do you find that there is pressure by banks in the system to encourage people to use cards that result in higher fees for you?

Mr. Smith. There is no question to that, sir, yes.

Mr. Cannon. Do you push back on that at all?

Mr. Smith. There is no way we have the ability to push back. We have to take all cards. We can't discriminate on any type of cards. And even if we could, with 64 different payment structures, I don't know how that would be possible in a retail environment.

Mr. Cannon. Given this policy, I appreciate that.

There is one other--I have many questions, but one I want to direct to Mr. Muris. You talked about the benefit of the system and some of the robustness of it and how merchants have a choice--I think you mentioned Costco doesn't take some cards. Costco, I think, is a little unique.

But however you consider the market for merchants today, how do you deal with the online environment? What does the merchant do who is online, where a customer has a different set of choices? Is it not more important for someone online to have the ability to process a credit card than it is, say, a store down the street?

Mr. Muris. Absolutely. And I would submit that, without payment cards, we wouldn't have the vibrant online economy that we have. And the key to the functioning of payment cards has been their ability to balance these two sides of the market.

Interchange rates could be higher online, because the fraud possibilities are higher, but I think the Internet makes the case for payment cards, not the opposite.

Mr. Cannon. Well, so my point here is not that it is enhanced--I mean, I believe that it has. And Mr. Duncan earlier talked about profit, and I think actually profit is a wonderful motive. It gets people to do things they might never have thought of doing, like getting out and working. So there is nothing critical in this question.

But the question more that I am asking is, is there a disproportionate bargaining position on the part of the credit card companies when they are dealing with people online?

Mr. Muris. In many ways, I don't think so. PayPal and other people are trying to come up with different kinds of payment systems. Again, we have a variety of--we have four credit card payment systems. It is quite frequent. I don't know how you much you purchase online, but when I purchase online, most of them seem to take all the major systems.

Although there has been a tremendous benefit, there is competition in this business, and I think that competition acts like it acts otherwise, to protect the consumer.

Mr. Cannon. I only buy things online in D.C., where I don't think I have to pay sales tax on them. You have to remember everything you buy in Utah and declare that on your sales tax, another issue for one of the Subcommittees of this full Committee to deal with at another point in time.

Mr. Chairman, I recognize my time is expired, and thank you, and yield back.

Mr. Conyers. Thank you very much.

Mr. Darrell Issa?

Mr. Issa. Boy, it is hard to know where to begin. We are not the courts, and, Mr. Chairman, I respect the fact that we have certain limited jurisdiction. So let's assume for the moment that it is the courts' job to decide if you are a trust, if, in fact, Visa and MasterCard are operating as monopolies.

But, Mr. Muris, I guess since you are the apologist for the credit card companies here today, to use a technical term I think we use from time to time here at the dais, why in the world within our powers shouldn't we have a piece of legislation that says that, from a contractual standpoint, since it is very clear that credit cards have monopolistic power as a group, then why is it that it wouldn't be appropriate for us to sponsor legislation, on a bipartisan basis, that would simply allow those taxes to be added, 64 different--and, by the way, Mr. Smith, I am assuming you will answer affirmatively that your stores could have a computer that would add the exact amount of those 64 different rates so that whatever card I chose, I got the effective tax rate back to me, as a pass-through, no profit, just a pass-through--why in the world shouldn't we sponsor legislation that says that?

And then, secondly, and probably even more importantly, why in the world should this Committee allow a gag rule to be in place that prevents the public from knowing what is being added to the cost of the product, particularly when a gallon of gasoline has more profit in it for your companies than it has for any of the people they are buying from?

Mr. Muris. Well, I am speaking--although I have done work for Visa, I am speaking, as I always do in front of Congress, for myself. I decided 40 years ago that I wanted to be active in public policy issues and speak my mind, and that is what I am doing today.

Mr. Issa. Oh, okay. So when your firm advertises that as a lobbyist organization, that you are the premiere one in Washington, that it has nothing to do with that? You are doing this on your own dime for free, not for a client?

Mr. Muris. No, what I am saying is that this is not my full-time job. I am a college professor, as well, and I am doing other things. I only speak in public and I only represent people in whose cases I believe. In fact, Discover came to me in 1990 in a case against Visa and wanted to hire me to work for them, and I said Visa was right.

Mr. Issa. Okay, well, in that case, I think I will switch to Mr. Buhrmaster. As a small banker--I will ask you the question--why in the world do you believe that you only have essentially two people you can deal with and both of them, Visa and MasterCard, guarantee you a profit, even though your various banks are on the back end, the smaller end, but they set the price high enough that the smallest of banks still make a profit on it? Why do you think that occurs?

Mr. Buhrmaster. Well, I don't believe they set the price. I do believe that the price is set by the marketplace. When a merchant comes and sits down at my desk and says, ``I am interested in this product,'' chances are they spoke to someone else. And I disagree with Mr. Smith when he says there is no competition here, there is no negotiation.

Mr. Issa. Well, let me switch. I will switch, but I want you--just double check--I want you to have your banker's hat on, okay?

Mr. Buhrmaster. Certainly.

Mr. Issa. If I came to you tomorrow with a product that cost 25 cents per $100, 0.25 percent as a transaction fee, and that is all you had to pay, and then you could price your amount on top of that for a merchant, let's say another 0.25 percent or another 0.5 percent, so that for 0.75 percent, instead of 2 percent or 2.5 percent, you could provide a merchant with this transaction, no frills, would you for a minute not take that 0.25 percent, add your 0.25 percent or 0.50 percent, and undercut the existing competitors of Visa and MasterCard? If that was available today, is there any reason you wouldn't take that?

Mr. Buhrmaster. When I look at a product I am buying--and that is one of my jobs at the bank; I examine new products--I want to know the same thing my customers ask when they walks in here: Where am I going to get the best service and the best price?

If I made my decision solely based on the best price, I would probably not be in business, because I have gotten some great deals thrown in front of me that turn out pretty bad. Now, that said----

Mr. Issa. Okay, well, let me rephrase that.

Mr. Buhrmaster. But, no, I know what you are saying.

Mr. Issa. Let me re-ask the question one more time, because the time is limited, and I think we have to get the basic question of: Is there an absence of an a-la-carte for a reason? If Visa or MasterCard offered you the transaction separate from all the other things that go in it, the 0.25 percent rate, which would be about what I guess is the 13 percent of the fees that are going on, just my arithmetic, if they offered that, would there be any reason in the world that you would not use that, at least with merchants who wanted it as a competitive advantage?

Mr. Buhrmaster. I want the best deal I can get for my bank and my customers, so if someone is offering me a better rate and I am used to their service, and I can verify their service, and I can make sure I am getting the value for my price, I would take it. Now, that said----

Mr. Issa. I am assuming that, if that were offered by Mr. Buhrmaster, that you would take that rate of about half what you are paying and put the rest of it either into savings or, perhaps, eking out a profit. Is that roughly correct?

Mr. Smith. I think that would be fair to say. We would enjoy having a lower rate and competition to get there.

Mr. Issa. So it is the absence of competition and the absence of disclosure that we are dealing with here today within our jurisdiction?

Mr. Buhrmaster. I have to disagree with that. That is been said a number of times here, and we are talking about an absence of competition. There is not an absence of competition. As a merchant acquirer, there is not.

I have people coming into my office--out of my 160 merchants, we have people that come in and say--I had a guy come in, and he showed me his business card. On the back of it, it says, ``I can give you this rate.'' Well, I say, ``All right, what services are they offering?'' There is competition. Every day, there are people in my merchant shops trying to offer them a better rate.

I price the way I feel I can make a profit and I can deliver good service. I don't want to do both. I don't make a big profit on this. I deliver good service.

Mr. Issa. But Mr. Buhrmaster--and my time is up, and I don't want to take too much of the indulgence of the Chairman, but since I am, oddly enough, the only member of a public company's board, and my company does about $40 million of transactions a year, and I am the former CEO, with all due respect, I have been at the negotiation table on behalf of my company with the various banks. And it simply isn't true.

Yes, you can negotiate over 0.02 percent or so. You cannot negotiate beyond that. We are dealing here today, with the Chairman's leadership, on the portion that is, in fact, the price-fixing portion. And I would hope that, in the future, that the kinds of hearings we have continue to expose the fact that there is an absence of competition and a gag rule in place in America today.

And, Mr. Smith, thank you for your leadership and the rest of you that helped flesh this out.

Thank you, Mr. Chairman, for your leadership. I yield back.

Mr. Conyers. I thank you so much.

Mr. Chabot?

Mr. Chabot. Thank you, Mr. Chairman.

I just have one final question that I would like to put to both sides. To the banks-credit card folks, obviously you have been on the receiving end of the more probing questions. And my question to you is: Are there any misimpressions that you have heard here, that the Committee may have received? Is there anything that you would like to clear up? Is there any other criticism that you have heard that you think is unwarranted? I would like to give you both a last shot to make your best case to us.

And then, to the retailers, if you could comment as to why--oftentimes, a lot of us believe that you don't necessarily want Congress getting involved in something that marketplaces can kind of take care of things, but that is not always the case, and sometimes we do need to step in and regulation is appropriate. Would you tell us why this is an area that ought to be probed further and that we ought to look into and how we could be involved to the extent that we can be helpful and not screw up the marketplace out there, as Government is sometimes apt to do?

And I don't care who goes first. We can just go down the line, however you want to do it. Why don't we go, Mr. Smith, if you would like to? And we will just go right down the line. And if you could keep your comment to perhaps a minute or so, because I have only got 5 minutes.

Mr. Smith. Well, thank you, Mr. Chabot.

I think that the thing that we look at in our business is we are the purchasing agent for our consumers. It is our responsibility to make sure that we can bring food to the table of our consumers as inexpensively as we can with quality merchandise. The problem we have got, when you see a 2 percent fee for credit cards and a 1 percent profit margin, you must understand that there is a pass-through to the consumer.

Our concern is, as it has gone up 117 percent, we don't know where the end is. We have credit card fees that are going up faster than our health care, faster than any other expense that we have in our business.

I don't know that I have a solution for you here today. I wish I did. But I what I do think works and what I have experience with is being in a free market enterprise system, one where competition is readily available, and folks vie for your business each and every day. And I hope that is what we can work with this Committee to come up with.

Mr. Chabot. Thank you.

Mr. Buhrmaster?

Mr. Buhrmaster. Well, I enjoyed the probing questions, and I wish you would have asked me more. I came here, and I enjoy asking the questions for you folks.

I feel that we have missed something here. There is competition in this business. From where I sit, I sit at a desk, in a small bank, in a small town, in a small community, and I have my merchant customers bombarded with people coming in and offering them better deals. There is competition out there.

The base price may be set, but that is what allows a bank like ourselves to be in the business. You know, we can compete with the Bank of Americas. We may add on what our cost is so that we can be competitive. But it is so important to note: There is competition out there. And I do lose customers, and I gain customers.

Second is just don't forget the small banks in this equation. You can't forget that we are driving the economy of this country and that this is an important part of our driving the economy. We have to have these payment options for our people, for our consumers, and for our merchants and our small businesses. It is important.

And if legislation is put forth that restricts our ability to compete with the large banks, you will lose the small banks in the payment acceptance arena, and it will be dominated by large players that traditionally have not looked out for the consumers the way small banks do.

Mr. Chabot. Thank you.

Mr. Mierzwinski?

Mr. Mierzwinski. Thank you, Mr. Chabot.

The first thing I would like to say is simply that the consumer groups care about all consumers, not only cardholders. And if cardholders represent 50 percent of the business of a store and the cost is 2 percent added on across all 100 percent of the store's customers because of unfair interchange rates, well, then everybody is paying 1 percent more, regardless of how we pay, with a card or without a card. So that is the first issue out there.

Second, in terms of the unfair practices, one thing that we haven't pointed out is that the cheapest form of interchange is actually PIN debit. There are statistics out there and there are facts out there that show that many banks are now starting to impose a PIN debit fee on consumers to drive them to signature debit, which is the higher cost debit. And that is why you have all these rewards programs. They put the rewards programs on the signature debit only, just like on credit cards, because they want to drive you to that, because they make more money from the merchants.

Rewards, by the way, we think are overrated, particularly on credit cards. Most people don't redeem them. And if this is what we are paying for, it is a ridiculous system.

Then, finally, you asked, what else should you be looking into? The final point of my testimony was that, in addition to this system of interchange being broken, we believe that the issuer system is an oligopoly and that there are bad practices that companies engage in, because of those anti-competitive practices at the issuer level, and we would encourage a second hearing just on issuer competition.

Mr. Chabot. Thank you.

Mr. Muris?

Mr. Muris. Thank you very much. And let me submit for the record that I have heard a lot of facts--many more than I could talk about now--that I thought were wrong. Just let me make a few points.

First of all, regarding rewards cards, I like my rewards. I don't think it is the job of Government to tell people what kind of products they should take.

Second, fees are not out of control. And let me submit for the record data I obtained from Visa involving supermarkets, which show that the increase in volume explains, virtually percentage point for percentage point, the increase in interchange that supermarkets have paid to Visa in the last 7 years.

Next is, despite what we have heard, merchants can discount for cash. They can disclose all this information. They can steer. They can have people use debit. They can have people use Discover. There are lots of things they can do.

Next, what we heard from both Mr. Smith and Mr. Duncan when they were asked for remedies shows that, if this were really an antitrust case, they wouldn't be here. An antitrust case would simply end the price fix. By asking for a complicated AT&T break-up kind of remedy, that is clearly an implicit admission this is not the cartel case they claim.

Finally, consumers do know that merchants pay. In fact, two-thirds of them know that merchants pay to use the cards.

Thank you.

Mr. Chabot. Thank you. If we could get some follow-up on that, because there have been some discrepancy this afternoon from both sides. We would like to get--I think, I am sure we all would--just to verify it one way or the other.

Mr. Muris. Yes, sir.

Mr. Chabot. Thank you.

Mr. Duncan?

Mr. Duncan. Yes, first, I guess what I would like to say is that what we have here is a market failure. We don't have a market. We have prices that are regulated privately and supported by a secret set of rules. So that is not a functioning market; that is not the definition of a market.

Now, the courts--as Tim points out--the courts are very good at deciding liability, and they can determine damages. But if we are talking about fixing this, we are talking about prospective remedy, that is not something a court is very good at. So it is really the prerogative of Congress to come up with the kind of nuanced solutions we need to help correct an anti-competitive market. I would suggest that one of the first places we look is at these rules.

Mr. Chabot. Okay, thank you very much.

Mr. Chairman, I want to thank you for having this hearing and just say that I think both the witnesses on both sides here were very, very good. And I think they had great presentations, handled the questions very well on both sides, so thank you to the panel.

Mr. Conyers. But there is a lot of conflicting testimony here, sir. Somebody is less correct than somebody else, which is our job to determine.

Ric Keller?

Mr. Keller. Thank you, Mr. Chairman.

And I want both sides to know that I have read everything you have had to say, I have listened to every word you have had to say, taken notes on everything you have had to say, and really hope we have given you a fair shake, both sides, and will continue to do that.

Following up on what Chairman Conyers said, I am going to try to create order out of chaos just a little bit. I have found six factual inconsistencies between you--one side said one thing; one said the other--and one area of agreement. And I will go through that and see if we can at least get the agreement.

The retailers say, ``We just want to be able to see these Visa and MasterCard operating rules, and they are kept secret from us and the public.'' Mr. Muris, on behalf of the credit card companies, banks, ``No, we don't keep them secret. They are right there on the Web site. Anybody can see it.''

Retailers said, ``We can't advertise or offer cash discounts or debit card discounts; in fact, Visa threatened some California gas station for offering lower cash prices.'' Mr. Muris said, ``Not true. You can offer lower prices, cash discounts, offer debit card discounts, advertise it if you want.''

The retailers said, ``We don't have the bargaining power to deal with these credit card companies. It is take-it-or-leave-it, and we have to take it, since they have got 80 percent market share, companies like MasterCard and Visa.'' Mr. Muris says, ``Not so. Costco cut a deal with American Express, using their bargaining power, and American Express typically had a higher merchant rate, 2.5 percent, more than MasterCard and Visa, so just cut your deal.''

Retailers say that, ``When interchange fees increase, it hurts consumers and cardholders.'' Mr. Muris says, ``When interchange fee increase, cardholders benefit. Higher interchange fee revenues to issuing banks result in increased benefits to users of payment cards, such as increased rewards and lower fees. These benefits come not only in the form of air miles, but also include rebates.''

Retailers say, ``We don't want price controls. We want competition.'' Mr. Muris says, ``Critics, including the merchants, want the Federal Government to impose price controls.''

Mr. Smith, on behalf of the retailers, is the CEO of Food City and the president of food marketing, says the supermarkets are hurting. Mr. Muris pulls out a letter and says supermarkets are doing great. They are not hurting.

Well, here is my one area of agreement that I have seen: It seems that people at least agree, pursuant to these operating agreements that Visa and MasterCard issue, if there is a company such as Mr. Smith's company, Food City, and they agree to accept Visa, and someone comes along with one of these Visa premium cards, with lots of bells and whistles, like airline miles and rewards and rebates, and it has a much higher interchange rate, you have got to take it, just like the more basic one. And Mr. Muris hasn't disputed that.

And one of the solutions--in fact, the only solution I have heard today that Mr. Duncan has offered is maybe that should be changed, maybe you should have the freedom to turn down some of these big-ticket premium reward cards that are charging you very high interest rates. Is that essentially your idea, Mr. Duncan?

Mr. Duncan. That would be a first step.

Mr. Keller. Mr. Muris, have I accurately laid this out, or am I mistaken?

Mr. Muris. Yes, what you have done is destroyed the value of Visa and MasterCard as a brand, because what that means----

Mr. Keller. I didn't know I was that powerful. [Laughter.]

Mr. Muris. Well, that is what your remedy would do, because what that means is--the value to me is I can take my Visa card and it will be honored anywhere. And what you are saying is, no, the merchant can pick and choose. So you really would hurt the value of the brand.

Mr. Keller. But you would agree with the statement--and I don't want to quarrel with you; I just want to make sure I am getting my facts right--that, if someone enters into a Visa agreement, such as Food City, and you agree to take the Visa cards, you have got to take all the Visa cards, the premium ones and the basics? Is that right?

Mr. Muris. Absolutely. I think you are doing a superb job of summarizing. I was just saying the implications of what you want would have disastrous consequences.

Mr. Keller. Thank you, Mr. Chairman. I will yield back the balance of my time.

Mr. Conyers. My commendations to you, because that is precisely what we are going to have to do after this hearing, is what you have already initiated. I thank you very much, Ric.

Steve Cohen, were you just passing through the Rayburn building, wandered in here, or do you have a purpose?

Mr. Cohen. Mr. Chairman, I was going through the payphone return coin places to try to get some money to pay my credit card bill, and I hadn't come up with enough yet, but I did stop by. Thank you, Mr. Chairman.

I am interested in this issue, and I have had an interest in consumer issues for some long time. And I am afraid I am not as maybe up to speed as Mr. Keller and some of the others, having listened to the testimony.

But one of the things that--and it is just shocking to see that these rates have continually gone up, and the United States is appearing to be the only country in which credit card interchange fees are increasing, and has far higher fees than almost any other industrialized country. And I guess that is--whose testimony is that from, or is that just the gospel?

Mr. Duncan. That is the gospel.

Mr. Muris. Well, it is not true. You know, it is another fact I will dispute, but we could----

Mr. Cohen. Is it the gospel according to Ed?

Mr. Mierzwinski. The statistics we have seen, Representative Cohen, are that the U.S. has the highest rates. The retailers and the consumer groups agree on that.

Mr. Cohen. And, Mr. Muris, which countries have higher rates?

Mr. Muris. Well, I will submit for the record two pieces of evidence, one from Aite, which shows that what merchants pay is lower in the United States than most places; another from the European Union that shows what merchants pay in the United States for Visa is right in the middle of other countries.

Mr. Cohen. But Visa is different. We may be talking about

MasterCard.

Mr. Muris. Well, no, I believe Visa and MasterCard are very similar.

Mr. Cohen. They are very similar.

Mr. Chairman, may I ask a question? I may be confused. Wasn't this about antitrust?

Mr. Conyers. Well, this is the Antitrust Task Force of the Judiciary Committee, yes.

Mr. Cohen. So is this an admission that Visa and MasterCard are kind of doing something together?

Mr. Conyers. Well, no, wait a minute. We haven't gone that far yet.

Mr. Cohen. Okay, I am sorry.

Mr. Chabot. Would the gentleman yield?

Mr. Cohen. Yes, sir.

Mr. Chabot. I thank the gentleman for yielding.

Mr. Muris, if you have evidence to the contrary or there are studies out there, I would like to have that material. I think we all would, again. You know, otherwise, if there isn't something, then I would tend to accept that. You know, if there is something that is inconsistent, then I would like to see it.

Mr. Muris. No, I will submit the information for the record, but the truth is, in competitive markets, firms tend to--and I believe it was Mr. Keller who pointed that out--when you walk into stores, close competitors have similar prices. That is what often happens in competition.

Mr. Conyers. Well, that is also possible price-fixing, too.

Mr. Muris. Sure, it is a possibility of price-fixing, monopoly, or competition.

Mr. Chabot. And I am talking specifically about whether the United States has the highest rates.

Mr. Muris. Oh, yes.

Mr. Chabot. That is what I was talking about.

Mr. Muris. Yes, and I have--and I will submit two different pieces of data for the record.

Mr. Chabot. Yes, I mean, I would be very interested in seeing it, but I haven't seen it, other than what Mr. Cohen has referred to, so I am assuming that that is the case, unless I see something different. Then I would look at the source of that.

Thank you.

Mr. Cohen. Sure, that is on page three here of the consumer group testimony on credit card--let me ask this question. Mr. Muris, are you with a credit card company?

Mr. Muris. I am testifying today, as I always do--we had a little exchange about that--I am----

Mr. Cohen. I think I heard that one. You are a citizen, and you only come out for folks you like? I heard that. Between telephone booth places, I did hear a little bit of that.

Mr. Muris. I have spent 40 years doing this. I have had six jobs in the Federal Government. I have had a lot of other policy jobs. I only speak and work for people in whose cause I believe, and I am proud of that, sir.

Mr. Cohen. Do you have any reason to know why the credit card companies continually send out all these requests for people to get credit cards? I live in a house for 19 years, and there is still soliciting the people who died before I moved in and saying, because of their good credit rating, they are entitled to get this card. They have been dead for a long time.

Mr. Muris. Sure, and it is one of the----

Mr. Cohen. They are debt-free.

Mr. Muris. It is one of the ways that people get credit cards. One of the things that I suspect you helped us with, when I was chairman of the Federal Trade Commission, we made it easier for people to opt out of those solicitations. It was not like--we did the National Do-Not-Call Registry when I was chairman, and Americans overwhelmingly signed up for that. Americas overwhelmingly don't----

Mr. Cohen. But these people are dead. They can't opt out.

Mr. Muris. But I am saying that, if you wanted to, sir, you can opt out. But like me, you probably don't, because most people--it is very easy to sift through their mail. And, in fact, I have accepted credit cards based on the mail solicitations. But if I wanted to, I could opt out.

And thanks to you and the other Members of Congress, a few years ago, you made it easier for people to opt out, and I thought that was a good thing.

Mr. Cohen. But the cost of sending that letter to make you opt out and then to make you opt out cost all this money that we then charge in fees. And then to make money, we have to charge more money even.

Mr. Muris. Sure, advertising and marketing----

Mr. Cohen. So why you can't be more selective in who you pick, who really is somebody that deserves and has good credit? Isn't there some way to--because it bothers me as a consumer, and it bothers me as somebody who invests, that is such wasteful spending.

Mr. Muris. Again, I would be glad to help you exercise your right to opt out.

Mr. Cohen. I think we have a volunteer here. End of my 5 minutes, please.

Yes, sir?

Mr. Buhrmaster. As a credit card issuer, everybody has a different way they do business. And I am speaking as a small bank, but there are other large banks that their way of doing business and getting credit cards into the hands of consumers is the mass mail. To my grandmother who passed away several years ago, we still get mailings for her, but that is the way they choose to pick their customers.

Other banks, other issuers choose other ways. It is just in the business model. It has nothing to do with the interchange debate. It probably has more to do with the shrinking margins that the banks are experiencing because of the rate environment. They are looking for ways to find more ways to lend to people.

The money they are making off of people with bad credit come from these interest rates that are high. So----

Mr. Cohen. Right. And, apparently, according to this information, there are nine billion unsolicited credit card offers sent just this last year, nine billion. Even in China, that is a lot of people.

Mr. Buhrmaster. But I get more requests for charitable donations than I do for credit cards.

Mr. Cohen. That is different.

Mr. Buhrmaster. It is different. It is different. But it is what comes----

Mr. Cohen. And you are apparently quite wealthy and probably----

Mr. Buhrmaster. I wish I were.

Mr. Cohen. Thank you, sir.

Mr. Buhrmaster. Thank you.

Mr. Cohen. Thank you, Mr. Chairman.

Mr. Conyers. Well, this has been a very conflicted set of testimonies we have received, but then that is what we are here for, isn't it?

I thank all of the witnesses. I know you will be submitting--if you keep your promises, we will be getting more statements to build up into this record than we usually normally receive. And we have 5 days--you may get questions from us, and we will get answers back from you. And then we will have concluded the first hearing.

What is important is, what are we going to do in the second hearing, or maybe even the third? It has not escaped my notice, Mr. Keller, that solutions to this problem are pretty few and far between, so it is going to test the skills and competency of this Judiciary Committee a great deal.

But you have got to start it, and you have opened up this testimony in a very fine way. We thank you very much.

And the hearing is now adjourned.

[Whereupon, at 4:16 p.m., the Task Force was adjourned.]

A P P E N D I X

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Material Submitted for the Hearing Record

Prepared Statement of the Honorable Lamar Smith, a Representative in Congress from the State of Texas, and Member, Antitrust Task Force

Mr. Chairman, today we consider an issue that is vital to the American economy.

America has gone through a radical transformation in the way it pays for its goods and services. Ten years ago, almost 80% of all financial transactions were made with checks or cash. Today, less than half of purchases are conducted this way. And three years from now, consumers will use credit and debit cards for over 70% of all their purchases.

Properly used, credit cards offer many benefits for consumers and businesses alike. For consumers, they offer fraud protection, payment flexibility, the ability to track purchases and airline miles. For merchants, they offer guaranteed, faster payment and the opportunity to expand businesses through Internet and phone sales.

Some studies have shown that consumers who use credit or debit cards at the time of purchase are likely to spend more than they would otherwise.

Of course, this growth has not come without its costs. Consumer groups have complained for years about credit card practices that they think are unfair or illegal. Merchants, too, have had their complaints. In 2005, the Second Circuit affirmed a settlement in which VISA and MasterCard paid $3 billion. The settlement arose from a case brought by a group of retailers who claimed that VISA and MasterCard had illegally tied the acceptance of their credit cards to their debit card offerings.

This resulted, among other things, in the imposition of fees on the banks that issue credit cards that were higher than they would have been in a competitive market.

Today, retailers continue to claim that VISA and MasterCard are charging these higher fees for the acceptance of their cards, and that these fees are ultimately passed on to consumers. A group of retailers has brought a series of federal antitrust suits challenging the way that VISA and MasterCard set these interchange fees and they are pending in the Eastern District of New York.

At the same time, retailers complain that VISA and MasterCard do not make available to them all of the rules that govern their transactions. They cite examples of merchants that have been assessed fines by the credit cards for rules that they did not know existed.

For their part, the credit card companies insist that they have provided all the relevant information to merchants. They also maintain that the setting of credit card interchange fees is a necessary part of their business that maximizes the number of consumers who are willing to carry their cards and the number of merchants who are willing to accept them.

Retailers have raised some serious questions. For example, who sets the interchange fee, and how it is set? How much of the interchange fee is passed on to merchants and, ultimately, the American consumer?

What are interchange fees used to finance? Who makes the rules the merchants must abide by, and who enforces those rules? Which of these rules have been made available to the merchants and which have not? And if those rules have not been made available, why have they not?

As for the retailers, I would like to know what is the remedy that they would really like out of these hearings? What is the information that they feel that they are not getting from the credit card companies and why is that actually important to them? What are the benefits that they receive from the credit card payment system? Are those benefits outweighed by what they have to pay in interchange fees?

Prepared Statement of the Honorable Sheila Jackson Lee, a Representative in Congress from the State of Texas, and Member, Antitrust Task Force

Prepared Statement of the Honorable Steve Cohen, a Representative in Congress from the State of Tennessee, and Member, Antitrust Task Force

Credit card interchange fees represent a hidden cost to consumers because merchants will pass on these fees to consumers. These fees may be all the more harmful to consumers because the major credit card companies may be colluding to fix the fees charged to merchants, thereby imposing higher costs on consumers than the market might otherwise. Such conduct, if in fact it were occurring, would constitute anticompetitive behavior in my view. I look forward to learning more about the issue from today's witnesses.

Letter from Timothy J. Muris, Of Counsel, O'Melveny & Myers LLP to the Honorable John Conyers, Jr., enclosed with attachments

Prepared Statement of the National Association of Convenience Stores (NACS)

Chairman Conyers and Members of the Antitrust Task Force, I am Hank Armour, the President and Chief Executive Officer of the National Association of Convenience Stores (``NACS''). Prior to taking my current job, I owned and operated fifty-nine retail facilities in Washington, California and Oregon. I am pleased to submit for the record this testimony on behalf of the NACS.

Founded in 1961, NACS is an international trade association representing more than 2,200 retail and 1,800 supplier company members in the United States and abroad. NACS is the pre-eminent representative of the interests of convenience store operators. The convenience store industry in the United States, with over 145,000 stores across the country,\1\ posted $569.4 billion in total sales in 2006, with $405.8 billion in motor fuel sales. Overall, eighty-two percent (82%) of the motor fuels (gasoline and diesel fuel) sold in the United States is purchased at the more than 114,000 convenience stores that sell fuel. And, to give some perspective on the issues being discussed today, the industry posted $4.8 billion in profits last year--which includes both profits at the pump and inside the store--but paid $6.6 billion in credit and debit card fees on its transactions. The next time you stop for a fill-up, keep in mind that more of the money you are paying goes to the card companies than the retailer selling you gasoline will get to keep.

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\1\ More than 70,000 stores are operated by NACS members. NACS members include forty-nine (49) of the fifty (50) largest companies in the industry, but seventy-three percent (73%) of members operate ten (10) or fewer stores.

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Last year was the first in which card fees exceeded profits industry-wide, and they did so by a large margin. These changes have made interchange fees the top issue for our industry. The rapid increase in fees is unjustifiable and unsustainable. We cannot thank the Task Force enough for agreeing to look into this issue and we look forward to working with you throughout your review.

To raise awareness of the many problems caused by interchange fees and their impact on everyday consumers, NACS has worked with many in the retail industry to establish a broad collection of voices known the Merchants Payments Coalition (``MPC'' or the ``Coalition''). The Coalition's member associations collectively represent about 2.7 million locations and 50 million employees. These merchant associations account for more than 60 percent of the non-automotive card based transaction volume in the United States. The MPC includes 22 trade associations representing many of the retailers in your districts--the very grocery stores, drug stores, restaurants and shops that you and your constituents frequent daily. The MPC represents a diverse group of interests who often disagree on many issues, but who have banded together to challenge the unfair and unjustifiable practices of Visa and MasterCard. The MPC is fighting for a more competitive and transparent card system that works better for consumers and merchants alike.

There has not been nearly enough information and discussion about interchange fees in the past and we applaud the Task Force for its willingness to examine them. These fees have escalated to the point that they are now the third highest operating cost to my industry--

behind only payroll and rent. Of the many types of fees charged by credit card companies, interchange fees are the most pernicious because they are arbitrary, excessive, are not disclosed to retailers or consumers, and ultimately, they drive up the cost of all products. This is a burden that is borne by both credit card users and non-users alike. And retailers have virtually no choice but to accept them, as Visa and MasterCard leverage their dominant market power to force them upon an unwitting public.

The collective setting of interchange fees represents an ongoing antitrust violation by the two leading payment card associations, Visa and MasterCard. These antitrust violations cost merchants and their customers tens of billions of dollars annually. This system is anticompetitive in several ways. First, these fees have been fixed by banks that compete to issue payment cards to consumers or to sign up merchants to accept Visa and MasterCard cards. No matter which Visa or MasterCard member bank issued the card that is used to make a purchase or which Visa or MasterCard member bank signed up the merchant making the sale, the same uniform fixed interchange rates apply. This system also cements Visa's and MasterCard's substantial individual and joint market power. The higher the interchange fees charged by Visa or MasterCard, the more attractive that card system becomes to banks compared to other card systems. Thus, the member banks have every incentive collectively to ensure that the card system sets high interchange fees.

We hope that the following discussion provides the Committee with some insight into the opaque and costly world of interchange fees, so that it may better understand the challenges thrust upon our small businesses by Visa and MasterCard and the need for greater disclosure of interchange fees.

INTRODUCTION TO INTERCHANGE FEES AND THEIR CURRENT USE

Interchange fees are the fees credit card companies and banks charge merchants every time a credit or debit card is used to pay for a purchase. The fee is a percentage of each transaction that typically varies with type of card, size of merchant and other factors--but it averages approximately 2 percent for credit card and signature debit transactions. Interchange fees are set by the collective action of MasterCard and Visa member banks (which include most banks in the United States) and are imposed on merchants by the banks to which merchants submit credit card transactions for payment. Merchants must then treat the interchange fee expense as a higher cost-of-doing-business.

When a consumer buys an item with a Visa or MasterCard credit or debit card, the merchant does not receive full face value from the bank to which it submits the charge. The difference between the face value of the customer's purchase and the amount the merchant actually receives is called the ``merchant discount,'' the vast majority of which is the interchange that is paid to the bank that issued the customer's card. As these interchange fees increase and card use expands, merchants are naturally forced to pass these costs along to consumers in the form of higher prices for all products.

The average consumer has no idea that this fee is imposed every time he or she makes a purchase with a Visa or MasterCard card. In this way, interchange acts as a hidden sales tax on U.S. commerce, raising both merchant costs and ultimately the price of goods and services sold to consumers.

To make matters worse, interchange fees are not tailored to Visa's and/or MasterCard's cost of processing the transaction. While there may have been some reasonable basis for the size of these fees decades ago, the proliferation of card transactions has driven down per transaction costs. In fact, a bank consulting firm reported last year that the cost of processing transactions was only 13 percent of the interchange fees charged. As described in greater detail below, interchange fees are now an arbitrary revenue source on top of already significant interest fees, late fees, over-the-limit charges and other fees charged by Visa and MasterCard. How can Visa and MasterCard get away with this practice? To put it bluntly, it is because they have market power and exercise that power in ways that violate the antitrust laws.

Interchange fees are set in secret by Visa and its member banks. MasterCard and its banks do the same. Visa member banks all agree to charge the same fees and this collusion (as well as the separate collusion engaged in by MasterCard member banks) is a massive antitrust violation. Not only that, Visa and MasterCard rules make it virtually impossible for merchants to disclose the fees to the public. The rules run more than a thousand pages, governing every detail of electronic transactions. Retailers must contractually agree to abide by all of these rules in order to accept Visa and MasterCard, but retailers do not get to see those rules. Visa and MasterCard make excerpts available, but that is not good enough as retailers often have problems with rules that are not covered by these excerpts. Visa now allows retailers to view the full set of rules only if they sign a non-disclosure agreement and only after they sign a contract agreeing to abide by the rules.

PROBLEMS WITH INTERCHANGE FEES

1. Interchange fees are a product of dominant market power and retailers have no choice but to accept them

Credit and debit card transactions are a large and growing part of retailers' business. In the convenience store industry, approximately 65 percent of motor fuel sales are paid for with credit or debit cards, and when prices rise, retailers tell us this rate can reach 80 percent in many markets. In fact, across all industries in the United States, the number of electronic payments--most of which are credit and debit card payments--now exceeds the number of payments by check. The average U.S. consumer carries a limited amount of cash at any given time, and experience shows that when consumers want to buy something that costs more than about $20, the transaction is likely to go on a credit or debit card. In this environment, NACS members simply must accept credit and debit cards--if they do not, these merchants would quickly lose customers to nearby competitors that accept all forms of payment.

Visa and MasterCard dominate the card market. Accordingly, most of the buying public holds Visa- and/or MasterCard-branded cards, and the two companies enjoy greater than 80 percent market share in the electronic payment industry. Our judicial system has acknowledged the vast market power enjoyed, and scrupulously maintained, by Visa and MasterCard. In 2003, the Second Circuit Court of Appeals held in the U.S. Department of Justice's case against Visa and MasterCard that the two card associations, both jointly and separately, had market power.\2\ This is consistent with other cases and with retailers' experiences.

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\2\ United States v. Visa U.S.A., Inc., 344 F.3d 229 (2d Cir. 2003).

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Perhaps the ubiquity of Visa- and MasterCard-branded cards has something to do with the fact that U.S. consumers receive well over 5 billion mail solicitations for credit cards each year. That is more than 20 solicitations for every man, woman and child of all ages every year. And, frankly, exorbitant interchange fees are fueling the over-saturation of consumers by these direct solicitations. Regardless of the reason for the boom in cards and card usage, it is clear that cards, especially those issued by Visa and MasterCard, are so commonplace that retailers are effectively forced to accept them.

Visa and MasterCard protect their market share with the complex web of rules alluded to above. Retailers are often prohibited by these rules from presenting pro-consumer pricing solutions such as offering cash discounts to customers, even though they cannot prohibit cash discounts under the Truth in Lending Act. Recently in California, some retailers began to offer cash discounts for gasoline purchases. If a customer chose to purchase using cash, he would receive several cents off each gallon purchased. This discount was to incentivize consumers to pay with cash so that the retailers would save on the interchange fees and the savings could be passed along to consumers. Unfortunately for consumers, Visa unilaterally determined that such practices violated their rules and threatened to fine some retailers $5,000 per day for such ``infractions.'' Because Visa could not simply prohibit the discounts, it argued that these retailers could not call the higher price offered the ``credit'' price. Visa suddenly decided that doing so turned these cash discounts into credit surcharges which Visa does not allow--even though this method had been used by gasoline retailers to describe cash discounts for decades. Instead, Visa directed retailers to call the higher price the ``full'' or ``regular'' price. Visa pushed these terms even though the state of California determined that the use of those terms for gasoline purchases would confuse consumers and break California law because full serve and regular fuel are often used to describe other aspects of gasoline pricing. Visa thereby presented retailers with a Catch-22 situation: either break Visa's rules and face stiff fines or break California law and face its penalties. Of course, what Visa really wanted was for retailers to abandon the discounts so no one noticed the huge costs associated with credit cards.

2. Interchange fees lead directly to higher costs for merchants and, ultimately, for consumers

As discussed above, interchange fees act as a tax on the American consumer. When merchants incur fee after fee, ultimately they are forced to pass some of the cost to the consumer in the form of higher prices for goods and services. In fact, the average American family pays $331 in interchange and related fees every year. And that is true whether or not that family uses a single credit or debit card. Because these fees are hidden in the cost of virtually everything we buy, even cash-paying consumers ultimately pay for them.

In the aggregate, retailers and their customers paid $36 billion in interchange fees last year. When all of the other fees on credit and debit transactions are included, the tab increases to over $40 billion. And this figure does not include the many other fees collected directly from consumers such as annual fees, late fees, interest, etc. According to a report by the Government Accountability Office, for every $100 in credit card purchases, credit card companies collect $2.50 in interchange and processing fees.

Last year, in fact, convenience stores paid more fees for accepting cards than they made in profits. Card fees paid by the industry rose 22 percent last year so that the industry paid $6.6 billion while making $4.8 billion in profits. Think about that the next time you fill-up. Card fees are the second largest operating expense in our industry--behind only labor costs. If you are concerned about gas prices, these out-of-control fees are the place to start.

The statistics regarding the growth of interchange fees are astounding. In 2001, Visa, MasterCard and their issuing banks collected $16.6 billion in credit card interchange fees. They have now ballooned by 117 percent to $36 billion--more than all the late, over-the-limit and other fees we all know about combined.

The United States enjoys the highest volume of credit card transactions in the world (see Figure 1). Theoretically, this should lead to significant economies of scale and lower interchange rates. We also have the best technology for processing these transactions and we have very low, and decreasing, rates of fraud. Yet, somehow, U.S. rates are higher than corresponding rates in other countries. In the United Kingdom, interchange fees average 0.7 percent, and in Australia, they stand at 0.45 percent--well below the 2 percent charged in America. Even more troubling, our rates are rising, while most other countries' rates are flat or declining. Visa and MasterCard are putting the weight on their worldwide business on the backs of American consumers. About sixty percent of all of the interchange in the world is paid by American consumers and that is wrong.

Not only have interchange fees been historically exorbitant, but there is little hope that the fees that are drowning America's small businesses will recede any time soon. Visa and MasterCard compete by raising, not lowering, their interchange rates. When they raise their rates, Visa and MasterCard induce their bank members to issue more of their cards. Higher interchange rates mean those banks, in turn, get more money from transactions put on those cards. These practices create perverse incentives that actually reward fee increases, as normal competitive market dynamics are inverted and consumers are left footing the bill.

For example, in May 1998, Visa announced that it would increase a debit card interchange fee by about 20 percent. The increase was to take effect in April 1999. In November 1998, however, MasterCard announced a 9 percent increase (also to take effect in April 1999) that was enough to keep its fee higher than Visa's. In most competitive markets, Visa's price increase would have presented an opportunity for MasterCard to hold or lower prices to gain market share--but apparently not when both card brands enjoy merchant acceptance of over 98 percent. In fact, those increases were just the start. In January 1999, Visa announced it would increase its fee by an additional 6 percent. Then MasterCard announced another increase five days later. All of these increases were made before the first rate increase even took effect. When the dust finally settled, Visa's rates went up 26 percent and MasterCard's went up 17 percent. Overall, these increases alone cost U.S. consumers an additional $300 million per year.

Unfortunately, without healthy and competitive market forces, we lack the necessary checks and balances to prevent rates from rising to stratospheric levels. The shear market power of the credit card companies combined with the straitjacket of anti-competitive rules they maintain inhibits retailers from refusing to take cards in general or declining to take a card with higher interchange rates. And in a non-transparent market, these practices go unchallenged.

3. Interchange fees and their impact are not disclosed to consumers

It is not surprising, given the nature and cost of interchange fees, that Visa and MasterCard go to great lengths to ensure that consumers remain in the dark about these fees. The efforts of credit card companies to keep interchange hidden drives up costs. Without any price cues, it appears that credit card use is costless and consumers are deprived of the opportunity to choose lower cost options. It is in this shroud of darkness that Visa, MasterCard and their member banks collect literally billions of dollars from unwitting consumers.

Furthermore, it is not just consumers who are left in the dark; Visa and MasterCard refuse to fully disclose their operating rules to retailers as well. The card associations have a complex matrix of interchange rates ranging from about 5 cents plus 1.15% for each transaction to 15 cents plus 2.95% of the transaction. But it is hard for retailers, particularly small mom-and-pop stores, to figure out why they fall into a particular rate category. Plus, retailersare charged different rates within the course of the same business day. Corporate cards, rewards cards, fleet cards and others carry very high rates while basic cards can have lower rates. Other factors can change the rates as well. For example, if a card swipe doesn't work and the retailer needs to call to get authorization, the transaction then falls into a different risk category and a different interchange rate is charged. And if the phone call doesn't go through, then again, a higher rate is charged.

MasterCard has put its rates on its website--and the document is 100 pages long. These rates are 100 pages long. Visa's rates are also very confusing. Retailers simply are not given the clear, understandable and timely information they would need to accurately inform consumers about the rates being charged. And Visa and MasterCard make no effort to inform consumers--instead, as I noted, they actively try to keep the fees hidden in the overall prices of goods.

As this Congress moves forward on this issue, it is imperative that transparency of interchange fees be improved. Without adequate disclosure, true competition is impossible and interchange fees and consumer prices will continue to climb upward.

4. Interchange fees are without justification and priced without regard to the cost of transactions

The volume of electronic transactions has increased dramatically in recent years. Since 2001, debit card use has surged by more than 20 percent a year. Economies of scale, competition, plummeting computer costs, low interest rates and low inflation, however, are not driving down payment fees. In fact, the fees are up 117 percent just since 2001.

Banks and card companies acknowledge the fees are not based solely on processing costs. In fact, the fees help subsidize marketing efforts to entice consumers to use more cards, to use them more frequently and to purchase goods and services in greater amounts. In fact, many of these marketing efforts are specifically designed to drive consumers to higher fee transactions. Solicitations for corporate and rewards cards are becoming more common and Visa in particular has aggressively promoted consumers signing for debit transactions. Using a signature rather than a PIN code on a debit transaction not only results in far higher interchange fees, but also is a far less secure method of transacting. Just last year, a bank industry consulting firm estimated that only 13 percent of the interchange fee covers processing costs, while 44 percent pays for rewards programs and the balance goes to marketing, advertising, services, profits and other items (see Figure 2).\3\

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\3\ A New Business Model for Card Payments, Diamond Management & Technology Consultants, 2006.

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It is troubling that interchange fees continue to increase while they should be declining due to decreased costs. When evaluated in the context of their market power, these rates are nothing less than outrageous.

CONCLUSION: ACTION IS NEEDED

Congress, the executive branch, and the courts have, at times, looked into the interchange pricing system. Meanwhile, interchange rates increased again in April of this year. Some of the new rates are now more than 3 percent when the percentage rate and fixed fee are both calculated. In addition to increasing rates, Visa and MasterCard are pushing more consumers into the higher-rate premium cards and away from lower-rate standard cards.

When Visa and MasterCard act with the false imprimatur bestowed by duopolistic market power, we can expect that these activities will continue unabated. In other words, without immediate intervention, their exploitative pricing and policies will surely persist. NACS is pleased that this Task Force is taking an active role in examining an industry long in need of reform and increased disclosure. Hopefully, this hearing will be the first critical step toward leveling the playing field for the small business owners and consumers of America.

ATTACHMENTS

Prepared Statement of the National Grocers Association (NGA)

The National Grocers Association (N.G.A.) greatly appreciates the opportunity to submit this statement for the record of this important hearing before the U.S. House of Representatives Committee on the Judiciary Antitrust Task Force. N.G.A. thanks Chairman Conyers and the Task Force for holding today's hearing on interchange, a matter of great antitrust importance to consumers and the retail community.

N.G.A. is the national trade association that represents exclusively the interests of independent, community-focused grocery retailers and wholesalers. An independent, community-focused retailer is a privately owned or controlled food retail company operating in a variety of formats. Most independent operators are serviced by wholesale distributors, while others may be partially or fully self-distributing. A few are publicly traded, but with controlling shares held by the family and others are employee owned. Independents are the true entrepreneurs of the grocery industry and are dedicated to their customers, associates, and communities. N.G.A. retail and wholesale members accounted for over $200 billion of U.S. grocery sales last year. N.G.A. is a founding member of the Merchants Payment Coalition that is made up of trade associations representing supermarkets, retailers, convenience stores, restaurants, drug stores, gas stations and other businesses that are concerned about increasing and unfair interchange fees charged by credit card companies and banks.

An interchange fee, usually in the form of a percentage of the transaction, is charged to the merchant by the card issuing bank and the card association. N.G.A. believes that there are major antitrust problems with the current interchange fee system, causing profound harm to consumers and merchants. For the benefit of the American consumer, federal governmental agencies and members of Congress must exercise oversight of debit and credit card interchange fees and the lack of a competitive market.

I. INTERCHANGE: A MARKET FAILURE THAT HARMS CONSUMERS AND MERCHANTS

Interchange fees charged by MasterCard and Visa, and the rules under which they are levied, are nothing more than a hidden tax on retail grocers and the consumers they serve, including customers using other payment methods who indirectly subsidize cardholders. Interchange fees are hidden from consumers by credit card companies, but consumers ultimately pay them because costs are passed along in the form of higher consumer prices. Visa and MasterCard rules require that the fees be collected from the merchants, not directly from the card users. These card-based fees are the single most profitable source of income for banks. These fees now exceed $36 billion annually (up over $10 billion from 2006 reports) with contracts that actually prohibit merchants from disclosing the cost of interchange fees to their customers who use the cards.

In a competitive marketplace when costs go down, rates should fall. Interchange fees have increased precipitously even though fraud is down and transaction volume is up significantly. This is because debit and credit card systems and their interchange rates are a private, unregulated money system that has exceeded cash and checks as the favored means of paying for goods and services since 2004. The debit and credit card interchange rates of Visa, MasterCard and their member banks are established collusively by the competing banks that constitute the boards of directors of Visa and MasterCard. This is a clear violation of federal antitrust laws. As a result, interchange rates can be increased at will; they bear no relation to any legitimate charges that arguably should be imposed on merchants and consumers.

The interchange system is a clear example of a market failure. No competitive forces exist to pressure the card associations to lower rates. Rather, competition raises interchange fees, as Visa and MasterCard compete for bank issuers by offering them higher and higher payouts from interchange fees.

Few issues have received the attention of retail and wholesale grocers, as well as all other retail merchants, as that being given to the high and increasing cost of interchange that retailers must pay to Visa and MasterCard for accepting their debit and credit cards. The United States has the highest credit card interchange fees of any industrialized country, and interchange rates have continued to increase in the United States even while costs of processing and fraud have declined. In contrast, interchange rates internationally continue to decline dramatically. The international precedents for antitrust investigation and government intervention are persuasive and demand serious review and appropriate action by this Committee.

A recent Morgan Stanley report found that the weighted average for Visa and MasterCard interchange had increased from 1.58 percent in 1998 to 1.75 percent in 2004 (an increase of 10.8 percent) and is forecast to grow to 1.86 percent in 2010 (an additional increase of 6.3 percent over 2004 and 17.7 percent since 1998).

The recent ``Diamond Study'' of interchange examined, among other issues, the costs presently being borne by consumers and merchants under the present interchange system. The study found that the largest single use of interchange paid directly by merchants and indirectly by consumers is cardholder rewards--a 45% slice of the interchange pie. There is no justification for this charge, but there is an explanation--the exercise of unbridled market power by VISA, MasterCard and their banks. On two levels, the charge is also unfair, first, because merchants cannot negotiate their rates, and they are forced to pay these rates to the issuing banks, without viable alternative options. The rewards programs are arrangements between the issuing banks and the cardholders. Second, the cardholders who receive the benefits are not the only ones who pay for them in the form of higher prices. All customers pay the same prices, regardless of how they pay, and those prices include the cost of interchange. So everyone pays for the rewards. This burden falls heaviest on the poorest consumers, who are least able to absorb the higher prices. Consumer rewards must no longer be part of the interchange rate.

The next largest slice of the interchange pie is ``other issuer costs'' and profit, set at 35% by the Diamond Study. One estimate places more than half of this amount--20%--on the cost of direct mail solicitation of new cardholders--more than six billion pieces of mail in 2005! All that was said about cardholder rewards can be repeated about direct mail solicitations as well as another 3% slice of the pie that Diamond refers to as ``network branding expenses,'' also known as advertising. So, bank solicitations and Visa and MasterCard advertising are roughly 23% of the pie. Add the 45% represented by cardholder rewards, and by any rational approach, 68% of today's interchange fees should disappear. While not separately identified in the Diamond Study, part of the remaining 15% of other issuer costs is likely to include fraud and interest revenue foregone due to the cardholders' interest free period. The interest is merely another cardholder benefit, which is not a proper charge to merchants and all consumers. Fraud losses have been disallowed in most of the countries that have acted on the interchange issue. In addition, the system in which the fraud is perpetrated is the system that Visa, MasterCard and the banks designed and created, a system that is ripe for picking, and they want merchants and consumers to bear the cost of their mistakes.

The vast majority of grocers do not have the ability to overcome the market power of Visa and MasterCard in order to negotiate lower rates. The results of the recent settlement in 2003 of the Wal-Mart lawsuit against the credit card companies clearly illustrate the anticompetitive nature of the interchange system. Visa and MasterCard agreed to pay the plaintiff retailers more than $3 billion, but immediately increased credit card interchange rates to cover the cost of the settlement--and then some.

Except for the very largest merchants, efforts to negotiate lower interchange rates have been rejected, even when retailers have attempted to aggregate. The vast majority of merchants, therefore, have no control over this discriminatory cost of doing business, because it is set by a cartel.

The issue here is about the need for competition, and when it does not exist, then solutions must be pursued to correct the unfairness and level the playing field. In November 2005 N.G.A., together with some of its members, Affiliated Foods Midwest, Coborn's Inc., and D'Agostino's Supermarkets, filed a class action suit against Visa, MasterCard and a number of banks, alleging the named defendants conspired to fix the interchange fees that are charged to retail grocers and ultimately consumers in violation of the Sherman Act. This action was consolidated in the U.S. District Court for the Eastern District of New York with over 47 other actions filed.

One must ask why the United States lags behind other countries in addressing this

important issue. Australia in 1998 passed its Payment Systems (Regulation) Act 1998 after an investigation by the Australian Competition and Consumer Commission found against the collective fixing of interchange fees. Consequently, on August 27, 2002, the Reserve Bank of Australia adopted a new cost-based approach to interchange fees and eliminated the no surcharge rule, which prevents retailers from directly charging consumers the cost of interchange when they pay by card. The purpose is to ensure that the setting of interchange fees in designated credit card systems is transparent and promotes efficiency and competition. In the Bank's view, interchange fees in the credit card systems were not subject to the normal forces of competition which pushed fees up, not down. The Reserve Bank of Australia reported in August 2005 that, ``Prior to the reforms, this fee averaged 0.95 percent of the amount spent; it now averages around 0.54 per cent.'' The Reserve Bank of Australia also found, ``In total, as a result of the Bank's reforms, merchants' costs of accepting credit and charge card payments were around $580 million lower than they would otherwise have been. Given the competitive nature of Australian business, these cost savings are finding their way into lower prices for goods and services, or smaller price increases than would have otherwise have taken place.'' On November 25, 2005, the Reserve Bank of Australia announced further amendments that became effective on July 1, 2006. Some observers predict rates will drop to .35 per cent.

On September 6, 2005, the United Kingdom Office of Fair Trading (OFT) found that a collective agreement between members of MasterCard UK Members Forum (MMF), including most banks, setting the multi-lateral interchange fee paid on virtually all purchases using UK-issued MasterCard credit and debit cards between March 1, 2000, and November 18, 2004, restricted competition and infringed Article 81 of the EC Treaty and the Chapter 1 prohibition of the Competition Act. It gave rise to a collective agreement on the level of the multilateral interchange fee and resulted in unjustified recovery of certain costs.

The OFT found the inclusion of extraneous costs provided a large flow of revenue to card issuers and the incentive to induce customers to hold and use MasterCard cards, for example, through loyalty schemes, advertising and funding the interest-free period. The fee was passed on to the retailers by the merchant acquirers through higher merchant service charges. The OFT stated, ``Consumers, including those who do not use MasterCard cards, ultimately picked up the cost for the higher interchange fee through higher retail prices.'' Sir John Vickers, OFT Chairman, said, ``This unduly high interchange fee was like a tax on UK consumers.''

Although the OFT consented to the Competition Appeal Tribunal's setting aside of the OFT's September 2005 decision, the investigation will continue and will include Visa. OFT chief executive John Fingleton stated in June 2006: ``We still believe that the interchange fee arrangements that are now in place could infringe competition law and are harmful to consumers, who pay higher prices as a result of these fees. Continuing to defend appeals against the original decision before the Competition Appeal Tribunal diverts us from dealing most effectively with the overall problem of interchange fees. Our resources are better spent in reaching decisions on MasterCard's and Visa's current interchange fee arrangements rather than continuing with these appeals that concern only MasterCard's historic arrangements.''

In September 2000, the European Commission challenged Visa's anticompetitive multilateral interchange fee, and Visa agreed in 2002 to lower the weighted average fees in stages to 0.7 per cent in 2007. Numerous other countries, such as Sweden, Italy, Netherlands, Switzerland, Spain, Israel and Mexico have addressed the anti-competitive nature of interchange.

Other countries have addressed and reduced anticompetitive interchange fees, and now it is time for Congress and federal agencies to do the same.

The current interchange system is inherently flawed and presents gross inequities for both retailers and consumers. Transparency is a must. All parties involved, especially consumers and merchants, should be made aware of the interchange fees charged to merchants, and ultimately consumers. The consumer has a right to know how interchange fees affect the prices of goods and services from merchants. Retailers are charged increased interchange fees to cover the incentives given to consumers to use the cards carrying the highest interchange rates. Those incentives by any objective standard should not be part of every consumer's grocery bill; they should be absorbed by Visa, MasterCard and their card-issuing banks, which reap the majority of the huge financial benefits. It is time to end this ``hidden tax'' on merchants and consumers, including customers who pay by cash or check and thereby subsidize cardholders.

The present system has another major antitrust flaw in addition to interchange rates: anticompetitive card association rules and procedures. For example, imagine yourself as a retailer who wishes to accept Visa and MasterCard as a means of payment by your customers. You sign merchant agreements in which you agree to abide by all of these associations' rules, but a wall of secrecy and nondisclosure hides them from retailers. Those rules must end.

## II. COLLUSIVE SETTING OF INTERCHANGE FEES AND OPERATING RULES VIOLATE ANTITRUST LAWS

In the Department of Justice case against Visa and MasterCard, the U.S. Court of Appeals for the Second Circuit found that when Visa and MasterCard pass rules, that it is the collective action of a cartel of banks that compete to issue cards or sign up merchants to accept Visa and MasterCard U.S. v. Visa U.S.A., Inc., 2003 WL 22138519 (2d Cir. Sept. 17, 2003). It follows that the setting of interchange rates by those same Visa and MasterCard banks also work as a cartel in the setting of interchange fees and violates Section 1 of the Sherman Act. The existing system eliminates any incentive for card issuing banks to lower interchange fees in response to the demands of the merchant community, consumers and other participants in the marketplace.

Visa's and MasterCard's complex system of rules amplify the power of this cartel to maintain supra-competitive pricing by restricting merchants' ability to disclose fees to consumers or charge cardholders a different price based on differences in interchange fees for various cards. For example one rule requires merchants to accept all Visa and MasterCard credit cards despite the fact that interchange rates vary by as much as 100% based on the type of card (Platinum Plus(r), Visa Signature(r), corporate, small business etc.). The sad consequence of this system is that all consumers, regardless of form of payment, end up subsidizing the rewards of select cardholders. This type of cartel rate setting and rule making are clearly in violations of the Sherman Act.

III. CONCLUSION

N.G.A. strongly believes that action by Congress and federal agencies is needed to end the anticompetitive and illegal price fixing and discriminatory establishment of interchange rates and card association rules. Interchange fees should be set by competitive forces, not by collusion. In addition, anticompetitive rules which harm merchants and consumers and maintain the market power of card associations must be ended, and retailers must be informed in advance of the rules to which they will be subjected.

N.G.A. applauds the Committee for holding this important hearing and urges Congress to continue to investigate and correct the unfairness of the current interchange system.

Letter from John Gay, Senior Vice President, Government Affairs & Public Policy, National Restaurant Association, to Chairman Conyers and Ranking Member Chabot

Letter from G. Kendrick Macdowell, General Counsel and Director of Government Affairs, National Association of Theatre Owners (NATO), to Chairman Conyers and Ranking Member Chabot

Letter from Randy Schenauer, Chairman, Government Relations Committee, Society of American Florists (SAF), to Chairman Conyers and Ranking Member Chabot

Letter from Brian E. Cartier, CAE, Chief Executive, National Association of College Stores (NACS), to Chairman Conyers and Ranking Member Chabot

Letter from Lisa J. Mullings, President and C.E.O., NATSO, Inc., to Chairman Conyers and Ranking Member Chabot

Letter from Darrell K. Smith, President, National Association of Shell Marketers (NASM), to Chairman Conyers and Ranking Member Chabot

Letter from Heidi M. Davidson, Vice President, Global Public Policy, MasterCard Worldwide, to Chairman Conyers, with enclosed news releases

Letter from the Petroleum Marketers Association of America (PMAA) to Chairman Conyers and Ranking Member Chabot

# Exhibit B

**STATEMENT OF W. STEPHEN CANNON**
**ON BEHALF OF**
**THE MERCHANTS PAYMENTS COALITION, INC.**

**BEFORE THE**
**UNITED STATES HOUSE OF REPRESENTATIVES**
**COMMITTEE ON THE JUDICIARY**
**ANTITRUST TASK FORCE**

**HEARING ON**
**H.R. 5546, THE "CREDIT CARD FAIR FEE ACT OF 2008"**
**MAY 15, 2008**

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**MAY 15, 2008**

## I. INTRODUCTION

Chairman Conyers, Ranking Member Chabot, and Members of the Antitrust Task Force, thank you for inviting me to participate as a witness today. I am honored to appear before you on behalf of the Merchants Payments Coalition to discuss H.R. 5546, the "Credit Card Fair Fee Act." The Merchants Payments Coalition fully supports and endorses H.R. 5546 as a remedy to the interchange problem.

Currently, competing banks collude to fix the price of interchange that they charge Americans on millions of transactions every day. These colluding banks may have formed Visa and MasterCard to manage their cartel activities, but make no mistake about it: the $42 billion of interchange fees that Americans paid last year went directly to these banks, not to Visa and MasterCard. This price fixing conduct by otherwise competing banks is anticompetitive under the antitrust laws, as antitrust authorities in other countries have concluded and more than 50 currently pending individual and class action lawsuits allege.

Using their collective market power, the banks affiliated with Visa and MasterCard force merchants to accept these anticompetitive interchange fees as well as rules that, among other things, prevent merchants from offering customers any financial incentives to use other brands of payment cards. In essence, the banks have colluded to design and perpetuate a dysfunctional marketplace. The banks' use of Visa and MasterCard to manage these two price fixing cartels does not change the fact that their collusive behavior is anticompetitive. Highlighting the current absence of competition, none of these individual banks affiliated with Visa or MasterCard will negotiate interchange rates and terms with any merchant that are different than those established by their cartel.

H.R. 5546 is a market-based remedy that fixes this current anticompetitive behavior. It facilitates voluntary agreements between the parties every three years using both a carrot and a stick. The carrot is limited antitrust immunity so that both sides can negotiate collectively on a level playing field. The stick is that if the parties cannot reach agreement then judges will pick one of the two sides' final offers using a competitive market standard after a short proceeding. The banks and their cartel managers (Visa and MasterCard) argue without any factual support that such proceedings would constitute "price controls." They would not. What the banks and their allies refuse to acknowledge is that H.R. 5546 limits the discretion of the judges – they can only choose one of the two "final offers" submitted by the parties themselves. No modifications and no other options are allowed.

In short, H.R. 5546 addresses the current anticompetitive and dysfunctional interchange scheme that the banks have designed and perpetuated. Specifically, H.R. 5546 offers a market-based remedy to fix this existing antitrust problem based upon statutory precedent reported out of this committee and enacted into law in 2004.

### *A. Background on the Merchants Payments Coalition*

The Merchants Payments Coalition ("MPC") is a group of 23 trade associations[1] representing retailers, restaurants, supermarkets, drug stores, convenience stores, gasoline stations, theater owners, on-line merchants, and other businesses that accept debit and credit cards. MPC's goal is to create a more competitive and transparent card system that works better for consumers and merchants alike. The coalition's member associations collectively represent about 2.7 million locations and 50 million employees.

By way of background, I am currently Chairman of the law firm Constantine Cannon LLP, and was privileged to serve as Chief Antitrust Counsel to the Senate Judiciary Committee during the 97th and 98th Congresses (1981-1984). In addition, I served as a trial attorney and subsequently as Deputy Assistant Attorney General for Policy and Legislation in the Antitrust Division of the Department of Justice. More recently, I was a Commissioner on the Antitrust Modernization Commission, which concluded its work in 2007. Further, as General Counsel of Circuit City Stores, Inc. from 1994 to 2005, I had numerous opportunities to see the impact of interchange issues, and I can understand the plight of merchants and consumers throughout this country.

### *B. Leadership of this Task Force on the interchange issue*

The MPC congratulates you and your colleagues, Mr. Chairman, for holding this hearing as the next step in your consideration of H.R. 5546, the Credit Card Fair Fee Act. You and Representative Cannon have provided bipartisan leadership on this issue. Twenty-

[1] MPC's members include the Food Marketing Institute, National Association of Convenience Stores, National Grocers Association, National Retail Federation, National Association of Chain Drug Stores, American Petroleum Institute, Retail Industry Leaders Association, National Restaurant Association Petroleum Marketers Association of America, National Council of Chain Restaurants, National Association of College Stores, National Association of Truck Stop Operators, International Association of Airport Duty Free Stores, International Franchise Association, National Association of Theatre Owners, American Beverage Licensees, Bowling Proprietors Association of America, National Association of Shell Marketers, Interactive Travel Services Association, Society of American Florists, Society of Independent Gasoline Marketers of America, National Franchise Association, and Coalition of Franchisee Associations.

eight additional members (15 Democrats and 13 Republicans) already have expressed their support for your bill. Building upon your successful oversight hearing last year, this legislation provides a market-based solution to the problem of unlawful cartel pricing by payment card systems with market power.

Price fixing of interchange fees by the two dominant electronic payment systems—Visa and MasterCard—cost Americans $42 billion in 2007 alone. These fees, hidden from consumers, are in addition to other fees and practices of individual banks, like universal default. Consumers are only too familiar with those. While other legislative proposals before Congress and even our financial regulators may address those practices, H.R. 5546 is currently the only vehicle that addresses the cartel practices of competing banks that collectively set interchange rates and terms.

### *C. Visa and MasterCard have a history of antitrust trouble*

Visa and MasterCard have become well-known in recent years for anticompetitive behavior. For example, the government successfully challenged Visa's and MasterCard's so-called "exclusionary" rules, which prohibited literally thousands of their affiliated banks from issuing cards of other electronic payment systems. Additionally, Visa and MasterCard paid billions of dollars to settle another antitrust case regarding their longstanding practice of forcing merchants to accept their debit cards as a condition of accepting their credit cards.

Despite this antitrust trouble during the past few years, Visa and MasterCard continue to engage in anticompetitive conduct regarding interchange rates and terms. As described in more detail below, each of these electronic payment systems (and their affiliated banks) has established a cartel to fix the price of interchange and related terms. Each then uses its market power to force merchants to accept these anticompetitive rates and terms. In light of this behavior, Australia decided to have its central bank comprehensively regulate these interchange practices. Moreover, just this past December, the EC found that these interchange practices violated Europe's antitrust laws.

### *D. The Credit Card Fair Fee Act is a market-based remedy to the interchange problem*

Because of the intractable nature of this interchange problem – addressed in detail at the Task Force's hearing last summer – action is necessary. Having analyzed a variety of possible legislative remedies, the Merchants Payments Coalition agrees that the best approach is to have a market-based remedy analogous to an existing statutory framework that this committee approved with respect to music licensing. The Credit Card Fair Fee Act is such a remedy. Under H.R. 5546, parties are encouraged to reach a voluntary agreement on rates and terms that merchants must comply with to access an electronic payment system such as Visa or MasterCard. If they cannot, these parties must participate in a binding proceeding before a judicial panel. The panel would decide which of the parties' "final offers" best approximates the outcome in a competitive marketplace.

My testimony today will focus on three general topics. First, I will provide an overview of the interchange problem and how it harms American merchants and consumers. Second, I will review what MPC believes to be the key aspects of the Credit Card Fair Fee Act. Finally, I will address why H.R. 5546 is a strong pro-consumer, market-based remedy to the interchange problem.

## II. OVERVIEW OF THE INTERCHANGE PROBLEM

Visa, MasterCard, and their affiliated banks suggest that the problem raised by merchants regarding interchange is too complex to understand. It is not.

### *A. Merchants must accept Visa and MasterCard brands of credit and debit cards*

In 2006, the dollar value of all U.S. general-purpose payment card transactions exceeded $2.7 trillion. This represents more than 38 billion credit and debit card transactions in the United States alone, which account for more than 40% of all transactions between merchants and consumers. Such widespread use of general-purpose credit and debit cards dictates that most merchants cannot conduct business without accepting at least certain card brands.

More specifically, Visa and MasterCard collectively control approximately 75% of electronic card payments. Given this market power, the competitive nature of the retail market, and consumer demand for electronic card payments, merchants effectively are compelled to accept Visa and MasterCard as a matter of economic necessity.

### *B. To accept these cards, merchants must accept interchange fees and related rules without negotiation*

A merchant that wants to accept a specific brand of general-purpose credit or debit cards must have access to that brand's electronic payment system. This access, however, is conditioned upon the merchant paying interchange fees and following certain rules (*e.g.*, merchants accepting any Visa credit cards must accept all Visa credit cards from every bank that issues them).

Thousands of banks issue branded cards for specific electronic payment systems (*e.g.*, Visa and MasterCard). Each of these competing banks charges a fee, called an interchange fee, whenever a consumer uses a card issued by that bank to purchase products or services from a merchant. The banks simply deduct this fee from the purchase price otherwise owed to the merchant before remitting the funds to the merchant.

### *C. Competing banks collude to fix the interchange rates and related terms*

Simply put, interchange rates and terms are not determined by competition in the marketplace between these thousands of competing banks. Instead, the rival banks that use Visa and MasterCard as cartel managers collectively set uniform interchange rates (that apply to every Visa or MasterCard transaction regardless of the bank that issued the card or signed the merchant). They similarly agree to impose the same terms (*i.e.*, operating rules) on the merchants. In short, these rival banks collude rather than compete.

In the Visa and MasterCard electronic payment systems, therefore, the interchange rates and terms imposed upon the merchant are the same regardless of which bank issued the consumer's card.[2] In short, the banks have established cartels within different electronic payment systems (*e.g.*, one for Visa, a different one for MasterCard). The result is that merchants cannot negotiate with individual banks regarding interchange rates and terms. Because rival banks don't compete, merchants don't get rates and terms that would have been negotiated in a competitive marketplace.

### *D. Interchange fees cost Americans $42 billion in 2007 alone*

These colluding banks imposed $42 billion of interchange fees on Americans in 2007 alone. Research indicates that these fees are more than <u>seven times</u> the banks' costs to process the transactions. Given the magnitude of these fees, merchants must factor this cost into the price of the goods or services they sell. As a result, consumers using payment cards and even consumers who pay by cash, check, or food stamps are harmed by these fees. Unfortunately, consumers are not aware that their choice of payment card will affect the amount of hidden fees imposed upon merchants, and that this choice can affect the prices all consumers pay.

In sum, the problem is that (i) competing banks collude to fix anticompetitive rates and terms and (ii) because of market power, merchants are forced to accept them. The result is that Americans currently pay $42 billion a year in interchange fees that are set by collusion, not market forces.

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[2] It should be noted that there is not a single interchange rate for each specific brand (*e.g.*, Visa). Rather, there is an entire schedule of interchange rates that differ depending upon the type of card the consumer uses. For example, a "premium" Visa card marketed to affluent individuals is likely to have an even higher interchange rate than a "classic" Visa card marketed to college students. The key point is that while a couple of hundred different interchange rates may exist within a specific brand like MasterCard, every issuing bank for that electronic payment system imposes the same schedule of interchange rates on merchants.

## III. THE CREDIT CARD FAIR FEE ACT IS A MARKET-BASED REMEDY TO THE INTERCHANGE PROBLEM

### *A. Overview of the remedy*

H.R. 5546 addresses the interchange problem by creating two paths to market-based rates and terms. First, and primarily, the bill facilitates voluntary negotiation and agreement between the parties. Second, if the parties cannot reach agreement, each side submits a final offer. Then a judicial panel chooses the one final offer that it decides (based upon evidence and witnesses presented by the parties in an expedited proceeding) is closest to the rates and terms that would have been negotiated in a competitive marketplace.

Either way, the parties themselves propose the interchange rates and terms under this bill. Even if the judges have to choose one of the two "final offers," both offers contain rates and terms proposed by a party. The judges have no discretion to make any modification. Thus, the bill's practical, market-based approach – driven by the parties, not government regulators – levels the playing field without dictating the outcome.

### *B. Key elements of the Credit Card Fair Fee Act*

Mr. Chairman, based on the MPC's analysis of H.R. 5546, we believe its provisions provide an effective, market-based remedy to the underlying problems created by Visa and MasterCard's anticompetitive behavior. In particular, the MPC believes the following are key elements of the Act:

1. <u>Precedent exists for using this type of market-based legislative remedy</u>. This remedy follows an approach Congress has used for years to determine market-based royalty rates and terms for the licensing of copyrighted sound recordings. It was most recently revised by the Copyright Royalty and Distribution Reform Act of 2004, legislation supported by the bipartisan leadership of the House and Senate Judiciary Committees. This approach is codified in Title 17 of the U.S. Code.

2. <u>The remedy would apply only to electronic payment systems with substantial market power</u>. Regardless of their corporate form, Visa and MasterCard are both electronic payment systems controlled by rival banks. For each of these electronic payment systems, otherwise competing banks that control them currently eliminate competition by collectively setting the rates and terms that they then impose upon merchants. Because both Visa and MasterCard have substantial market power, merchants must accept these anticompetitively-set rates and terms which ultimately harm consumers. Accordingly, the remedy covers only electronic payment systems that have substantial market power (and these may change over time).

3. <u>The remedy would facilitate reaching a voluntary agreement on rates and terms</u>. Voluntary agreement would be facilitated by granting both merchants and a covered electronic payment system (including its affiliated banks) limited antitrust immunity to negotiate collectively. Additionally, these

parties will negotiate in the face of a binding judicial proceeding if they fail to reach a voluntary agreement – a proceeding whose outcome neither side would be able to control.

4. Absent voluntary agreement among all parties, each side would submit a set of rates and terms for judges to choose between in an expedited, market-based proceeding. If the parties fail to reach a voluntary agreement, a panel of judges appointed by DOJ and the FTC would hold a binding proceeding. This panel would choose one of the two sets of rates and terms offered by the parties. Each proceeding would be expedited with a limited 60-day discovery period and other statutory deadlines. Critically important, the judges would be required to apply a market standard in making their choice – they would select the set of rates and terms that most closely represents what would have been negotiated in a competitive marketplace.

5. Market-based rates and terms would be available to any merchant regardless of size, industry, or location. A covered electronic payment system would have to offer the rates and terms chosen in such a market-based proceeding to any merchant who wants them. A covered electronic payment system could not force any individual merchant to negotiate separately.

6. Non-universal voluntary agreements would be possible and could be used as evidence in proceedings before the judicial panel. One or more merchants and a covered electronic payment system (including its affiliated banks) would have the option to negotiate a voluntary agreement at any time. While such an individual agreement would not formally apply to all merchants and parties, the judges and parties could look to it in a subsequent proceeding as evidence of the appropriate rates and terms.

7. Rates and terms would be set for only three years. The rates and terms chosen by the panel of judges would be in effect for three years, and then the process would repeat itself. This would allow the parties and judges periodically to take into account any changed circumstances that may impact the rates and terms. Experience with Title 17 suggests that any voluntary agreements negotiated likely would have the same duration.

8. Both sides would have limited antitrust immunity for negotiating voluntary agreements and, if necessary, participating in the market-based proceedings. Pursuant to a limited grant of immunity, all of the parties on each side would be able to negotiate and participate in any binding proceedings collectively without any risk of antitrust liability. In fact, each side could create and use a single common agent to engage in these negotiations and proceedings, as has occurred under Title 17's existing, analogous statutory approach.

### *C. Differences from Title 17 music licensing*

Although the Credit Card Fair Fee Act is modeled after a similar process for licensing copyrighted sound recordings that is codified in Title 17 of the U.S. Code, there are significant differences and, we think, improvements. These include:

1. Statutory approach even better suited for the electronic payment system industry. The Credit Card Fair Fee Act addresses the electronic payment systems industry rather than the sound recording industry. This type of statutory approach is better suited for the electronic payment systems industry because that industry has well-defined revenue and cost attributes. In contrast, applying this statutory approach to the music industry can implicate intangible measures of artistic value.
2. Competitive market standard governing judges clarified to close loopholes. If a judicial proceeding is necessary under the Credit Card Fair Fee Act, the Act would require judges to select one of the final offers submitted by the two sides based upon a competitive market standard. This competitive market standard is more specific than the general willing buyer/willing seller standard in Title 17 whose meaning parties have litigated. Accordingly, this more precise standard should result in less need for interpretation.
3. Determination by judges limited to choosing one of the two final offers submitted by the parties. Under the Credit Card Fair Fee Act, the judges do not have the authority to select any rates and terms they wish if there is a proceeding. Instead, they are constrained simply to choose the one final offer of rates and terms (of the two presented by the parties) that they determine more closely reflects what would have been negotiated in a competitive market. Title 17 places no such constraint on its judges.
4. Required filing of voluntarily negotiated access agreements. Unlike Title 17, the Credit Card Fair Fee Act requires that the parties publicly file any voluntarily negotiated access agreements. This facilitates a transparent process as well as the use of these arms-length agreements as evidence of marketplace behavior in all subsequent negotiations and proceedings.
5. Oversight bodies with antitrust expertise and limited role. The Credit Card Fair Fee Act delegates a limited oversight role to the Antitrust Division of the Department of Justice and the Federal Trade Commission because they have extensive experience addressing the very type of antitrust concerns that create the need for the Act. This differs from Title 17, where the Librarian of Congress and Register of Copyrights provide oversight and copyright expertise. Further, while both approaches permit appeal to the D.C. Circuit, the Credit Card Fair Fee Act relieves the oversight bodies of having to address "novel questions of law." This results in a more limited and less burdensome role for the oversight bodies than under Title 17.
6. Reexamination of rates and terms every three years. The Credit Card Fair Fee Act requires a reexamination of the rates and terms every three years to take into account any relevant changes in the marketplace. Under Title 17 cycles typically last five years.
7. Streamlined initiation of judicial proceedings if no voluntary agreement among all. Under the Credit Card Fair Fee Act, all merchants participate in a single consolidated proceeding for each covered electronic payment system. In contrast, Title 17 calls for multiple proceedings for various users of

copyrighted sound recordings. By avoiding the need to determine which merchants are supposed to participate in which of several proceedings, the procedure for initiating a judicial proceeding under the Credit Card Fair Fee Act is more streamlined than the procedure under Title 17.

8. Initial disclosures to further expedite discovery. To further expedite the 60-day discovery process, the Credit Card Fair Fee Act requires a limited number of affected companies to provide initial disclosures to the other side. Although analogous to the approach of the Federal Rules of Civil Procedure, there is no provision for initial disclosures in Title 17.
9. Penalties for failure to comply with discovery requests. The Credit Card Fair Fee Act also provides for sanctions against parties that fail to comply with discovery requests. Again, this approach is analogous to procedures in other judicial proceedings, but Title 17 does not include any such penalties.

## IV. H.R. 5546 PROVIDES A STRONG PRO-CONSUMER, MARKET-BASED REMEDY TO THE INTERCHANGE PROBLEM

Mr. Chairman, based upon the MPC's analysis, the pro-consumer, market-based rationale for H.R. 5546 is strong.

### *A. The collective setting of interchange fees by a cartel of competing banks is classic price fixing that violates the antitrust laws. Merely changing corporate form through an IPO does not immunize this anticompetitive conduct.*

Traditionally, Visa and MasterCard were associations of competing banks. The collective setting of interchange fees (by or on behalf of member banks) by each of these card associations constitutes classic price fixing by a cartel of competitors that violates the antitrust laws.

Recent changes in ownership structure due to the Visa and MasterCard IPOs reflect changes merely in form, not substance. The card systems now simply act as the agents of these competing banks in managing the interchange fee cartel. The card systems (regardless of the nominal "independence" of board members) have every incentive to fulfill their expected cartel manager function, since these affiliated banks are the card systems' only customers. These cartel manager arrangements continue to violate the antitrust laws.

Specifically, the antitrust laws forbid a "hub-and-spoke" form of conspiracy in which a central agent manages a cartel even if the conspirators do not expressly agree with each other to go along with the hub's plan.[3] The antitrust violation is even clearer where there is an agreement among members along the "rim" to utilize the hub.[4]

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[3] *See, e.g., Toys "R" Us v. FTC,* 221 F.3d 928, 932 (7th Cir. 2000).
[4] *See, e.g., Spectators' Communication Network v. Colonial Country Club,* 253 F. 3d 215 (5th Cir. 2001).

This is precisely the case with the Visa and MasterCard reorganizations. By agreeing to these reorganizations based on the understanding that existing agreements such as the interchange fee mechanism would continue, the member banks have agreed to use the services of Visa and MasterCard as managers of their existing interchange fee cartels. Moreover, when the member banks agreed to designate Visa or MasterCard as the ongoing manager of the interchange fee-setting process, they had every reason to believe that their boards would operate in their collective best interest as cartel agent: the member banks would remain significant shareholders, and they would remain the payment systems' dominant, if not only, customers.

According to Visa, "[a] significant portion of our operating revenues are concentrated among our largest customers . . . Loss of business from any of our largest customers could have a material adverse effect on our business."[5] Similarly, MasterCard says "[w]e are, and will continue to be, significantly dependent on our relationships with our [member banks]."[6] As the saying goes the proof of the pudding is in the eating: since the IPO, MasterCard has not made any changes to reduce interchange rates or make its rules more reasonable for merchants, and none of its affiliated banks has offered to accept interchange rates different from those set by MasterCard. The price fixing continues unabated.

The existence of a post-IPO antitrust violation was recently confirmed in the European Commission's decision holding that MasterCard's setting of interchange fees in Europe violates European competition law, notwithstanding the IPO. The Commission has ordered MasterCard to terminate those interchange fees within six months, rejecting the argument that a change in corporate form somehow immunizes an electronic payment system from antitrust liability:

> MasterCard's viewpoint that the IPO . . . had changed the organization's governance so fundamentally that any decision of MasterCard Incorporated's Global Board no longer qualifies as a decision of an association [of its member banks] but rather as [a] "unilateral" act which each member bank bilaterally agrees to abide by, cannot be accepted . . . MasterCard's member banks shaped and eventually approved the IPO in order to perpetuate the MIF [multilateral interchange fee] as part of the business model in a form they perceived to be less exposed to antitrust scrutiny. Contrary to MasterCard's argument, the aim of avoiding exposure to antitrust risks due to the MasterCard MIF was a clear driving force behind the IPO. Rather than modifying the business model to bring it in line with EU competition law, the banks chose to change the governance of their co-ordination specifically for antitrust sensitive decision making. The member banks effectively "outsourced" this decision making to a new management body and made sure that their direct influence … would be limited to minority rights. However, the banks also agreed to the IPO … after MasterCard's management assured them that the banks' interests will continue to

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[5] Visa SEC Form S-1, at 23 (November 2007).

[6] MasterCard SEC Form S-1, Amendment No. 8, at 21 (May 23, 2006).

be preserved under a new "enhanced customer approach" and via the local input of the banks in the decision making. It cannot be doubted that in approving the IPO and thereby delegating the decision making powers for the MIF to the new independent Global Board, the member banks legitimately expected and therefore agreed that the Board would henceforth set the MIF in a manner that is in their common interest.[7]

### *B. Courts have ruled recently that Visa and MasterCard possess market power*

Whatever the merits of the use of an interchange fee when Visa was an "infant" electronic payment system, those justifications have become irrelevant more than three decades later. The electronic payment system marketplace is now mature. Courts last reviewed the legality of interchange more than two decades ago when the "VISA business arrangement [wa]s relatively young."[8] At that time, "the court determined that the relevant product market was all payment devices (including cash, checks, and all forms of credit cards) and that VISA did not possess power in that market."[9]

Much has changed over the last several decades. More than twenty years of evolution in payment systems has substantially changed the boundaries of the relevant market. In the current century, "neither consumers nor [Visa and MasterCard] view debit, cash, and checks as reasonably interchangeable with credit cards."[10] Another court pointed out that Visa itself had "adopted this market definition, excluding all forms of payment except credit and charge cards" in a previous case.[11] Accordingly, the findings in *NaBANCO* are irrelevant to any antitrust analysis of today's mature credit card market.

Not surprisingly, therefore, multiple courts have held recently that Visa and MasterCard have market power:

- Following a thirty-four day trial, a district court in the Southern District of New York held that "whether considered jointly or separately, [Visa and MasterCard] have market power." [12] Specific evidence supporting this holding was that "Visa members accounted for approximately 47% of the dollar volume of credit and

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[7] European Commission Decision, COMP/34.579, at ¶¶ 357, 378-379 (December 19, 2007) (footnotes omitted).
[8] *National Bancard Corp. (NaBANCO) v. Visa USA,* 596 F. Supp. 1231, 1263 (S. D. Fla. 1984).
[9] *National Bankcard Corporation v. Visa U.S.A., Inc.*, 779 F.2d 592, 603 (11th Cir. 1986) (concluding also that the fees were "reasonably cost related").
[10] *United States v. Visa U.S.A., Inc.*, 163 F.Supp.2d 322, 338 (S.D.N.Y. 2001) (holding that "general purpose cards constitute a product market").
[11] *In re Visa Check/Mastermoney Antitrust Litigation*, 2003 WL 1712568 at *3 (E.D.N.Y. April 1, 2003) (citing *SCFC ILC, Inc. v. Visa U.S.A., Inc.*, 36 F.3d 958, 966 (10th Cir. 1994) ("Visa USA stipulated 'the relevant market is the general purpose card market in the United States'").
[12] *Visa U.S.A., Inc.*, 163 F.Supp.2d at 341. The court defined this market as the one in which networks like Visa and MasterCard "provide the infrastructure and mechanisms through which general purpose card transactions are conducted, including the authorization, settlement, and clearance of transactions." *Id.* at 338. The court also noted that "[m]erchant acceptance of a card brand is also defined and controlled at the system level and the merchant discount rate is established, directly or indirectly, by the networks." *Id.*

charge card transactions and MasterCard members for approximately 26%."[13] Combined, Visa and MasterCard together control over 73% of the volume of transactions on general purpose cards in the United States and approximately 85% of the cards issued.[14] In addition to these high market shares, Visa and MasterCard "have demonstrated their power in the network services market by effectively precluding their largest competitor from successfully soliciting any bank as a customer for its network services and brand."[15] Based upon these and other facts in the record – *e.g.,* that the market is highly concentrated and has high barriers to entry – the Second Circuit affirmed the trial court, ruling that Visa and MasterCard "jointly and separately, have power within the market for network services."[16]

- In addition to this government case against the Visa and MasterCard joint ventures, there was a private case brought by merchants who also claimed that Visa and MasterCard engaged in anticompetitive conduct in violation of the antitrust laws. In this private action, another court held that "Visa possesses appreciable economic power" in the credit card services market, finding that Visa's share of the credit card market alone was nearly 60 percent.[17]

Given this market power, merchants cannot refuse to accept Visa and MasterCard cards as a practical matter. As the court in *Visa Check/Mastermoney Antitrust Litigation* observed, "evidence establishes conclusively that merchants have not switched to other payment devices despite significant increases in the interchange fees on the defendants' credit cards."[18] These findings are consistent with a recent staff report by the Kansas City Federal Reserve that concluded merchants cannot realistically refuse to accept Visa and MasterCard.[19] The bottom line is that the market power of Visa and MasterCard means that the vast majority of merchants have no realistic ability to refuse to accept their cards.

### *C. No individual bank will negotiate interchange fees with merchants*

Visa and MasterCard each claim that on certain occasions they will negotiate with a merchant or set of merchants regarding interchange fees (typically as part of a settlement of a lawsuit or as an initial offer to entice new categories of merchants to start accepting their cards). Such claims actually prove the merchants' point because the anticompetitive harm at issue here is that rival banks collude to fix prices rather than compete. The banks' use of Visa and MasterCard to manage the two cartels is part of the problem. The

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[13] *Id.* at 341.
[14] *Id.*
[15] *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 240 (2d Cir. 2003).
[16] *Id.* at 239.
[17] *In re Visa Check/Mastermoney Antitrust Litigation*, 2003 WL 1712568 at *3-*4 (E.D.N.Y. April 1, 2003).
[18] *Id.* at *3 ("there is no cross-elasticity of demand at the merchant level between the defendants' products and all other forms of payment").
[19] F. Hayashi, "A Puzzle of Payment Card Pricing: Why Are Merchants Still Accepting Card Payments?" *Review of Network Economics* 144, at 172 (March 2006).

fact that Visa or MasterCard, in their role as cartel manager, may negotiate with merchants on behalf of the cartel of colluding banks underscores the anticompetitive nature of this interchange scheme. In a competitive market, *individual* banks would compete with each other by negotiating interchange rates and terms on their own with the merchants. Under the current Visa and MasterCard interchange systems, this never happens – no individual bank will negotiate interchange fees with merchants.

### *D. The Act directly addresses the inability of individual merchants effectively to bargain with a cartel with market power*

As just noted, Visa and MasterCard each has the ability to act as a collective cartel agent on behalf of all of its banks. In contrast, competing merchants (given the constraints of the antitrust laws) must attempt to bargain individually with each cartel. Not surprisingly given this disparity of bargaining power, meaningful bargaining over interchange rates and terms does not occur under the circumstances. The Australian central bank highlighted this reality just last month, following an extensive review of the first four years' operation of interchange fee regulation:[20]

> Following a careful consideration of this issue, the [Bank's Payment Systems] Board remains of the view that, in the absence of regulatory oversight, there is a significant risk that interchange fees in some systems will be set at levels that are too high . . . The main reason for this is that *merchants find it difficult to exert sufficient downward pressure on interchange fees, largely as a result of the structure of incentives that they face* . . . In a sense, merchants are in a game akin to the 'prisoner's dilemma': *they would be better off if they could collectively agree on the terms of credit card acceptance, paying no more than their collective benefit, but instead they act individually and, as a result, can in aggregate potentially pay more for credit card acceptance than the benefit they receive.*

Rather than adopting Australia's regulatory solution, however, H.R. 5546 solves these problems of negotiating structure by facilitating merchants' ability voluntarily to negotiate with a card system as part of a group in a market-based process that promotes transparency. If there is no agreement, a judicial panel will choose one of the two parties' final offers that most closely reflects a competitive solution, a further incentive to the parties reaching an agreement.

### *E. Interchange fees account for approximately 2% of every Visa and MasterCard transaction in the United States*

As explained in a recent GAO study, merchants pay interchange fees of approximately 2% on Visa and MasterCard transactions ($2 on a $100 transaction).[21] While there are other fees that go to the merchant's bank and the electronic payment system (Visa or

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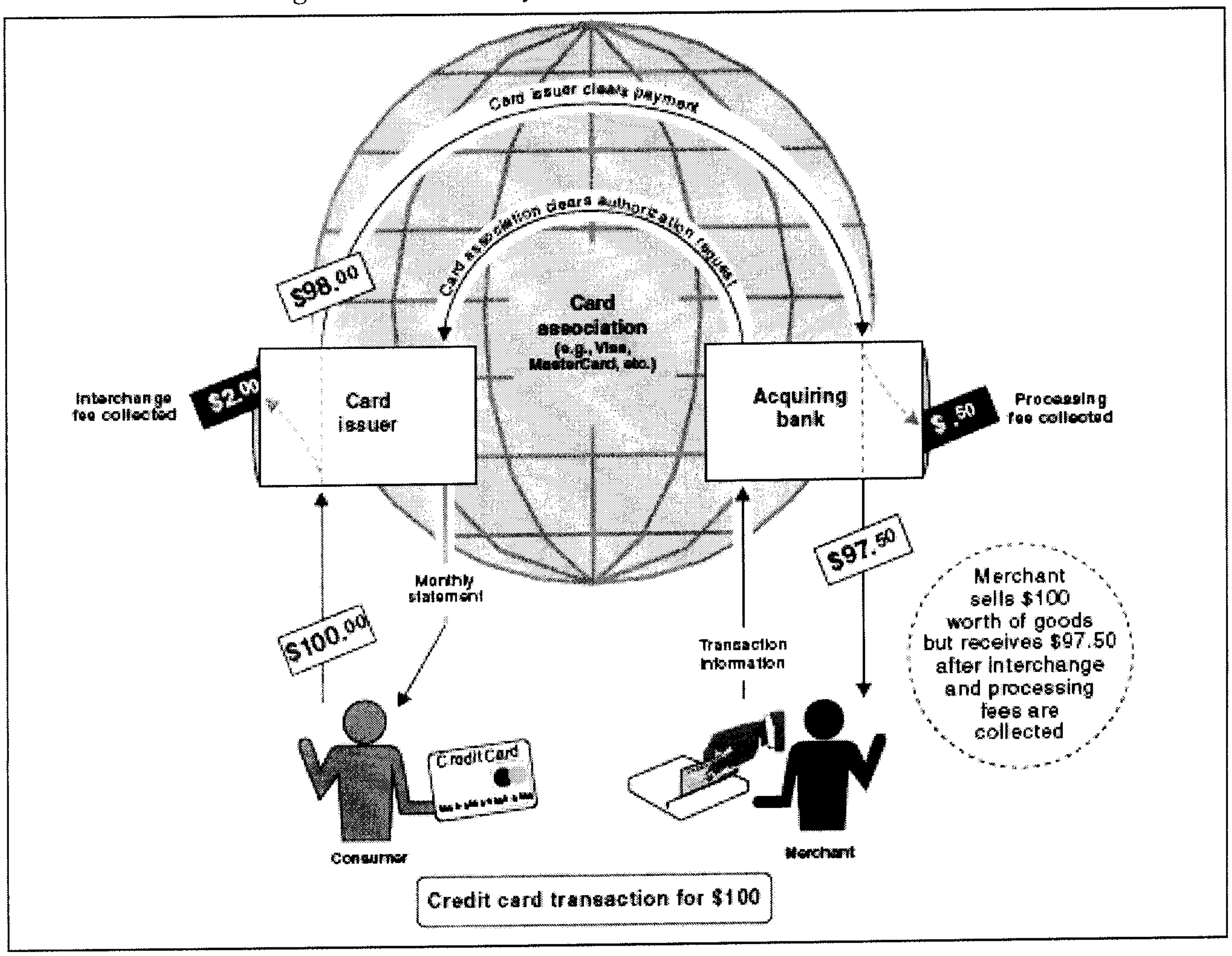
[20] Payment Systems Board, Reserve Bank of Australia, *Preliminary Conclusions of the 2007/08 Review,* at 15 (April 2008) (emphasis added).

[21] GAO, *Credit Cards- Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosure to Consumers,* GAO-06-929, at 74 (September 2006).

MasterCard), the interchange fees account for approximately 80% of the total fees charged. Here is a graphic from that GAO study explaining how the Visa and MasterCard interchange scheme works:

*Illustration of a Typical Credit Card Purchase Transaction Showing How Fees Paid by Merchants Are Allocated*




Source: GAO (analysis); Art Explosion (images).

It is also notable that interchange fees are largely imposed on a percentage basis rather than as a flat per-transaction fee, so merchants pay an interchange fee of $0.20 on a $10 transaction but $2 on a $100 transaction. This means that the banks realize a surge in interchange fees simply when prices rise for items like gasoline or food, even though there is no increase in the cost to process these transactions. Visa and MasterCard also charge interchange fees on the gross amount of the transaction, which typically includes some amount of state and local taxes. In other words, the banks charge interchange fees even on amounts that merchants collect for the government but do not retain.

Additionally, interchange rates in the United States are significantly higher than in those countries in which policymakers have challenged the anticompetitive conduct of Visa, MasterCard, and their affiliated banks. As noted above, the average interchange rate that Americans pay is approximately 2%. In contrast, the average interchange rate in Australia is only 0.5 percent.[22] Similarly, under a recently-expired consent decree with the European Commission, Visa's cross-border interchange rate had decreased to 0.7 percent.[23]

### *F. There is no procompetitive justification for the electronic payment systems' price fixing and exploitation of market power*

H.R. 5546 appropriately affects only payment systems that process at least 20% of U.S. electronic card payments. According to a recent working paper by the staff at the Federal Reserve Bank of Kansas City, it appears "market power of credit card networks" is a factor that "plays a critical role in determining the card pricing."[24] The reality is that Visa and MasterCard interchange fees do not appear to be based upon costs – a further indication that market forces do not determine interchange rates. A 2006 consultant's report concludes that transaction processing comprises only 13% of interchange costs.[25]

Visa and MasterCard argue there are justifications for their anticompetitive interchange rates and terms, but the governments that have addressed these justifications have rejected them. For example, a 2006 study jointly undertaken by the EC's Competition and Financial Services Directorates:[26]

> [S]eem[s] to cast substantial doubt on the justifications for the existence of interchange fees put forward by the payment card systems. For instance, one international network believes that in the absence of . . . interchange fees paid by acquirers to issuers, issuers would have to recoup all of their costs from cardholders and this would lead to a level of card issuing that is "not optimal" for the system as a whole. This statement seems to be largely refuted by our results. The justification put forward by another international network, which considers that the interchange fee provides for a transfer of revenue between issuers and acquirers to achieve the optimal delivery of services by both acquirers and issuers to merchants and cardholders, is also not supported by our results . . . In such a context, the role of interchange fees as a "mechanism to redress the imbalance

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[22] Reserve Bank of Australia, "Interchange Fees for the Visa and MasterCard Schemes" (Press Release, September 29, 2006).

[23] European Commission, "Antitrust: Commission prohibits MasterCard's intra-EEA Multilateral Interchange Fee, at 2 (Press Release, December 19, 2007) The Commission noted that the MasterCard's credit card interchange fee, which the Commission found to be unlawful, varied between 0.8 and 1.2 percent. *Id.* at 1.

[24] Z. Wang, *Market Structure and Credit Card Pricing: What Drives Interchange?* at 38 (December 2006).

[25] Diamond Management and Technology Consultants, *A New Business Model for Card Payments,* at 10 (2006).

[26] European Commission, *Financial Services Sector Inquiry, Interim Report I: Payment Cards,* at 71 (April 12, 2006).

between issuers' and acquirers' costs and revenues in delivering a payment card service" is not readily understandable.

More specifically, in its recent investigation of MasterCard's interchange fee system, the European Commission's Competition Directorate gave MasterCard the opportunity to demonstrate that the theoretical justifications given for interchange fees could be demonstrated factually. The EC concluded that MasterCard simply could not show that the theoretical benefits of interchange fees actually exist.

In particular, the EC attempted to verify "whether the model underlying MasterCard's MIF [multilateral interchange fee] was founded on realistic assumptions, whether the methodology used to implement that model could be considered objective and reasonable and whether the MIF had indeed led to the positive effects that MasterCard claims." The EC concluded that MasterCard could not meet that burden.[27] Accordingly, the EC gave MasterCard six months (from December 2007) to end its interchange fee for transactions across European national boundaries or institute a new compensation mechanism that did not violate EC competition law.

### *G. Congress is best-suited to remedy the interchange problem prospectively*

Visa, MasterCard, and some members of the MPC currently are participating in litigation regarding interchange. Specifically, *In re Payment Card Interchange Fee & Merchant Discount Antitrust Litigation* (MDL Docket No. 05-1720) is comprised of approximately 50 class actions and individual lawsuits that have been designated multidistrict litigation and transferred for pretrial proceedings to U.S. District Court Judge Gleeson in the Eastern District of New York. Visa and MasterCard have argued that it is inappropriate for Congress to act while this litigation is pending, noting specifically that the parties have been participating in mediation sessions. This argument is misguided.[28]

First, resolution of these antitrust class action lawsuits can take literally years. For example, a similar antitrust class action against Visa and MasterCard was pending for over seven years before they agreed to settle. It is also typical for courts to require the parties in complex commercial litigation to participate in non-binding mediation sessions.

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[27] European Commission, *Antitrust: Commission prohibits MasterCard's intra-EEA Multilateral Interchange Fee – frequently asked questions*, MEMO/07/590, at 2-3 (December 19, 2007). MasterCard is appealing this decision.

[28] Visa and MasterCard also like to cite an individual case – *Kendall* – from California that addressed interchange practices but was dismissed prior to full discovery because the complaint was not well-pleaded. In contrast, substantial discovery already has taken place in *In re Payment Card Interchange Fee & Merchant Discount Antitrust Litigation* that would make a dismissal like in *Kendall* virtually impossible. With the benefit of this discovery the amended complaint in *In re Payment Card Interchange Fee & Merchant Discount Antitrust Litigation* is not susceptible to dismissal on the points raised in *Kendall* given its additional allegations and specificity supporting its claims. Tellingly, while Visa and MasterCard like to highlight the *Kendall* dismissal here in Congress, their lawyers have not even attempted to make the same arguments to the court in the pending litigation.

Unfortunately, however, participation by the parties in these mandatory sessions does not indicate that the case is about to end. Any resolution of the pending interchange litigation may take years, including possible appeals and remands, while Visa and MasterCard's ongoing price fixing and exploitation of their market power continues unabated.

Second, while courts are effective at remedying past unlawful conduct, Congress better-suited to prevent *future* anticompetitive conduct in a complex industry such as electronic payment systems. In large part, this is because there are only a limited number of injunctive relief options available to courts to affect on-going conduct. The experience of the AT&T divestiture decree is surely a cautionary one for Congress. In that case a federal district judge ruled on the fundamental details of the telephone industry for over a decade based primarily upon an historical court record.

For these reasons, the MPC believes Congress should enact the Credit Card Fair Fee Act as a market-based, non-regulatory remedy and not wait for resolution by the courts.

### *H. Consumers will benefit from lower interchange fees under H.R. 5546*

All consumers shoulder the burden of interchange fees as they are a factor in merchants' pricing of goods and services. In fact, U.S. households paid an average of more than $300 for hidden interchange fees in 2006, including households that did not even use payment cards. The Credit Card Fair Fee Act is a market-based approach to relieving consumers of this burden.

This market-based approach stands in contrast to the solutions undertaken in other countries, such as direct regulation of interchange fees by the central bank (Australia), negotiated rate reductions between card systems and central banks (Mexico), or direct intervention by competition authorities (in the European Union). While their approaches differed, however, all of these countries addressed the same problem we are facing in the United States – anticompetitive interchange rates and terms imposed by cartels of rival banks that possess market power. Accordingly, despite these differences in approach, experiences in countries like Australia are instructive in anticipating the potential impact of H.R. 5546 here in the United States:

1. <u>Billions of dollars of relief to merchants and consumers</u>

Australia's regulators have found that lower interchange rates for Australian credit and debit card holders have benefited consumers in several ways. For example, the central bank concluded that the overall consumer price index was lower than it otherwise would have been had interchange fees not been subject to central bank limitations, with the bulk of interchange fee savings passed on to merchants' customers.[29] More specifically, the Reserve Bank found that as a result of the reforms, "the net savings to merchants was around $920 million in 2006/07. Since the reforms came into effect in 2003, merchants

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[29] Payment Systems Board, Reserve Bank of Australia, *Preliminary Conclusions of the 2007/08 Review*, at 23 (April 2008).

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have saved a net total of at least $2.5 billion which, in the normal course, would be passed through into lower prices for goods and services."[30]

2. Increased competition among banks for consumers

Additionally, even the credit card companies themselves have recognized that competition among credit card issuers has flourished in Australia since the reforms. Notably, however, the new competition has focused on price rather than on mileage points and other features apart from price. This reconfirms that high interchange fees are a subsidy from merchants and their customers to cards with high marketing costs and expensive features. In an August 2005 letter to the Reserve Bank of Australia, MasterCard stated:[31]

> MasterCard does not disagree that there is, *at present,* strong competition amongst issuers of credit cards. Such competition has been enhanced by the fact that, at present, issuers have been able to recover eligible costs.... One distinct characteristic of the product offerings in recent times, however, has been the increase in the number of 'low cost' credit card offerings. While MasterCard believes that it is beneficial for there to be 'low cost' credit card products being offered, it also believes that, with the common benchmark interchange fee, in the future there will be fewer 'fully featured' credit card offerings and the competition between issuers will be based on increasingly homogeneous 'low cost' credit card offerings.

Subsequent events have confirmed the benefits to cardholders from this interest rate competition. According to the central bank, "Interest rates on 'no frills' cards range from 9-13 per cent compared with interest rates of 17 percent or higher on most standard rewards-based cards."[32] The head of one major Australian bank (ANZ Bank) was pleased with the results of competing on interest rates, rather than rewards: the shift away from the bank's loyalty point system resulted in a loss of credit-card transactors which has been offset by growth in customers wanting the lower-rate cards. "We lost a lot of ground (in transactors) but gained a lot of ground in people actually borrowing against their credit cards because of the lower rates . . . Over the long run that will be more beneficial to us in terms that the earnings have shifted away from transactions to much more interest bearing accounts."[33]

3. Lower net bank fees

Opponents of the Credit Card Fair Fee Act reportedly have argued that if cartel-set interchange fees are lowered, banks will merely raise other fees to their customers. This

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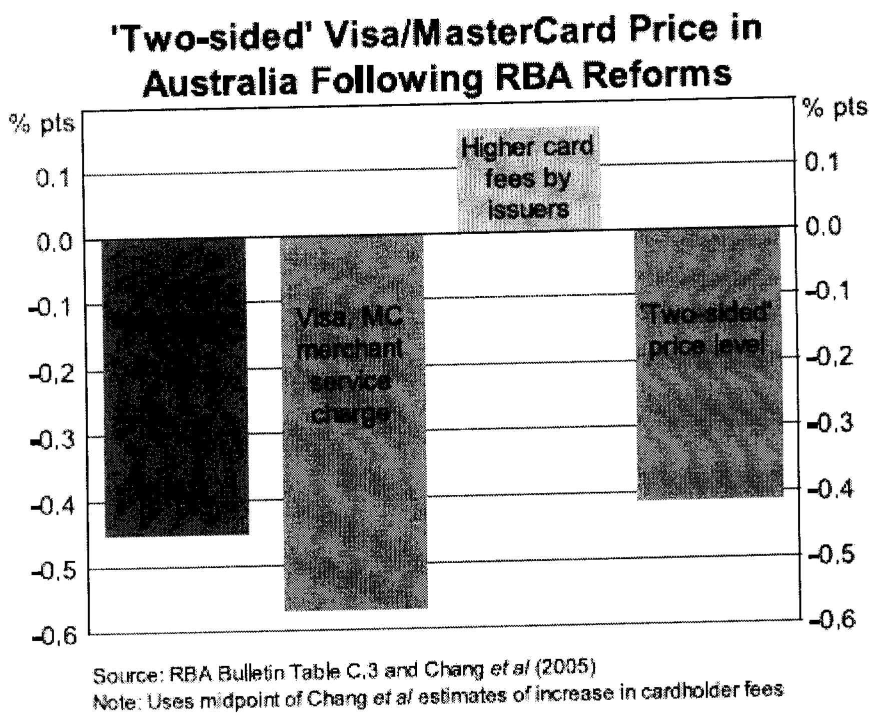
[30] Payments System Board, Reserve Bank of Australia, *Annual Report 2007*, at 26 (October 2007).
[31] Letter from Senior Vice President—Australia, MasterCard International to Head of Payments Policy, Reserve Bank of Australia, August 25, 2005, at 3 (emphasis in original).
[32] Reserve Bank of Australia, *Statement on Monetary Policy*, at 50 (Feb. 13, 2006).
[33] "Credit Cards Trend to Lower Rates," *The Australian*, (Feb. 22, 2006).

line of argument is truly remarkable. No bank is entitled to the illegal revenues from high cartel prices. Visa and MasterCard banks around the world continue to issue cards even though interchange fees in many countries are significantly lower than they are in the United States. In fact, it is far more likely that banks will respond to lower payments from merchants (if that is the result of the agreement process) by reducing their extraordinary card marketing expenditures, such as the billions of unsolicited junk mail credit card solicitations they send out each year.[34]

One study of the impact of interchange fee regulation by the Australian central bank concluded that the merchant discount charged by acquirers fell more than the decline in interchange fees, and the decline in costs to merchants more than offset any increased fees charged to cardholders. Consequently, looking at payment cards as a "two-sided" market of cardholders and merchants, the controls on interchange fees had led to a net 41 basis point per transaction reduction in the cost of cards:[35]




[34] There were over 5 billion such solicitations in 2007, with a response rates of 0.5 percent (one out of 200). Thus, banks with loan losses and/or sub-prime card holders apparently reduced mailings, while banks with relatively fewer problems, such as Chase, *increased* their junk mail solicitations. Synovate, "US credit card mail volume declined in 4th quarter 2007 as troubled issuers pulled back" (Press release, February 6, 2008).

[35] A. Frankel, "Towards a Competitive Card Payments Marketplace," in Reserve Bank of Australia, *Proceedings, Payments System Review Conference* 27, at 63 (April 2008).

4. Competitive pressures on all merchants to compete away cost reductions in the form of lower consumer prices

Some opponents of the legislation also argue that even if there are significant reductions in the interchange fees charged merchants, consumers as a whole will not benefit because merchants will not reduce prices for consumers. I find such claims divorced from reality.

Australia's central bank has concluded that the bulk of cost savings to merchants resulting from the lower interchange fees "ha[s] been, or will eventually be, passed through into savings to consumers."[36] At the same time, these interchange reforms have provided credit card users with a *choice* they previously did not have: no-frills cards with lower fees and interest rates or rewards cards with higher rates – just the outcome one would expect in a competitive card marketplace. Not surprisingly, the Reserve Bank's current review of its regulation of credit and debit card interchange fees and related rules found significant benefits to society from improving the pricing signals to consumers regarding the true relative costs and benefits of various forms of payment: [37]

> The Board's overall assessment is that the welfare gains from the reforms are likely to have been substantial. Not only has the change in payment patterns *relative to what would have occurred in the absence of the reforms* resulted in lower costs, but there has also likely been an increase in welfare from consumers using a payment instrument from which they derive higher benefits.

Further, retailing is one of the most competitive segments of the American economy, and there is competitive pressure on all merchants to compete away cost reductions in the form of lower consumer prices. My ten years' experience as a Circuit City executive taught me that retailers factor cost reductions in pricing decisions to remain competitive, particularly when, as here, any lower interchange fees achieved through H.R. 5546 would be broadly available to all merchants.

## V. CONCLUSION

Mr. Chairman, for the reasons discussed above, the Merchants Payments Coalition supports H.R. 5546 as a market-based remedy to address the current anticompetitive and dysfunctional interchange scheme that the banks have designed and perpetuated. The MPC urges the full committee to report H.R. 5546 favorably to the House as soon as possible.

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[36] Payment Systems Board, Reserve Bank of Australia, *Preliminary Conclusions of the 2007/08 Review*, at 23 (April 2008).
[37] *Id.* at 20 (emphasis in original).

# Exhibit C

FOCUS - 8 of 223 DOCUMENTS


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WELCOME

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**BODY:**

ABSTRACT

A panel discussion on "Consumer Issues" is presented. When you talk about a joint venture, one of the things to keep in the back of your mind is that a joint venture is a merger, of a kind. But sometimes when you create a joint venture -- and they are created, very often, by competing organizations -- they get together and merge any number of items and processes and operations to achieve a business objective. Visa and MasterCard are of that kind. Antitrust law has recognized, as a general proposition, that joint ventures are often pro-competitive. However, joint ventures also can be a device for anti-competitive activity, particularly when there are competitors involved. Most joint ventures are adjudicated under the so-called rule of reason. Networks are often formed through joint ventures, as with Visa and MasterCard. Such network joint ventures can raise significant antitrust issues, particularly in industries where, as with Visa and MasterCard, barriers to entry are high.

FULL TEXT

THE ANTITRUST ASPECTS OF BANK MERGERS[dagger]

PROF. FELSENFELD: As contrasted with this morning's session, this afternoon will be devoted to the effect of bank mergers on consumers. Our moderator this afternoon is Duncan MacDonald, who was the general counsel of Citicorp's international card business.5

MR. MACDONALD: Banks, as a matter of statutory law, are very highly regulated institutions.6 There are both limitations and favoritism in terms of regulation that affect how they behave. That is fairly important.

There is the safety and soundness doctrine that, in effect, says that bank regulators and banks themselves have to be cognizant of stepping over the line and stopping themselves or reversing themselves.7 They can do it any number of ways.

There are lots of mergers that have taken place over the years.8 Although there is a broad body of antitrust law that applies to both the regulatory industry, like banking, and unregulated industries, it has not been applied all that much in the last fifteen or twenty years against banks.9 A good part of the reason has to do with the Justice Department, in particular, paying deference to the so-called expertise of the bank regulators, like the Federal Reserve, the Comptroller of the Currency, and so on.

There is a decision, the Chevron decision, that goes back some time.I0 Basically, the Supreme Court of the United States said that the expertise of federal regulatory agencies ought to be given high deference in various kinds of lawsuits.11 To some extent, that may have had an effect.

In any event, the law, at least as I see it, is not being enforced. There are two ways to enforce antitrust laws: by government and by private action.12 Outside the United States, there is an enormous amount of antitrust or equivalent activity in various countries around the world with respect to bank cards.13 There is no public or government action against the bank card industry in the United States, but there has been a ton of litigation involving price fixing, misused market power, et cetera.14

The two speakers today are going to discuss both that issue and the consequences of antitrust misbehavior by banks, in particular with respect to joint ventures, like Visa and MasterCard.15 Banks created these joint ventures back in the late 1960s, and they have thrived ever since.16 Now suddenly they seem to be stumbling because they allegedly-and determined by courts-have stepped over the line and violated the Sherman Act.17

When you talk about a joint venture, one of the things to keep in the back of your mind is that a joint venture is a merger, of a kind. If Citibank or Chase merges with X National Bank of Chicago, that's the standard merger we think of. But sometimes when you create a joint venture-and they are created, very often, by competing organizationsthey get together and merge any number of items and processes and operations to achieve a business objective. Visa and MasterCard are of that kind.

We are going to start with Jeff Shinder. The major lawsuit brought against the bank card industry, when all is said and done-the paradigm-is the Wal-Mart lawsuit that turned into a class action.18 It was led by Jeffs firm, Constantine Cannon.19 They won a big settlement.20 He is going to talk about that. He is an expert on joint ventures, antitrust litigation, retail pricing policies, et cetera.

After he speaks, Robert Manning, a Ph.D and a professor at Rochester Institute of Technology,21 who wrote a book that is very important to the card industry-because they hate it-called Credit Card Nation: America's Dangerous Addiction to Credit.22 I have written about that topic, too, addiction to credit. So I am somewhat sympathetic to it. But, he is a four-letter word in banking, but otherwise a very honorable and good person. He is very much involved in litigation matters as an expert witness, and he has testified before House and Senate committees.23 He has a book coming out fairly soon called Borrowing the American Dream2" which should be out next year and which you should read.

Let's turn to Jeff.

MR. SHINDER: Thank you, Duncan, for that introduction. I am going to speak about joint ventures and antitrust treatment of joint ventures,25 and then I am going to apply some of the general principles to the experience of Visa and MasterCard. It's important to keep in mind that Visa and MasterCard were formed as joint-venture associations, purportedly nonprofit, by banks that competed both in the issuance of credit and debit cards and in the acquisition of merchants for Visa and MasterCard.

It's ironic; Visa just filed its preliminary prospectus, its S-I document, to go public, and is about to end its thirty-plus years as a joint-venture association.26 MasterCard went public a couple of years ago.27 It may be the case that a lot of the lessons that I am going to go through are in the past. I will address that towards the end.

Before I get to the specifics of Visa and MasterCard, let's outline some general principles about the antitrust treatment of joint venture. First and foremost, it's important to know that the antitrust laws recognize that many, perhaps most, joint ventures are actually procompetitive. Firms, even competing firms, get together and often produce something that they cannot produce by themselves.28 Integration is happening. They create something that the individual actors couldn't do themselves.

Visa and MasterCard are an example of this. Before Visa became Visa, there was BankAmericard, and there were restrictions on interstate banking that prevented Bank of America from acquiring merchants or issuing cards across the country.29 It limited the scope of what was then this emerging payment system. To construct something that BankAmericard could not do by itself, Visa was formed as an association of competing banks that issued cards and acquired merchants around the country and then around the world.30 All of a sudden, something that not one bank could do by itself was created. It's something we take for granted. You can go anywhere around the world and carry your Visa card and know that it's going to be accepted by the merchant.

Antitrust law has recognized, as a general proposition, that joint ventures are often pro-competitive.31 However, joint ventures also can be a device for anti-competitive activity, particularly when there are competitors involved. This can show up in a bunch of ways. It can show up in what's called a naked restraint of trade, where a joint venture is merely a disguised device to fix prices or allocate markets, where consumers are harmed by virtue of higher prices and less competition, or, in a more subtle example, where a joint venture, a restraint, created for purposes that are arguably pro-competitive, actually has harmful consequences outside the functioning of the joint venture.

Most joint ventures are adjudicated under the so-called rule of reason.32 In antitrust law, restraints are divided into two categories. Per se restraints of trade, which, from longstanding experience, we know that a restraint is almost always going to injure competition.33 When a per se restraint is set forth, no significant injury to competition needs to be shown.34 Price fixing/market-allocation schemes between competitors are classic examples of per se restraints of trade. Everything else is adjudicated principally under the rule of reason.35 The rule of reason, in the context of a joint venture, often simply comes down to whether or not there is market power at work. Does this joint venture comprise a significant enough portion of the market-the first criterion is, "What is the market?"-that it could harm competition by excluding competitors or raising prices?

Under the rule of reason, if there is a potential for harm to competition along the lines I just described, the joint venture or a restraint within the joint venture will be evaluated under the following criteria:36 (1) The agreement must be necessary to achieve the purposes of the joint venture;37 (2) If there is a pro-competitive effect, it must outweigh the anti-competitive harm;38 (3) The pro-competitive effect that is used to justify the restraint at issue must not be speculative, but something that can actually be verified;39 and (4) There may not be any significantly less restrictive means to achieve that purpose.40

Visa and MasterCard are examples of something that we are seeing more of in the marketplace today: networks-platforms that function to link two sides of a market. In the context of Visa and MasterCard, they link cardholders and merchants. But we see platforms all over the place. Network industries in the marketplace today, from the telecommunications industry to real estate listing services, to dating services, are all networks that link disparate constituencies of consumers.

Networks are often formed through joint ventures, as with Visa and MasterCard. Such network joint ventures can raise significant antitrust issues, particularly in industries where, as with Visa and MasterCard, barriers to entry are high. It's not easy to replicate what Visa and MasterCard did. It would take years. Many examined doing so and decided that the cost and the effort were too daunting. Network industries tend to tip, for example, in software industries, where once a leading firm gets sufficient advantage in the marketplace, the market tends to tip to them, where they become the standard. They can then exercise market power by virtue of being the leading standard. That is a classic example where standardization can have positive benefits, but could also lead to the exercise of market power that could hurt consumers by stifling innovation.

Network industries raise interesting and unique antitrust issues. For example, in a network industry where networks have essentially become the standard, membership rules can raise significant antitrust issues. In the case of Visa and MasterCard, then" rules were too inclusive, in that everyone who was a member of Visa was also allowed to be a member of MasterCard. The same banks owned, operated, and controlled both associations,41 which led to allegations, with some credibility, that their common ownership caused them not to compete.

Membership rules can also be too restrictive. A network that dominates the market and denies access to potential entrants can abuse market power and harm competition by denying something necessary for effective competition to a would-be entrant. So, membership rules can raise significant antitrust issues in the context of a network.

I didn't discuss ancillary restraints.42 A naked restraint is a restraint of trade that really has no redeeming justification.43 It is enacted in the context of a joint venture but is really simply an artifice to fix prices and exclude competition.44 There is obvious injury to consumer welfare. Most restraints in the context of a joint venture are ancillary restraints, restraints that could have pro-competitive benefits by being reasonably necessary for the functioning of the joint venture and are evaluated under the aforementioned criteria.45 Weigh the positive aspects of the restraint against the potential harm to competition and see whether there are other means that could have been applied to achieve the procompetitive benefits.46

The experience of Visa and MasterCard is instructive as to the various ways that a network joint venture can get into antitrust hot water. First, its membership rules. A common feature of the payments industry was something called duality, where virtually every member of one of the two leading associations was also a member of the other.47 That led to an allegation by the Department of Justice, in the late 1990s, that duality or, more properly, dual governance-the fact that the boards of directors were comprised of banks that ran Visa and MasterCard, and that banks sitting on the MasterCard board were leading members of Visa and vice versa-was anti-competitive. 48 That formed part of the basis of the DOJ lawsuit against Visa and MasterCard in the late 1990s.49

Another aspect of the DOJ suit was various rules of Visa and MasterCard that said every bank in the country can issue cards over our network, but those banks cannot at the same time issue cards over the Discover or American Express networks. Citibank, for example, could issue a Visa card or a MasterCard card, but if it wanted to issue an American Express card or a Discover card, it would do so at penalty of being thrown out of the Visa or MasterCard association.50 In that sense, the Visa and MasterCard membership rules were too exclusive. They said to their banks, "You have to stay in the club, but if you do business with Discover or American Express, we will throw you out." That comprised the other side.

There were two theories of the DOJ case: one, dual governance; the other, that these rules that prevented banks from doing business with Discover and American Express were anti-competitive.51 The DOJ lost the dual governance portion of the case, but won on the theory that the rules excluding banks from doing business with Discover and American Express were anti-competitive.52

What was the theory of competitive injury? Visa and MasterCard litigated the case all the way to the Supreme Court.53 Ultimately, the Supreme Court declined to review the decision affirmed by the second Circuit.54 They said, all the way up, there is absolutely no consumer harm here, period.55 Discover and American Express, as issuers, can issue to anyone in the country, and the fact that they cannot distribute through the banks that are members of Visa and MasterCard has not harmed consumers one whit.56

The theory in that case was not the typical consumer welfare, higher prices; this was a lost innovation case.57 The theory was that Citibank, partnering with American Express or Discover, would be able to offer something that was unique, differentiated, different for consumers, and not deprive consumers of consumer choice; but, the rules said Citi couldn't do that, or any of the other thousands of issuers of Visa and MasterCard.

Private lawsuits continue to be important terrain, and the loss by Visa and MasterCard in the DOJ case has spawned, as you would expect, the typical follow-on cases. American Express and Discoverin the spirit of full disclosure, I represent Discover in this case-have sued Visa and MasterCard for damages for lost profits as a result of those rules.58 American Express just settled its case with Visa.59

There was another important aspect that should be noted in the DOJ case, which was that joint-venture restraints, when they impact competition outside the joint venture, can have significant risk to competition, even if they have some kind of pro-competitive purpose.60 One of the theories of the DOJ case is that the banks who ran Visa and MasterCard were restraining competition between themselves.61 The idea was that Chase and Citi basically said to each other, through the rubric of Visa and MasterCard, "I don't want to let you have the advantage of issuing an American Express or Discover card, and so we will all agree not to do that." That impacted competition outside the joint venture in the market to issue credit cards and debit cards.

The various merchant cases provide a different example of how restraint within the Visa and MasterCard joint ventures had anticompetitive consequences-in this instance, outside the joint venturealthough the injury to competition outside the joint venture was at the network level. One of them was the so-called Wal-Mart case.62

What was the Wal-Mart case about? It was about Visa and MasterCard using their honor-all-cards rule, which is the rule that says to every merchant that accepts Visa and MasterCard, "If you accept Visa, you must accept every validly presented Visa card, no matter what you see. You can't choose between different kinds of Visa cards."63

This is a classic example of a restraint that was actually necessary for the functioning of the joint venture. When Visa and MasterCard were formed-think about this: You have thousands of banks across the country issuing these cards, thousands of banks acquiring merchants, millions of merchants accepting these cards-you need to have a seamless acceptance experience. We all take it for granted, but you needed to have a rule that ensured to you, as a consumer, that when you proffer the Visa card, the merchant is going to take it. It's not going to say, "I'll take a Chase Visa card, but I don't like Citibank, so I'm going to turn that one down."

The honor-all-cards rule, as applied to one product, which is what Visa and MasterCard were back in 1966-credit cards-was procompetitive. As Wal-Mart's lawyer, we never argued that, in that guise, it was anything other than pro-competitive. But something very interesting happened to the honor-all-cards rule over the years; it became an instrument to tie two distinct products.

There is a species of antitrust claim called a tying claim, which basically involves leveraging market power from one product to another by forcing the consumer to take an unwanted second product.64 The argument in the merchant case was that the honor-all-cards rule, when it was applied to debit cards and forced merchants to take debit cards at a very high price, allowed Visa, particularly, but MasterCard as well, to leverage their preexisting power in the credit card market into the distinct and very different debit card market, with anti-competitive effects in the debit market.65

The theory that was accepted by the court, in large measure, was that a superior platform for PIN debit-the same PIN that you use at the ATM, that you sometimes use in supermarkets at the point of sale, the platform that everyone thought was going to take off in debit in the early 1990s-was cheaper and safer and faster and more efficient, and was suppressed by virtue of the honor-all-cards rule. Thereby, consumers were harmed and competing PIN debit networks, who were not Visa and MasterCard, were suppressed.

That case, like the DOJ case, was largely litigated, although, unlike the DOJ case, we did not go all the way up to the Supreme Court on the liability issues.66 But, a score of findings emerged from these two cases that can be used against Visa and MasterCard in the future, findings about their market power; in the example of the merchant case, findings that debit cards and credit cards were distinct products for purposes of tying law, which sets up, potentially, future actions, where honor-all-cards policies are used to link distinct products.67 That precedent can be used. Debit is a market. Visa had market power in debit.

That leads me to the last example, and probably the most nettlesome of the legal issues facing Visa and MasterCard over the years, and that is interchange,68 a somewhat complex mechanism. Visa and MasterCard, through their boards of directors, have historically set something called interchange. Interchange is a fee that is ultimately paid by merchants as part of the discount they pay when they accept a Visa or MasterCard transaction that flows back to the issuer.69 If you go to a merchant with a Citibank-issued Visa card and you make a transaction, the merchant pays the interchange fee, and the fee flows back to Citibank as the issuer.70

Over time, interchange has become an increasingly critical proposition to the business for the issuance of payment cards, both in debit cards and in credit cards. The antitrust theory challenging interchange is that it is nothing more than a price; it's a price that is paid by merchants to competing issuers.71 That price is fixed by competing issuers who sit-I should say, sat-on the board of, at least, MasterCard, and they may continue, some of them, to sit on the board of Visa.72 Therefore, that's price fixing.73 Antitrust 101: price fixing harms consumers by raising price and is usually a per se violation of the antitrust laws when engaged in by horizontal competitors.

The first challenge against interchange was the so-called NaBANCO case in the mid-1980s.74 In that case, Visa succeeded to leverage a preexisting Supreme Court opinion-the BMI decision-to get the case treated under the rule of reason.75

Visa said interchange can't be treated like a normal price.76 Instead, it's a device that is needed to equilibrate two sides of this network industry.77 We need interchange for it to function.78 The side bearing the disproportionate share of the costs and the risks, the issuer, should receive a transfer from the merchant side of the equation.79 Otherwise, these systems won't exist.80 You can't evaluate interchange without understanding that this is a network platform with two sides to the market and a need for interchange to basically balance the two sides of the market.81 The court accepted that argument and Visa prevailed, on appeal, and it was allowed to continue to set interchange.82 This was in the mid-1980s, when interchange was applied to credit, and debit was a fairly minor part of the payments landscape.83

Going forward, Visa and MasterCard applied their ability to set interchange to debit cards, where they fixed very high credit card interchange to debit cards, a large part of the impetus for the merchant case.84 It was framed as a challenge to the honor-all-cards rule, but a subtext was that debit card interchange was just a disguised exercise of market power. They have set high interchange for commercial cards, for prepaid store cards, and have raised interchange over and over again, to the breaking point. It's at the breaking point around the world.

Let me note one other thing on this particular slide.85 Price fixing theory, a traditional antitrust attack, has so far failed in the United States on interchange.86 Some of the regulatory challenges are not framed on pure antitrust terms. Instead, they are framed that interchange actually funnels too much credit card use and that it leads to a regressive effect, where interchange is paid by merchants, it's too high, it's passed along in the form of higher prices to everyone, including the cash customer who is not paying with a credit card, and it finances all kinds of rewards cards for the very affluent, and too much credit.87

That was a large basis for the Australian challenge. I just cannot stress this enough-this was not a pure antitrust attack.88 Most antitrust lawyers would actually recoil, to some degree, at the analysis. The theory was, there is too much use of credit cards.89 Interchange is financing something that is socially problematic and something that is regressive. We are going to cut interchange down, and so be it if it leads to fewer rewards for the affluent.

This has been an ongoing battle. One of the things that Visa and MasterCard have said repeatedly, including to regulators in the United States, is that this was misguided, that it has had unintended and problematic consequences, and that regulators have no right getting into how much a particular payment form is used at the point of sale; it's not the province of a regulator.90 The Federal Reserve in the United States has accepted that its mission should not get into some of the things that the Australians were willing to get into.91

Europe was different. Europe has taken a more traditional price fixing approach to the issue of interchange, but then has superimposed a somewhat regulatory regime that I don't think an antitrust authority in the United States would ever countenance.92 They have essentially gotten into negotiations with Visa and MasterCard over what is actually the correct level of interchange.93 I cannot imagine the Antitrust Division doing anything similar here, getting into the mission of regulating what could be characterized as a price. Here are just some other examples of countries around the world that have looked into or are looking into the issue of Visa and MasterCard interchange.94

What about the United States? I went through the history of the NaBANCO case.95 There is another round of cases-this one, I will happily say, I am not litigating-where merchants have brought another class action based on a price fixing theory, based on a theory that the NaBANCO case and its factual underpinnings have proven to be wrong.96 That case is winding its way through the federal courts as we speak. If the merchants prevail, the entire system of collectively setting interchange will be rescinded in the United States.

One interesting question that merchant case will raise is whether or not the new corporate forms of Visa and MasterCard fix the problem, or at least fix the problem from the perspective of traditional antitrust analysis. Remember, the issue in antitrust terms is that you have competing issuers sitting on the boards of Visa and MasterCard fixing what could be characterized as a price that they receive, and a key price they receive.

MasterCard reformed itself. It's a public company.97 It no longer has banks sitting on its board.98 But one could argue-and the merchants, I assume, will argue-that banks essentially delegated authority to do what was done before to the staff of MasterCard.

The theory-I don't know if it's going to work-is that if you have ten people meeting in a smoke-filled room to fix prices and then decide, "We're not going to do this anymore, because the smoke-filled room is a magnet for antitrust cases; instead, we will designate Duncan as the agent of our price fixing going forward," that's still price fixing if there is an agreement that Duncan will carry forward the will of the banks. The merchants will have to prove that.

My only point is that I am not so sure that MasterCard has insulated itself from antitrust attack and price fixing by changing itself, but it has certainly improved its position and has an argument it didn't have before it restructured. One could argue that one of the main reasons it restructured was to protect itself against the interchange case.

Visa just filed its S-I document. Visa, though, is going to have banks still on its board, which will make it harder for Visa to make the same argument that MasterCard will be able to make.99

On that note, I think I will conclude.

MR. MACDONALD: Thank you. Before we turn to Bob, just to kind of round that out from an insider's perspective-he was the litigator; I was an in-house guy. By the way, all this happened after I left Citibank, but that's beside the point.

If you are an in-house guy, you have to prevent things from happening. You stay ahead of the curve, and you don't get yourself in a mess. You see the risks or the consequences of getting into a private antitrust lawsuit. The government is not ever a private party that can make a profit for themselves, in terms of damages. An antitrust loss in one case can be a disaster, and this has proven to be a disaster for the banking industry.100

One of the biggest dangers that came out of this was that everybody was asleep looking at the banking industry, and then all of a sudden there was an enormous knowledge transfer to the private bar about how the insides of banks work and how they collaborate. So firms like Constantine Cannon and others sprung up all over the United States with an enormous amount of knowledge about banking because of discovery, and because of the consequences of these lawsuits they build and create other lawsuits.101

What happened in this first loss was a tidal wave of lawsuits that is still tossing them. After they lost to the Justice Department, Wal-Mart was out there, and these guys got a $3 billion settlement.102 But that doesn't tell the whole story. The consequence of losing to the Justice Department, and then Wal-Mart-the biggest animal in the United States-was probably tens of billions of dollars in damages when it plays itself out.103

These lawsuits are not going to go away. Nobody knows how to make them go away. They have caused a reorganization of the industry.104 They have caused Visa and MasterCard to change. New competitors come out of the woodwork. None of this was managed by the banks themselves. They didn't have the foresight. They were macho. They thought they were going to be smart and win, and they didn't win.

One of the little things that came up just recently is the Super SIV, structured investment vehicle.105 Chase, Citibank, and Bank of America created this joint venture, in effect-I don't think they called it a joint venture-to deal with the subprime meltdown.106 The minute I saw the headline, I thought of this guy, and I thought of joint ventures and what would have been learned from all these cases. Is there somebody out there with a telescope saying, "Wait a second. These guys are getting together again. Is there any kind of antitrust rubric that will apply to this?"

The key point is if you are a bank and you get into antitrust trouble-just understand the evil that men do lives after them-these things can get very, very big.

With that, I turn to Bob. Take over.

PROF. MANNING: It's a pleasure to be here. I am coming with a little bit different perspective. As Duncan mentioned, my book Credit Card Nation101 did create a bit of a ripple. But I like to think of myself as a voice of prudence. We might not have had quite the subprime crisis if we had started thinking about some of the consumer issues and the exposure that banks have created, not only in terms of the anticompetitive aspects of the industry, but also the insulation of this industry in terms of consumer protections.

First, I would like to make very clear why this is a unique issue. Carl had asked for a particular focus on the Philadelphia decision108 and the Riegle Act.109 I want to look at the credit card industry as kind of a consequence of the emergence of deregulation in banking and the institutional form that it has assumed, what role credit cards play, and how profound the change really has been.

First, I want to look at the unique aspects of the industry. I come at it as a business school professor. I came in with some different slides.110 The second aspect is some of the specific negative consumer-related outcomes that have resulted in the era of deregulation, with tremendous consequences.

I have been an expert witness in about twelve class-action federal and civil suits in the last five years. The costs of litigating these suits are just extraordinary. We are not talking about the enormity of the Visa/MasterCard duality or the Wal-Mart suit, but just at an individual level, every single major issuer. There will probably be questions about some of the issues regarding predatory lending,111 deceptive marketing,112 and deceptive pricing practices113-and I will talk briefly about federal preemption and the role that has played, especially in terms of governance. Ultimately, when we talk about our dual banking system, we are talking about, largely, the fact that Congress, with the OCC and directives to the Federal Reserve and the FDIC, is the one setting the tone.114

As somebody who testifies to Congress frequently, with access to some discovery documents, the banking industry clearly has been listening to the signals of Congress. They don't want to be regulated. Yet, as soon as the pressure eases off, some of the most egregious policies occur again, and then, ultimately, these have to be settled through some very costly litigation.

I want to emphasize what has changed about this industry. Keep a couple of things in mind in terms of the postindustrial society. Today the most profitable aspect of our economy is financing production, not actually producing things.115

Second, in terms of the transformation of the banking system and community banking and the bundling of services at a local issuer and the nature of an expanded national market, the best customer in the banking system-and we are talking retail banking-has gone from someone who could pay off their loans to somebody who will never pay off their loans. When we talk about the issues of securitization and consumer rights, this certainly has an important place, both in terms of how these products are produced and the loss of consumer rights in that process.

We talk so much about competition. It is always striking to me that whenever there is a discussion about pricing and marketing policy, the American Banking Association116 always comes back and says, "There are 6,000 credit card issuers. This is the most competitive industry in the American economy."117 As we will see, in terms of the extraordinary pace of consolidation in this industry, it belies some of the realities that have occurred.

Remember when you would open up a savings account-this certainly isn't the students, but the faculty and the practitioners here-you would get a free toaster? One of the key points to keep in mind as we look at the evolution of this industry is that credit cards were essentially loss leaders to reward the most desirable customers, typically people who paid off their credit cards. This was a customer service to reinforce the use of the other bundle of services. In some cases, of course, in the 1960s and 1970s, the toaster-you can only have so many toasters, for affluent clients. Unlike getting a mortgage-you are only going to get one mortgage-you can get several credit cards. Credit cards then became a real effort to market as a status symbol for people who didn't need credit, but wanted to demonstrate that they had such high credit and such a favorable relationship with their banking institution that they were offered an unsecured loan with a relatively high line of credit.

This is a critically important issue to keep in mind. Until we see deregulation that occurs particularly in the late 1970s, where we are talking about state-regulated interest caps118-until the 1978 Marquette decision,119 banks were actually losing money in their efforts to mass-market credit cards.120 In fact, it's hard to believe today-Citibank was almost insolvent in the early 1990s-but between 1979 and 1981, my estimates are that the company lost at least $400 million in terms of scaling up to the problems of high interest rates and state interest rate caps here in New York City.

So a key issue is, what has happened and what have we done in terms of this industry?

I would argue that, as the national scope of the industry through consolidation occurred, credit cards became a crucial avenue for establishing a national marketing schema, not just in terms of vertical integration, in terms of particular markets, but the fact that the credit card, as we get to the end, in terms of personal consumer privacy issues, becomes an enormous opportunity to collect information for crossmarketing. The problem is that technology has grown and improved so much faster than the protection of consumer rights, to the point that identity fraud and exposure to our personal financial information is an epidemic.

I remember testifying in 2003,121 with the reauthorization of the Fair Credit Reporting Act.122 The major banks made it very, very clear that the quid pro quo of having a national, standard, uniform creditscoring system would be the protection of consumer privacy rights. In fact, if there is a price premium that has been passed on to consumers in terms of the national scale of this market, it has been that the burden of compromising personal private information has been passed on to consumers.

If we look just briefly at consolidation, both the number of banking enterprises and their scale have increased dramatically. On the one hand, credit cards as a cash-flow mechanism have helped drive the financing of consolidation, as well as the scale of its national operations. You had hundreds of different marketing associations in different states. There were efforts of franchising, which is essentially what happens with BankAmericard and Visa and MasterCard. But it was a chicken-and-egg phenomenon. You couldn't have a local credit card, because you wouldn't have the scale, if you went out of your town or locality, in terms of using it in another state.

Technology and geographic expansion meant that merchants weren't going to accept a credit card unless consumers were going to use it, and, of course, consumers weren't going to use it unless merchants could use it. Integral to this business plan is that there has to be an economy of scale that is going to be national.

I find this Life magazine astounding.123 This was a cover story in 1970, before any of the major deregulatory decisions-Marquette, of course, which allowed, through federal preemption, for nationally chartered banks to move to a state, in terms of its brick-and-mortar operations, and essentially import and then export that interest rate throughout the country.124 This is in 1970, when the outstanding credit card debt was less than $15 billion.125 Here, you see that the future of banking is retail banking, and credit cards were really the engine of that expected growth.126

There has been long-term planning, part of it, of course, in terms of globalization and the postindustrial economy. I have a chart about social inequality and the growth of credit card usage.127 Clearly, there was a view that if the cost structure of the labor-intensiveness of retail banking could be brought under control, and with the technology that would enable the scale to go nationally, credit cards were really the major future of retail banking. In 1977, the top fifty banks controlled approximately half of the credit card market.128 Today the top three banks control about 60% of the market.129

When I go back to that earlier comment about 6,000 issuers and it being the most competitive market, this is what those issuers look like. These are all credit cards that have now been purchased by Citibank.130 What is intriguing is the AT&T Universal Platinum Card that you see to the left.131 Notice that AT&T was actually losing money before it was purchased in 1997.132 Why? It had so many affluent, highly educated "deadbeats"-people who were paying off their credit cards. The price premium paid when Citibank purchased this card was because of the marketing base that it offered.133 It wasn't making money on credit cards; it could only make it in the one-stop-shopping business model that emerged when Travelers purchased Citibank.134

There are some very important issues here that bear on the question about consumer rights. If the profitability of some of these portfolios is driven by access to consumer information, what provisions are there in place to protect privacy and consumer rights?

Just to give you a sense of the evolution of the top ten credit card issuers-you really need a scorecard, because it happens so fast. Clearly, what we are seeing is an industry that will be driven, probably, by about five major players.

What is intriguing now is the growth of the debit card industry. Who would have thought that could be such an important, billion-dollar industry, to the point now that even Capital One has created a debit card product that decouples the debit card itself from the bank that you actually have your deposit account with? You can get a Capital One debit card that could access your funds from Citibank, and it will be accepted in a national network.135

The evolution of this industry is still continuing, largely technologically driven. It provides new, different opportunities.

I present this particular table in terms of outstanding consumer debt because it shows the shift as the profitability of credit cards became more and more central to retail banking.136 You see a shift in terms of the proportion of revolving credit card debt versus installment debt. The intriguing thing is, in the 1989-90 recession, we actually see for the first time that revolving credit card debt actually expands.137 We talked earlier about pricing through credit-scoring systems.138 Banks were beginning to recognize that there was an opportunity to dilute their riskaverse underwriting standards and begin to expand the debt capacity of individual consumers, which will then lead to other issues about collecting that debt.139

Credit card usage is exploding; tack onto this debit cards. Are we headed towards a cashless society? No, but we are certainly talking about a society where all our personal, private information is not only accessible to those that we are not aware of, but there aren't protections for it. They primarily argue that this is going to provide consumer benefits in terms of marketed products that the scoring system will say we are most interested in, but again that belies the fact that there just hasn't been enough investment in terms of protecting that information.

The top ten credit card-issuing banks, along with the two major associations, spent approximately $20 billion last year in marketing.140 How much has been spent in terms of protecting and upgrading the security protocol systems of our private, personal information? The $20 billion-I think we could see a little bit more taken out of that to protect our private information.

Similarly, credit card marketing solicitations exceeded 6 billion in 2005.141 Notice that the yield is continuing to diminish, all the way down to less than half a percent in 2005, with a slight uptick today.142 Part of this is reflecting the subprime crisis, people paying off credit cards with their refinancing and home mortgages.143 Now, they can't sell their homes; they can't refinance; they are now much more receptive to even less desirable credit card offerings.

Who the deadbeat is from the credit card industry is very clear. One of the reasons I want to emphasize this point is, what other banking product is there that is actually offered to lose money, in terms of administrative costs? If you pay off your credit card at the end of the month, you receive customer service and loyalty reward programs, as well as a free loan.

I like to explain the cultural history that underlies our cognitive views that are negative about being in debt. We essentially self-punish, each of us, over our debt because of the negative connotation that it holds. That is one of the arguments for why, if you pay off your credit card at the end of the month, you get rewarded with a free loan. This becomes a real problem to the industry, as we see that so many people were paying off their credit cards through refinancing. We are now seeing that uptick again. The question is, "What is the quality of the debt that is increasing at this point in time?"

Keep in mind, as you look at the statistics-and we are looking at the magnitude, in terms of risk assessment of these portfolios-there has been a big discussion about, "Gosh, the stabilization of credit card debt means that Americans are making better choices. They are more informed," et cetera. The reality is that this temporary plateau is largely based on refinancing of credit card debt into home mortgages and a significant uptick in discharge rates prior to the 2005 Bankruptcy Reform Act.144

Much attention has been paid to information and ease of understanding. Of course, anybody who has actually read their credit card contract knows that it has been written by a risk-averse lawyer. It actually has increased. In the Banking

Committee145 last year, there was a member who brought out some of his old contracts. He pointed out how ten years ago the contract was ten pages; today it's thirty-five pages. The assumption is that consumers are even more knowledgeable and informed than ever. The reality, as we look at the increase in consumer debt, and particularly the penalty pricing that emerges, is that we see a very high statistical correlation between the growth of economic inequality in America and the desperation of financially distressed groups of people that will accept virtually any financial terms for a consumer loan.146 Some of these deals are quite astounding.

In terms of where the major banks are headquartered today, there is only one major bank-and that's a nice trivia question-that is actually in a state that has an interest rate cap. That is Bank of America, at 36% APR.147 All the other banks are in states without usury law caps.148

This is a table,149 as we talk about pricing-and I want to show profitability-that is simply looking at the spread between a blue-chip loan,150 car lending, and credit card lending. It doesn't include fees. You can see how extraordinarily profitable this industry has become, exclusive of fees. The credit card industry became more profitable and became the engine of growth for retail banking. More and more resources were deployed to expand, not only in terms of depth of the average level of credit card debt, but also into less creditworthy markets-what is often referred to as "the democratization of credit." But, at what cost?

This is really the report card of the credit card industry. If we want to look at where the revenues come-Jeff was talking about interchange fees-you can see how extraordinarily important interchange is to the industry. Interest last year: $75 billion.151 Interest rate revenues are increasing again as the cost of bank funds continues to fall. Furthermore, what is most striking is the tremendous growth of late and overlimit penalty and cash-advance fees (over $14 billion),152 along with annual membership fees (over $3 billion)-totaling over $17 billion in 2006.153 That is just fees alone. I am talking about interchange fees. Transaction fees alone are almost net profits of the industry.

We were talking about information to consumers-if one focuses on interest rates, one is only scratching the surface of what pricing is all about.

One of the interesting subtexts about this discussion was that the credit card industry, for seven years, emphasized how the risk of expanding more and more into less financially strong markets required a much stronger bankruptcy bill. Yet, ironically, the profitability of the industry had its sharpest increase during 2005, when the bankruptcy law was passed.154 What does this mean to us in terms of issues dealing with consumers?

I am going to focus on the issue of safety and soundness of the banking system. Where is the balance of consumers in this process? For example, there was a lot of discussion by the OCC Advisory about increasing minimum payments.155 There was a lot of misinformation in the media, that increasing minimum payments was a way to help consumers regain control over their debt situation. The reality is that the intent of federal regulators was to purge unperforming credit card accounts from lender portfolios that were primarily associated with financially marginal borrowers that were entrapped in fee-harvesting, subprime credit card programs. Their goal was to cleanse bank debt portfolios so that regulators and potential investors could more accurately assess the value of these assets.

The consensus that emerged from regulators was that negative amortization was certainly a practice that should be not only frowned upon, but not tolerated. 156 In fact, from my discussion with regulators, three months of negative amortization really becomes the litmus test of when it really smells bad. Yet, we are seeing the emergence of a subprime credit card market that is based almost exclusively on negative amortization.157

I have been on cases where top-five card issuers have issued lines of credit for $300, and they would charge $178 in fees.158 There is another major issuer who has a "multi-card harvesting practice," where as soon as the $300-to-$500 line of credit has been exhausted, largely with fees, then another card is issued.159 That way, you can have a low-income or distressed consumer with five credit cards, and you could harvest maybe four or five or six different fees each month. That is the way in which this negative amortization process continues.

Some of the other issues I find disconcerting include this effort of binding arbitration. There have been some cases introduced about collusion in arbitration contracts. This limits consumer options in terms of class-action lawsuits.

Federal preemption has focused on, as a national market, that we no longer have personal local relationships, and banks need larger empirical, objective information, like credit scores, to assess the quality of their customer so they can make appropriate risk assessments.160 Federal preemption limits price competition, because there aren't any kind of regulatory limits; the major states no longer have interest-rate caps. The 1991 Smiley decision extended that also to fees.161

Most disconcerting to me was the 2002 California Lockyer case.162 I was actually an expert witness on that case. Federal preemption was extended to disclosure.163 If we are trying to make sure that consumers make informed decisions, the real question is why can't we push for stronger efforts of compliance to improve disclosure at that level?

The last thing I want to emphasize is the rise of predatory lending, deceptive marketing practices, and the emergence of securitization, where servicer and investor relationships mean that when your credit card or other consumer debts have been pooled and resold into assetbacked securities, your consumer rights have dramatically changed, not only from the servicer in terms of who actually holds your debt and is processing your payment, but also in terms of the Class B and C tranches of investors who are now basically taking some fiduciary control over your debt. If you go to court and you are going into a settlement or a bankruptcy, sometimes people find that their debts have been sold into an asset-backed security, and they can't go through that process. It's a whole different ballgame, as more and more consumer debt gets repackaged into asset-backed securities.

Thank you.

MR. MACDONALD: Before we take questions, I come back to some of the points made at the beginning: Keep your eye on regulation. If you look at a timeline here, the woes that both speakers talked about arguably have gone in tandem with the consolidation of the industry. The bigger it has gotten, the more it has approached an oligopoly market, the more the bad behavior seems to come to the fore. That is important.

Banks have a responsibility, and the regulators have a responsibility, under safety and soundness standards, to protect their reputations. Consumers have to trust that banks are going to look out for them. Trust is important, fiduciary duty is important, and reputation is important. If we have seen anything in the last five years, it is, in fact, harm to all three of those. You should ask yourself, "Why is that happening?"

QUESTION: I have a question for Mr. Shinder about the private litigation surrounding the interchange fee. You mentioned, if the class claims are successful, this will lead to a change in how the interchange fee is set. I was wondering what you think will be the likely result.

MR. SHINDER: If I had to handicap the case, I think they are going to have a hard time getting the class certified. The first big moment in that case is the class motion-having lived this in the Wal-Mart case, where I think the hardest thing we achieved was getting the class certified.164 That went all the way up to the Supreme Court.165

Interestingly, the precedent that we used has been clarified by the Second Circuit.166 They are in the same courtroom. The standards are a little harder. I think we would have satisfied them-a little bias-but I think this class is going to have a hard time getting certified.

Whether the cudgel of antitrust and blowing the system up is the best way to deal with interchange is unclear to me. I don't like what happened in Australia either.167 I look at the numbers that Bob put up, and you can see how this industry probably could survive without interchange. It leaps right out from those numbers. The argument that was initially made to defend the system was that interchange is necessary to give issuers incentives. Obviously, it's not anymore. That said, to just eliminate it could have significant effects on the system that are hard to predict.

QUESTIONER: I know one proposal would be to have the issuing banks negotiate individually with the merchants, rather than having it set by Visa and MasterCard-perhaps a consortium of smaller issuers. Do you think that would be a workable solution?

MR. SHINDER: You are talking about a system of bilaterale, actually, with the issuers and the large acquirers. That could be the solution. Now you have a situation that you didn't twenty years ago-it sounds like you know something about this industry-where the First Datas of the world and large merchant processors aggregate millions of merchants and perhaps could cut deals where there is equal bargaining power brought to the table. As you have seen, the issuer side has consolidated significantly.

That could be a solution. That's one of the arguments that the merchants, I assume, are going to proffer, that they don't need this system anymore. Back in 1985, they were exchanging paper.

MR. MACDONALD: If I could add a couple of comments. If you are on the defendant's side, and you are the banks, at least as far as prosecution of the case goes, you don't want to class-certify it, because it puts relentless pressure on you. You want to settle maybe at a higher price.

On the other hand, if you want to privately settle with the plaintiffs, you want a class because you want a universal settlement. If there are 200 plaintiffs on the marquee of the lawsuit, you want 6 million plaintiffs when you do the settlement. What good is it for you? That's point number one.

Point number two: In price fixing, it gets back to reputation. I would argue that the central sacrilege in commercial law in the United States is price fixing. With the exception of, maybe, environmental damage, oil spills and what have you, price fixing is the worst thing. If a decision were to come out as a result of a jury in Brooklyn deciding that the banks engaged in price fixing, it is a terrible, terrible headline for the banking industry. You guys are not only scoundrels, you fixed prices.

Which again begs the question: Where the hell were the regulators? Where is safety and soundness? Where is regulation? Is it laissez-faire all the way?

And so it ended quietly. The world ends with a whimper, not a bang. Thank you very much.

**GRAPHIC:** References

**LOAD-DATE:** July 22, 2008

# Exhibit D

# Visa International Operating Regulations
# Core Principles

Effective 15 April 2013

# 9.0 Dispute Resolution

Most transactions move smoothly through the Visa system and are processed, posted and paid without issue. There are times, however, when transactions may be disputed, either by the cardholder or issuer for improperly processed transactions. Visa has established rules and processes for issuers and acquirers for efficient dispute resolution that balances the interests of all affected parties, including their respective customers; a benefit not readily available with cash and check purchases.

9.1 Participating issuers are responsible for accepting and attempting to honor all transactions, but they may have rights to return transactions for reasons specified by Visa. These reasons can include events such as inadvertent processing errors, some types of fraud and certain cardholder disputes.

9.2 Participants in the Visa system agree to attempt to offer mutual assistance to other participants to resolve transaction disputes prior to escalating the dispute to Visa for final resolution.

9.3 Visa participants agree to take appropriate action to prevent unjust enrichment to themselves or their customers by failing to credit a customer for a transaction that is charged back, or by taking multiple credits for a single transaction.

9.4 For unresolved transaction disputes, Visa acts essentially as an arbitrator between participants.

# 10.0 Pricing, Fees and Interchange

There are costs to all participants in the Visa payments model to ensure the efficient and secure functioning of the Visa payments network and the maintenance and promotion of the Visa brand, just as there is a cost to issuing and accepting cards. Visa sets pricing & fees for its products and services based on dynamic and competitive market forces.

10.1 Visa system participants pay fees to Visa for access to and use of Visa products and services. Visa establishes certain fees between issuers and acquirers for specific participant actions such as rewards paid to store clerks for card recovery or the fulfillment of sales receipt copies.

10.2 Participating acquirers and issuers pay or receive interchange every time a Visa product is used. For example, acquirers pay interchange to issuers for purchase transactions and issuers pay interchange to acquirers for cash transactions and credit vouchers. In the case of a credit or a chargeback, interchange flows in reverse.

10.3 Interchange reimbursement fees are determined by Visa and provided on Visa’s published fee schedule, or may be customized where members have set their own financial terms for the Interchange of a Visa transaction or Visa has entered into business agreements to promote acceptance and card usage.

# Exhibit E

MasterCard
Worldwide

# MasterCard Rules

14 June 2013

**NOTE**

**An addition to this Rule appears in Chapter 13, "Latin America and the Caribbean Region Rules."**

### 9.2.2 Settlement Finality

**NOTE**

**Rules on this topic appear in Chapter 12, "Europe Region Rules."**

## 9.3 Interchange and Service Fees

A Transaction cleared and settled between Customers gives rise to the payment of the appropriate interchange fee or service fee, as applicable. The Corporation has the right to establish default interchange fees and default service fees (hereafter referred to as "interchange fees," "service fees," or collectively, "fees"), it being understood that all such fees set by the Corporation apply only if there is no applicable bilateral interchange fee or service fee agreement between two Customers in place. The Corporation establishes all fees for Interregional Transactions and Intraregional Transactions, and may establish fees for Intracountry Transactions. The Corporation will inform Customers, as applicable, of all fees it establishes and may periodically publish fee tables. Unless an applicable bilateral interchange fee or service fee agreement between two Customers is in place, any intraregional or interregional fees established by the Corporation are binding on all Customers.

**NOTE**

**A variation to this Rule appears in Section 10a, "New Zealand Rules," of Chapter 10, "Asia/Pacific Region Rules."**

## 9.4 Establishment of Intracountry Interchange and Service Fees

This rule is applicable only to Intracountry Transactions.

If intracountry interchange and service fees are not established by the Corporation, such fees may be established in one of two ways: by agreement of Customers in the country as set forth in Rule 9.4.1, or by application of intraregional interchange and service fees to Intracountry Transactions as set forth in Rule 9.4.2. Such fees may also be established by bilateral agreement between two Customers as set forth in Rule 9.5.3.

For any Transaction that is subject to a bilateral agreement between two Customers, the interchange and service fees set forth in the bilateral agreement prevail.

# Exhibit F

For Opinion See 2011-2 Trade Cases P 77654 , 2010-2 Trade Cases P 77224 , 2009 WL 3367059 , 2008 WL 1787674 , 2007 WL 4350707 , 2006 WL 1582166 , 2006 WL 1025588 , 2005 WL 2100930 , 2005 WL 2077286 , 297 F.Supp.2d 503 , 2003 WL 1712567 , 2003-1 Trade Cases P 73995 , 2002-2 Trade Cases P 73866 , 2002 WL 31528478 , 192 F.R.D. 68 , 190 F.R.D. 309

United States District Court, E.D. New York.
In re: VISA CHECK/MASTERMONEY ANTITRUST LITIGATION.
No. CV965238.
September 25, 2003.

Settlement Conference

For the Plaintiff: Class, Constantine & Partners, 477 Madison Ave, New York, NY 10022, by: Lloyd Constantine, Esq., Robert L. Begleiter, Esq, Matthew L. Cantor, Esq., Stacey Ann Mahoney, Esq., Gordon Schnell, Esq., Mitchell C. Shapiro, Esq., Jeffrey I. Shinder, Esq.

Before: Hon. John Gleeson.

THE CLERK: All rise.

THE COURT: Good morning everybody.

MR. CONSTANTINE: Good morning, Your Honor.

THE COURT: Please be seated.

THE CLERK: Do you want all of the parties to state their names?

THE COURT: No.

COURT REPORTER: Thank you, Your Honor.

THE COURT: Okay.

This is, obviously, the settlement hearing with respect to the proposed settlement of the Visa Mastercard antitrust case.

I am going to proceed this morning substantially in the way proposed in the letter from Mr. Begleiter, dated September 16th, with some modifications.

I will allow lead counsel for the Class to give a short description of the settlements, the allocation plan, and the petition for award of fees and reimbursement of costs. I will allow 30 minutes for that.

The I will hear from the objectors who want to be heard from. Let me empathize at the outset that I have read these objections. It is not useful simply to repeat them. I am going to give you an opportunity to be heard, but don't feel constrained to get up and repeat what is in your papers as though nobody has read them. I have. So you don't need to speak if you don't want to.

I want to hear first, assuming that he still wishes to be heard orally, from Mr. Schonbrun. Who will be limited to fifteen minutes. I recognize some people and not all. Some have made specific applications for amounts of time. To the extent that you have, and I am granting less than what you have asked for. Obviously, to that extent, overruling your request.

I want to hear last from Mr. Grossman. Let me first ask, Mr. Schonbrun, are you present?

MR. SCHONBRUN: Yes, I am Your Honor.

THE COURT: Do you still want to be heard.

MR. SCHONBRUN: I would, Your Honor.

THE COURT: All right.

I want to hear last before I hear once again from the plaintiff's counsel, from the lawyers who will argue the two release issues. They are. if I have my notes correct, Mr. Grossman on behalf of Nu-City Publications, Inc.

Are you present?

MR. GROSSMAN: Yes, I am Your Honor. I would like to be heard.

THE COURT: All right.

You don't have to take all of the twenty minutes that I will allow you. But I will allow you up to twenty minutes.

The second of those is Mr. Flamm. Are you present, sir?

MR. FLAMM: Yes, Your Honor.

THE COURT: Do you want to be heard orally?

MR. FLAMM: I have a pending motion for pro hac vice admission for Mr. Archer

THE COURT: Granted.

Do you want to be heard orally?

MR. ARCHER: Yes, Your Honor.

THE COURT: All right. You two can speak up to twenty minutes. Again, I want to hear from you at the end of the line of objectors who will speak orally.

Mr. Helfand. Steven Helfand.

MR. HELFAND: Yes, Your Honor.

THE COURT: Are yo present?

MR. HELFAND: Yes.

I would like to be heard. My co-counsel, Mr. Davis, will be making a brief presentation.

THE COURT: All right

MR. DAVIS: Good morning, Your Honor.

THE COURT: I am glad to hear it will be brief. It will be no longer than five minutes.

MR. DAVIS: Yes, Your Honor.

THE COURT: John Pentz.

MR. PENTZ: Present, Your Honor.

I would like to be heard.

THE COURT: On behalf of Round House, is that correct, doing business as Smuggler's Cove?

MR. PENTZ: Yes, Your Honor.

That is correct, Your Honor.

THE COURT: I am limiting your argument to ten minutes, Mr. Pentz.

MR. PENTZ: Yes, Your Honor.

THE COURT: Beaches and Cream is represented by Nicholas Fasto. Who is not present, I take it? I will take his objection in writing only.

Leonardo's Pizza By the Slice is represented by John Duane.

MR. DUANE: Yes, Your Honor. Good morning, Your Honor.

We would like to be heard. I have a pro hac vice motion pending.

THE COURT: I take it that you are a member of good standing of the bar of a state, at least one?

MR. DUANE: Your Honor, I am a member of this bar.

THE COURT: Okay.

MR. DUANE: I have my co-counsel here, who is a member in good standing of the bar of the State of Ohio.

THE COURT: Which one of you will argue?

MR. DUANE: Mr. Cochran will argue.

THE COURT: All right.

MR. DUANE: If the motion is granted.

THE COURT: You are moving for his admission pro hac vice?

MR. DUANE: The motion is pending, Your Honor.

THE COURT: All right It is granted.

MR. DUANE: Thank you, Your Honor.

THE COURT: He may argue for up to five minutes. I am sorry. Say his name again.

MR. DUANE: Ed Cochran.

THE COURT: Cochran?

MR. DUANE: Yes, Your Honor.

THE COURT: C-O-C-H-R-A-N?

MR. DUANE: Yes, Your Honor..

THE COURT: Thank you.

J. Scott Kessinger, are you present?

MR. PENTZ: Your Honor, he is not. I will be speaking on behalf of his objection also in my time.

COURT REPORTER: Your name again, sir?

MR. PENTZ: John Pentz.

THE COURT: Spell your last name.

MR. PENTZ: P-E-N-T-Z.

THE COURT: Okay.

You represent Kicker's Corner of Americas?

MR. PENTZ: I don't.

Scott Kessinger does, who I am appearing for today.

THE COURT: Who do you represent?

MR. PENTZ: I represent Smuggler's Cove.

THE COURT: Well, they are already being heard.

MR. PENTZ: Okay, fine.

THE COURT: I will take Kicker's Comer of Americas objection on submission.

R. Stephen Griffis on behalf of Sound Deals and Digital Playroom.

MR. GRIFFIS: Yes.

THE COURT: You sought thirty minutes.

MR. GRIFFIS: No more than that, Your Honor.

THE COURT: All right, good. I will limit you to ten minutes.

THE COURT: Charles Thompson indicated in his objection no intent to appear. I take it Mr. Thompson is not present.

MR. GRIFFIS: Charles Thompson and I submitted a consolidated brief on behalf of our clients and his clients.

THE COURT: Okay.

So you will be heard on behalf of everyone.

MR. GRIFFIS: Yes.

THE COURT: After Mr. Schonbrun I would like to hear, if he wishes to speak orally, from John Rasmussen.

Is he present?

MR. RASMUSSEN: Yes, Your Honor.

I will be vary brief.

THE COURT: I will limit you to ten minutes, sir.

THE COURT: William Kenneth C. Dippel.

MR. DIPPEL: Yes, Your Honor.

THE COURT: Do you wish to be heard orally, sir?

MR. DIPPEL: Yes, sir.

THE COURT: You are Limited to ten minutes as well.

Young Pioneers and others have withdrawn their objection. Is that correct?

MR. CONSTANTINE: That is correct, Your Honor.

THE COURT: Kem??e D. Hutz??er?

MR. GRIFFIS: That was the other firm, Your Honor.

THE COURT: Right. Okay.

Thank you, Mr. Griffis.

THE COURT: These is a pro se objection, Morris Dia Perv??a. He indicated no intent to appear. I assume Mr. Perv??a, forgive the mispronunciation, is not here.

Everyone is silent. He must not be here.

THE COURT: Paula McM??an from Southern Lady Rowers or representing Southern Lames Rowers.

Are you present? That is pro se objection which I will take on submission.

Douglas Cole? There is silence. He is not present. I will take Wagner Bakery's objection on submission.

Are there any objectors who are present through counsel who wanted to be heard, or pro se who wanted to be heard orally whose names I haven't mentioned?

(No response.)

All right. Who will speak first on behalf of the plaintiffs?

MR. CONSTANTINE: I will, Your Honor.

Good morning, Your Honor. My names is Lloyd Constantine for the record, I am accompanied today by my co-lead counsel, Bob Begleiter, and George Sampson of the form Hogan Berman. We are also joined today by Professor John Coffee from Co?? University. Who is up front here. We have Professor Franklin Fisher, from the Massachusetts institute of Technology, who has been our economist throughout these proceedings.

There are four motions before the Court, Your Honor. There is the motion for a final approval of the merchant's settlement with Visa, the motion for final approval of the merchant's settlement with Mastercard, a motion for approval of the plan of allocation, and our petition for costs, expenses, and attorney's fees.

I am going to try to address all of these issues either now or later. I will try to answer all of your questions and all of the objections raised by the objectors.

If I need assistance in certain areas I am going to call on the following people. I will introduce them. Anything that gets to the esoterica of the plan of allocation, I will call upon my partner Jeffrey Shinder.

The entire noticed plan, both the noticed plan which we implemented last Fall under court order, and the one which was implemented this Summer under court order, and anything about the other ways in which we have publicized the settlements, pertinent documents relating to the case, and made available to the public information about the case, about the settlements, etcetera, my partner Mitchell Shapiro.

Anything concerning the fee audits which my firm conducted, and which we had conducted by an independent outside auditor will be addressed, if it gets to be detailed by my partner Stacey Mahoney.

Anything relating to the esoteric of the law relating to releases, I will turn to my partner Matthew Cantor.

In terms of ?? we get into details on either of the settlements with Visa or with Mastercard or the law relating to the expenses or fees, my partner Gordon Schnell.

And anything that gets into the realm of procedure, obviously, we will turn to Bob Begleiter. If I become incapacitated or incompetent during the hearing, we will also turn to Bob Begleiter.

I would like to very briefly address some of the most important provisions of the settlements with Visa and Mastercard and of the plan of allocation also even more briefly.

We already responded in writing to the objections to the lee petition. I hear your admonition not to repeat what we have already given you in writing and I will not do that. I will try not to. I will generally reserve anything that I have on the objections until after the objectors had their time to speak.

The settlements with Visa and Mastercard I would like to just go quickly through them. The centerpiece of the settlements, and indeed the centerpiece of the case from the time it was fled in October of 1996 involved the Visa and Mastercard arrangements, ??eing the acceptance of debit card transactions to their branded credit card transactions.

On January 1st, 2004 those tieing arrangements end pursuant to the proposed settlements. I think I want to note also that although when the case began it was, as I say, the centerpiece of the case to end those tieing arrangements.

As part of the settlement there would also be an untieing beginning next year of other cards which have been defined as print of sale debit devices such as payroll cards, such as the Visa payroll cards, stored value cards, prepaid cards, electronic benefits transfer cards, and etcetera.

All of this, this centerpiece of the settlement, the untieing provision has been valued in declarations which we filed with the court by Professor Fisher over the course of the next decade at somewhere between 25 billion dollars and 87 billion dollars.

Second, as we speak although I am standing before you seeking final approval, there are already notices going out and between August and December of 2003 some 25 -- at least 25 million notices are going out to members of the Class notifying them of their new rights under the settlement agreements, and in particular their rights to accept or reject debit or credit untied from the other as of January 1st, 2004.

Also during the next few months signage will be made available to merchants which will allow them to signify to their customers whether or not they continue to choose, they choose to continue to accept off-line debit cards or these other point of sale debit devices.

The next provision that I would like to address is the one portion of the compensatory relief. The settlement agreements, the Visa agreement and the Mastercard agreement in total provide for 3.05 billion dollars to be paid into settlement funds in ten payments over the next nine years. This will be distributed according to the plan of allocation, which I will briefly address later on.

Again, as we speak, as I stand before you seeking final approval of the settlement agreements as of August 1st, some seven weeks ago, interim debit rate reductions are already in place.

We have valued this and Professor Fisher has filed a supplemental declaration with the court which places the total reduction and interchange for the period of August through December of this year at 846 million dollars.

Your Honor, I think it is important to note that, again, although we ere seeking final approval of the settlements, since these began in August of this year there has already been some 300 million dollars in compensatory relief received by members of the Class prior to final approval.

I think that is an important achievement of these settlements and I think it is, if not, unprecedented. It certainly is not something that I have been aware of in other cases.

Indeed, 300 million dollars would represent one of the largest recoveries in a mega-fund antitrust case in and of itself, and that relief has already flowed to members of the Class prior to final approval.

The next provision that I would like to mention is a prohibition on any Visa or Mastercard rules which in any sense prohibit or inhibit steering to other forms of payment or discounting as an incentive to a customer to use another form of payment, another brand, or another type of card, or simply another form of tender.

There are in the settlements also mechanisms which will be explored to assist merchants in blocking unwanted debit card transactions if they choose not to accept them beginning in January.

Visa and Mastercard have agreed to hold harmless, and their banks hold harmless for three years any costs associated with blocking such transactions by merchants.

In the settlements there is also a two year prohibition on Visa contracting with any bank to achieve debit card or ATM card exclusivity over any other competing network with the exception of Mastercard.

They can block Mastercard. They can do anything they want with Mastercard. One of the subsidiary - not the leading subsidiary. One of the goals of the case from the outset was to encourage increased competition between Visa and Mastercard.

As you know, one of the allegations in the case was that the reason that many of what we characterize as being anti-competitive acts and conduct had occurred was because of less than vigorous competition between Visa and Mastercard.

So, in the settlements we have prohibited Visa from taking certain actions against other competing networks but not with respect to Mastercard. I will note that their already appears to be some significant knew vigorous healthy competition between Visa and Mastercard. Both of the networks should be complemented for that, certainly.

Last week you may have heard that Mastercard moved before Judge Jones, in the Southern District case, in a kind of quasi lawsuit of its own emanating from the settlement in this case. Without taking any position on the merits of that particular thing, one certainly healthy sign of competition between real competitors is that they sue each other.

Another provision that I would like to mention, Your Honor, is that Visa and Mastercard banks over the next three and half years will be giving unique electronic identifiers to their projected more than 250 million point of sale debit cards, with 80 percent compliance with that electronic identification requirement achieved by July 1st of 2005.

The last one that I would like to mention now, Your Honor, is that over the same three and a half years Visa and Mastercard and their banks will be reissuing and rebranding the estimated 250 million debit cards with clear conspicuous uniform new debit identifiers.

I again want to compliment the defendants on this. They have done a really wonderful job in this respect. I would like to actually show you what they have done.

First, I would like to show you what an example of a Visa debit card looks like before this settlement. This is just one of certainly thousands of different designs. This is the ??lvern Federal Savings Bank line of credit card. But that, in fact, is a debit card.

Now I want to show you the new Visa design. You see dearly, conspicuously, uniformly debit will always be right above the hologram and agreed to capital latters, and agreed to size. I think they have done a wonderful job there.

I would like to show you what the Malvern card will look like with the new debit identifier. Can you do that, Kevin? This is before and after.

I would like to show you the same thing with respect to Mastercard, Your Honor. Please show an existing or a previous debit card. Your Honor, you didn't think we would bring all of this equipment in without using it did you?

(Whereupon there was laughter.)

Thank you for bearing with us. This is the St. Lake Parish Federal Credit Union easy money card. In fact, it is a point of sale ?? card. Now, I would like to show you the new Mastercard design. It is quite ??, elegant, simple. clean, and conspicuous. What you can't see, which I have seen is that within the hologram there, within debit there are numerous scares of Debit. Mastercard, and Mastercard Debit, which even makes it more conspicuous and somewhat more beautiful.

You can see how long I have worked on this case, when I start to thank that debit cards are beautiful. But in any event. I think a is quite an elegant design. It will also help prevent fraud. They did a wonderful job here.

I would like to show you what the St. Luke Parish Federal Credit Union card looks with the new debit identifier. This is before and after.

The importance of this is that, as you know from our various submissions, and as you know from the summary judgment submissions, as you would have heard had we proceeded with the trial after picking the jury, that there was very very significant confusion.

It is not only among Class members but certainly among consumers in the United States about what these cards were. I think that with the rebranding that Visa and Mastercard have agreed in, and that their banks are going to undertake, virtually all of that confusion should be eliminated.

I thank it is one of the most important aspects of the settlement. Commenting on all of this Professor Coffee, who is here, has stated that this is probably the largest Class action settlements ever presented to a federal court for its approval.

He has also stated that quote, “Projected benefits from this action are in order of magnitude greater than any benefits that have ever been presented to any court in the context of Class action litigation.”

He has also stated that in short, properly viewed, this is a landmark injunctive action to which is appended over three billion dollars in compensatory relief.

Professor Robert Lande, from the University of Baltimore, echoed that sentiment when he stated quote, “As eye catching as the three billion dollar settlements are the future savings to consumers from this case are likely to be even larger.” Having to do with things like rebranding and certainly the untieing provision which is the centerpiece of the settlements.

Professor Arthur Miller of Harvard has stated, quote, “There has never been an antitrust Class action as complex, as risky, and as hand fought that has led to similar beneficial results of the Class and the public at large.”

W??and Ogburn, who is the head of the National Consumer Law Center, said quote, “The settlement agreements should significantly alleviate consumer, particularly low income consumer harms caused by the on or all cards, rules, and practices.” And part of that relates to the widespread confusion about the debit card designs.

Professor Harry Furst from New York University has stated, quote, “The plaintiff's counsel did an extraordinary job representing the Class in this extremely difficult and highly risky case. The settlements they have achieved are historic. It is beyond anything that I might have predicted when this litigation was commenced. It is hard for me now to imagine any better result.”

Let me briefly address the plan of allocation. Which is the way in which we will give back one portion of the compensatory relief, the 3.05 billion dollars. Which gets paid into the settlement funds pursuant to the proposed settlements.

Beginning 120 days after the effective date, which is essentially 120 days after approval is final, meaning after the expiration of all appeals, etcetera. Virtually all of the Class members, the vast majority of the Class members will get notification. They will get notification that their claim has already been calculated for them.

Again, I have to compliment the defendants. The reason that that has happened is because the defendants have been very forthcoming in opening up their data bases to us. Is has not just been formulating and token assistance. They have gone the extra mile on opening up their data bases to us, and helping us with that. In helping the claims administrator in the Garden City Group, and working with our firm to be able to calculate those claims for the vast majority of Class members.

So 120 days after final approval or after approval is final, assuming that you grant approval, the vast majority of Class members will get notification that again that they are members of the Class, that their claim or the great majority of their claim has been calculated for them utilizing the information that we have in these data bases.

There will be very very little beyond that that they will have to do to actually get their first check. All they have to do is simply fill out a claim form, and it will not require any additional records Involving their volume of purchases, etcetera.

THE COURT: How does the plan deal with merchants who went out of business at some point during the Class period?

MR. CONSTANTINE: Many of those merchants who have gone out of business will have been in this data base. For example, the Visa data base that we have utilized Is a data base which begins in October of 1996. So if they went out of business anytime after October of 1996, it is likely that those merchants are still in the data base. But there are merchants who within the Class period, the Class period begins on October 25th of 1992, who are not in that data base. They are dealt with separately.

We, again, I think the hallmark of the plan of allocation was to provide as little burden as possible on all Class members. It was designed specifically with the interests of small class members in mind while taking into consideration large Class members as well. We were guided in this by our experience in the case.

As you know the Class representatives in this case included seven very large merchants. Indeed, the largest merchants in the history of the world, and nine or ten smaller merchants. So we had experience with them.

We found that even the largest merchants were unable to come up with accurate calculations of all of the Visa and Mastercard debit transactions and credit transactions they had received over the course of ten years.

If it is impossible for Walmart to do that. If it is impossible for Sears, which is one of the largest credit card companies in the world to do that. It is impossible for Safeway. It is impossible for Circuit City. It is impossible for The Limited to do that. We felt that it would be beyond impossible for small members to be able to do that.

THE COURT: How does the plan deal with someone, lets say, who went out of business in 1994?

MR. CONSTANTINE: The way the plan deals with them, If they are not In the Visa data base, first of all, they have all gotten notice. They have either gotten notice by first class notice, or they have gotten notice by publication, or they have gotten both.

If they have not gotten notice, they have not gotten first class notice, the notice is by publication and it is not just of that. There is also the wide publicity of that. There are numerous ways in which a merchant can get a claim form.

THE COURT: Is the award to each calculated by reference to the pro rata share of the 3 billion?

MR. CONSTANTINE: Precisely.

It is precisely based upon if you took the three billion or the 3.05 billion dollars, Your Honor, and if a hypothetical merchant represented one percent of all of the Visa and Mastercard debit volume and Visa and Mastercard credit card volume, they would get one percent of the portion. The 91 percent of the fund which is allocated to credit card damages and off-line debit card damages. Nine percent of the settlement funds are allocated to on-line pin debit card damages. They will take according to their proportion of that.

So the hypothetical merchant who represented one percent or one basis point of that overall volume during the ten year Class period, would get one percent of the net settlement fund.

THE COURT: What percentage of it is credit card overcharge?

MR. CONSTANTINE: 21 percent is credit card overcharge, 70 percent is off-line debit overcharge, and nine percent on-line debit overcharge.

THE COURT: About 21 percent is the origin of the over 600 million in monetary relief for the credit card overcharges?

MR. CONSTANTINE: Yes, which we have presently have valued at being something north of five hundred million dollars.

Yes, Your Honor.

THE COURT: What is your estimate, if you have one, as to the amount of money in the fund that is not going to be claimed because, notwithstanding all of these efforts, you are just not going to find the merchants?

MR. CONSTANTINE: Our estimate of that and there are provisions where if, for example, and bearing in mind that there is very little that a Class member has to do to recover the 70 percent of the fund which is allocated to off-line debit damages or the 21 percent of the fund which is allocated to credit card damages, there is more required of all Class members to recover that nine percent of on-line debit damages.

If that difficulty or that greater degree of work results in any significant portion of that nine percent, which is in and of itself a let of money some any percentage of three billion dollars is a let of money. There is a provision for subsequent additional distributions to the members of the Class who have already claimed on their credit card damages and their off-line debit card damages.

We thank that at the end of he day we will be down to very close to the minimum $10,000,000 residual which we have ?? into the plan for unforeseen circumstances.

So it is our intention to try to give all of this money track, and we will do that as long as it is efficient and cost effective. I say when we will do it that will ultimately be your determination, Your Honor, because everything in the plan of allocation ultimately we make recommendations. We have tried to alleviate some of the court's burden by giving lead counsel certain responsibilities. But ultimately at the end of the day it will come to you.

For example, if we make a determination that a subsequent distribution, a second or a third distribution, is not cost effective because the cost of doing that distribution will overwhelm the actual amount distributed we will make an initial recommendation to you. But that will be your call at the end of the day.

So with the vast majority of the class members they will have virtually all of this done for them. Generally

speaking when you do something like that you will be sacrificing accuracy for efficiency. In this case that was not true. Because we know that merchants are not able to come up with ?? information. We know that merchants are not able to distinguish from their processor statements, even those that they still have, debit card transactions and credit card transactions in all case.

Visa and Mastercard actually have in their data bases information which no merchant has. So it will not only be faster, and more efficient, and cheaper, but it will also be much more accurate than anything that merchants could do themselves to make these claims.

THE COURT: They can't tell from their own records whether it was debit or credit?

MR. CONSTANTINE: As you may recall Your Honor, for example, with Mastercard the same interchange rates until August 1st of this year. The same interchange rates applied to credit card transactions as to debit card transactions.

So a merchant locking at the processor statement would not be able, in most circumstances, to understand whether in looking at an interchange category whether that was a debit card transaction or a credit card transaction.

On the Visa side, there has been sine 1993 a discrete interchange category for debit card transactions. However, the record shows that roughly 50 percent of off-line debit transactions actually experience a so called credit card rate because of various technical issues having to do with the way the transaction was processed, the amount of information that was available at the point of sale.

So even with Visa, looking at a processor statement, the most sophisticated merchants in the world or the largest merchants in the world, who we represented, were unable to say with any certainly which of those transactions were debit and which of those were credit.

Visa and Mastercard have within their data bases that information. They have shared that with us and, therefore, would be able to do much more precise calculations than any merchant, a large or small merchant could.

Let me just spend one minute on just quantifying the objections, Your Honor. As you have noted, the Young Pioneer Group, which were eight objectors have withdrawn. That leaves 16 objections representing 26 objectors. That is 1/200th of what the Second Circuit calls a small amount of objectors in the recent D'Amato decision.

It is about 1/6th of what the Third Circuit has characterized as a quote, “infinitesimal” number of objectors in Bolger. There has been no objection to the compensatory relief of this case, the interim debit reductions or the payments into the settlement funds.

There has been no objection, zero objections to the core injunctive relief in the case. There has been no objection from arty major merchant.

I want to stop for a second. All Class members are equal, large, small, major, and minor. I make no distinction between them. The reason I point out that no major merchant has objected is because it is certainly the ability of major merchants who have followed this litigation from the beginning, who have called constantly about it over the last seven years, to understand whether this settlement is in their best interest. There have been no objections from them.

All of the objections, save the objection dealing with the Spanish language notice and the two objections from the Nu-City Group, and Raines, Costa, Beller are from professional objectors.

With respect to the Nu-City Group, four of the Class representatives in that case have filed a statement indicating that they disagree with the Nu-City objection, and that it is essentially a baseless objection.

Although no major merchant has objected to any aspect of the settlement, we have experienced in recent weeks three major merchants trying to opt back into the Class. These were merchants who opted out last Fall, by November of 2002. Now they have looked at the settlement agreement and they said well, I would like to come back in. It is a subsidiary of AT&T AT&T Wireless has attempted to opt back in.

The subsidiary of Ford Motor Company has attempted to opt back in. A subsidiary, or a former subsidiary of Best Buy, the largest consumer electronics company in the United States called Music Land has attempted to opt back in. My Partner, Mr. Shapiro, has notified all of these attempted opt-in's that their attempt to opt back in s ineffective.

Simply because if that right were to be afforded it would have to be afforded pursuant to court order, and it would have to be afforded to anybody.

That is really all that I think I should say at the outset I hope that I stayed within my 30 minutes. I would like to reserve the rest of what I will say after the objectors speak.

Thank you, Your Honor.

THE COURT: Thank you, Mr. Constantine.

Mr. Schonbrun.

MR. SCHONBRUN: Yes, Your Honor.

THE COURT: Just one second, Mr. Schonbrun. I have not turned the clock on yet.

Go ahead, sir.

MR. SCHONBRUN: Good morning, Your Honor. My name is Lawrence Schonbrun. I represent the plaintiff Class member, Roman Bu??olzer, of the Continental Garden Restaurant.

I would like to thank the court for the opportunity to present oral argument on these important issues in the Class action attorney's fee jurisprudence.

Your Honor, at the outset, none of my comments should in anyway be understood to deprecate any of the efforts of Class counsel in this case. However, it has been my experience that one should exercise the highest degree of skepticism in relying on Class counsel and experts hired by Class counsel as to what constitutes a reasonable attorney's fee in a case that they have litigated with hardly an objector.

Your Honor, my first objection is procedural. It involves what I believe are serious due process of law violations. This Class was entitled to have adequate representation in all aspects of this litigation. They have been denied adequate representation at this fee stage of the litigation.

Now I have requested that the court appoint a Class guardian, a fee expert and auditor. I also have requested because I understand that would take sometime, that an interim fee award be awarded to Class counsel. So that they can immediately get some fee, but that a final fee award not be rendered.

Your Honor, what is Class counsel's response to my request? First of all, they say it is not done that way. Second, they say I made this request in Intelligent Electronics, and the court refused and denied it. They state that Judge Sweet in the Nasdaq case refused the same request.

I would respond as follows, Your Honor Class counsel is correct that that is the way it has been done more or less. I did quote to you a judge who, because of this conflict that I talked about, had appointed an expert on behalf of the Class.

The problem is that this is a conflict of interest that has been recognized by the court's but hasn't been acted upon. What I would say to you is that I believe there is a new environment now. An environment that didn't exist when I made this request in Intelligent Electronics or when I made this request to Judge Sweet.

That new environment, I believe, is reflected in the recent issue of Richard Grasso of the New York Stock Exchange, and the conflict of interest issue with regard to brokers paying the salary of someone who is being regulated.

I just read in the New York Times yesterday on the question of conflict of interest, Martin Upton, the question of his multi representation. You also have Enron, and World Corn. All of these cases since I made these requests were conflict of Interest, and the problems caused by a conflict of interest have been brought to center stage.

So I believe that now is an appropriate time to look into this conflict of interest, to remedy this conflict of interest by allowing the Class to have representation. I would also point out that beyond the conflict of interest issue, the system hasn't been working, I believe.

I believe in the Goldenberger case when the Second Circuit, Court of Appeals said in its opinion fees have been too high. They have been awarding too much to lawyers based on risk. The prior system hasn't been working.

The PSLRA which states -- excuse me. The PSLRA was instituted to allow -- because they felt the fees that the lawyers were taking were too high, and this was a way of hopefully trying to reduce those fees, and to put these cases in the hands of clients and not lawyers.

You also have auctions instituted first by Judge Walker out in California. It was used effectively in the Auction House cases here. I believe that all of these problems in the Class action mechanism with regard to attorneys fees confirm the problem that handling it the way it always was done, the way Class counsel says it always has been done hasn't worked and needs to be changed. This I can't think of a more appropriate case to change it than this case here.

How is this case different from Electronics and Nasdaq. First, it is nearly a 500 million dollar difference between the fee in Nasdaq, which was around 130 or 140 million dollars and 609 million dollars. That is half a billion dollar difference.

Secondly, this fee of $??09 million dollars would be the largest fee every awarded in a Class action. On top of that, you have highly unusual circumstances in this case. it should be highly unusual or unusual. To wit, the amount of the fee not disclosed in the notice. Certainly, Class counsel has no right to argue that the Class knew about this fee and there are a few objections to it.

The Class didn't know about this fee because in the very unusual way this fee was not disclosed in the notice. That is number one.

?? two, I have never heard of a situation where Class members are told in a month or two later to look on a web site to find out what the amount of the fee is. I don't think that has ever been done before.

Also, you have the fact than on the web site itself the fee petition was not independently listed. Someone looking at that web site wouldn't know, it doesn't say anything about a specific attorney's fee petition.

Also, you have the unusual clear-sailing agreements. There are certainty clear-sailing agreements. The ones that I am most ?? with are the ones where the amount of the fee is disclosed to the defendant. The defendant agrees not to object to a fee if it is a certain amount. But you have this kind of clear-sailing agreement where the defendants were not given any information about that the fee was that Class counsel would ask for. They contracted not to give any opinion about it.

Also, I think most ?? is the fact that the amount of the fee is not mentioned in any of Class counsel's pleadings. Why is that? Why is this referred to as the 18 percent fee request? Because I believe that Class counsel correctly know that this fee is so high that they don't feel comfortable publicly talking about the fact that they are asking for 609 million dollars. I don't think that it is just an accident that the amount of the fee is not mentioned in their papers.

For all of these reasons I believe that this case is different, that this case warrants the Court's appointment of a guardian fee expert and auditor. Class counsel quotes Judge Sweet for the proposition that, well, of I were to appoint a Class guardian, I would be diminishing my role as a Judge in the case. I don't believe that is correct.

I can cite the Goldenberger case, for example. Where the Court of Appeals here in the Second Circuit specifically requested that the person who was assisting Judge Cram at the District Court level come to the Court of Appeals and argue the Classes position on the issue of the fee.

If Judge Sweet were correct, then the Second Circuit would not have had to do that. They could have said we can handle this, we don't need representation from the Class. The circumstance, Your Honor, is we have an adversary system. The judges they are neutral. They objectively listen to the facts, and they make decisions. They are not advocates for one position. Therefore, this Class is being denied an advocate. I believe they are entitled to on advocate.

I would Eke to talk about fee jurisprudence itself. Your Honor, in terms of fee jurisprudence I am not going to get into the issue that I briefed. There are two questions.

Number one, whether or not Class counsel violated a fiduciary duty in not seeking fees from the defendant but rather seeking fees from the Class in order I believe, understandably Your Honor but I believe improperly, to get them out of the restrictions made which would have denied them a contingent risk multiplier of the one they are seeking 9.74.

I am also not going to deal, because I mentioned in my brief the question of whether the unresolved question of whether DAG applies to common fund. Although, I will point out to you the decision in the In re: Boulder Pharmaceutical case. A case in this jurisdiction. In which that court said that it did, and I think rightly.

Your Honor, what I want to talk about a little bit is the issue of fee jurisprudence. Because Class counsel are citing you cases from the Seventh Circuit, the Third Circuit. the Ninth Circuit, the Second Circuit and acting as if these fees jurisprudences are all interchangeable, and they are not.

The Second Circuit, I believe to its credit, is the only Circuit who has adhered to the original common fund doctrine. It is the Grene?? case by the Supreme Court 100 years ago, which said that fees in common fund cases with moderation, a jealous regard to the rights of those interested in the fund.

The Seventh Circuit most glaringly has totally turned the Supreme court requirement on as head. It does not focus on the Class at this time at all. If focuses on the lawyer. What would a lawyer get in this so-called market.

You have the Third Circuit, the Ninth circuit in varying degrees. It is unclear exactly what their fee jurisprudence is. But certainly both of these fee jurisprudence talk about how much money do we need to incen??vize lawyers to take these case.

Again, total focus on the lawyers and what the lawyers need. When the Common Fund Doctrine was instituted the attention was on the client, the fund

I have talked about whether or not in my pleadings it should be gross versus net, if the Court were to apply a percentage approach. Your Honor, I would like to talk about the lack of retainer agreements. To me it is astonishing that Class counsel would attempt to introduce fee jurisprudence from jurisdictions such as the Seventh Circuit. Which talks about what the mirronng of the private market --

THE COURT: I don't have a red light. So I have to use this thing as a substitute.

(Whereupon the Judge puts a bottle of water up on the bench.)

(Whereupon there was laughter.)

Why don't you take a moment, collect your thoughts, and wrap it up.

MR. SCHONBRUN: Your Honor, I would say that the Goldenberger case, the most recent Second Circuit opinion supports my position in the following ways.

The Second Circuit never approved a 9.74 multiplier. The fee in Goldenberger was four percent It talked about that there is no hard data on market rates. It cited empirical data that recoveries of 50 to 70 million fell in the 11 to 19 percent range. It talked about the data on settlement rates. There is no data on settlement rates with regard antitrust cases. They talked about moderation and jealous regard. They talked about a concern about over compensation. It mentioned the issue that we are not dealing with the nsk of a specific case. We are dealing with Class-wide risk. Which is not addressed by Class counsel or their pleadings.

Thank you, very much, Your Honor.

THE COURT: Thank you very much, Mr. Schonbrun.

THE COURT: Mr. Rasmussen.

MR. RASMUSSEN: Good morning, Your Honor.

THE COURT: Come on up, please.

Good morning.

MR. RASMUSSEN: I apologize. I heard you say that I would follow. The order in which you announced them confused me a lit bit.

Your Honor, I have brought with me today, these were mailed to my office yesterday, a writ and response to the motion that was received last Friday that commented on our objection.

Everything that I need to say is contained in there.

THE COURT: Be careful because then I will just tell you to sit-down.

MR. RASMUSSEN: Well, I will be brief, Your Honor.

Mr. Begleiter, who I have never met, I am sure he is a fine attorney. Interestingly, was counsel, I think for the Secretary of Health and Human Services in the principal case that they cite It was the Perez case. However, Perez along with the other few cases that they cite in every instance involved personal notice, direct notice of some type being sent. Then the courts said when you receive that, even if you are Hispanic, as in the Perez case, all of the plaintiffs were Hispanic. Their dominant language was Hispanic. Each of them applied for a disability benefit or a supplemental Social Security income benefit.

Then anticipating a response they received, each of them personally received, direct notice in English. In that narrow instance the court found that there was no violation of the due process clause.

That is not what has occurred here. In the response to our objection, they have cited I think eight million notices having been sent. However, there is no affidavit from anyone to suggest that our Hispanic clients, whose principal language, whose language in their home, whose radio and television preferences, whose reading preferences are all Spanish were sent any notices.

I am sure if they have some evidence of that notice having been sent them, it would have been in their response. Your Honor, there is about 1.2 million Hispanic and Latino business owners here in America. They represent in my state nearly 25 percent. Generally speaking they are not the business owners, particularly. They are a group that has failed to receive notice of this settlement.

THE COURT: Is your objection that they failed to receive it or they failed to receive it In the proper language?

MR. RASMUSSEN: They failed to receive it in the proper language. Yes.

THE COURT: What was missing from your objection, and if I missed it I apologize. You had some interesting data about the number of Latino and Hispanic merchants. But I couldn't tell what percentage of them were unable to deal with an English language notice. I assume It Is not all of them.

MR. RASMUSSEN: No, Your Honor. What we provided was the most recent census data we could find which was 1997. The 2000 census, Interestingly, did address this subject within the Hispanic/Latino homes in America. The question is asked, as demographers phrase them, which language are you most comfortable with in speaking and reading.

In that sense, as data, the evidence appears to be that approximately one half of the 30 some million U.S. households with Hispanic or Latino, and report themselves to be so, with approximately one half of them Spanish would be spoken in the home. Spanish in the newspapers and television would be preferred. They would indicate that they are not comfortable. They are less comfortable with English than they are with Spanish

To extrapolate from that is all we can do.

THE COURT: Is that the right universe?

MR. RASMUSSEN: No, of course not.

THE COURT: Doesn't that matter?

MR. RASMUSSEN: Your Honor, the general population ??. I thank it is the only measure that I have seen.

THE COURT: ??, what I mean is you are talking about homes.

MR. RASMUSSEN: Right.

THE COURT: The Class members here are merchants.

Does that difference matter?

MR. RASMUSSEN: I don't believe so, Your Honor. For instance ?? our Class members are representative, which we believe they are, one owns a restaurant in a small enclave near the Phoenix Metropolitan Area made up of Yapping Indians. Which are Spanish and Canadian American indians and Hispanic Her entire customer base speaks Spanish.

Having been ?? that restaurant on several occasions I will tell you that I am a minority and English is not Spoken to that restaurant or with some difficulty. Certainly not comprehended and not understood.

The question here is what notice is practical. New Mr. Pine, in his affidavit attached, commented on I think 150 million publications ?? people were reached by this notice process. However, as I point out in our written response, Mr. Pine's in two recent matters, and I can't give you the dates, ?? in fact he designed a notice plan that included a Spanish notice.

The most recent being in a McDonald case. We had 137 million. It reached 137 million people in the McDonald case. In there the had a provision for some Spanish notice, albeit it was modest. We have come to this court and have shown, I think, for the fourth time to a court how simple it is to include the Hispanic Community and the Hispanic Business Community in this instance in the Class action process.

We attach the proper way to put a banner on their so that a person who reads the notice and does not comfortably read English is sent to a web site where he can have access to the settlement in Spanish. And also obviously Mr. Pines, as I mentioned, is familiar with publishing these notices in Spanish and has done so in prior instances. And it should have been done in this instance as reflected by the objectors that we represent, Your Honor.

Thank you, Your Honor.

THE COURT: Thank you, Mr. Rasmussen.

Okay, Mr. Helfand.

MR. DAVIS: good morning, Your Honor.

My name is John Davis. I am co-counsel with Mr. Helfand.

THE COURT: Good morning.

MR. DAVIS: I am speaking here this morning on behalf of Rent-Tech and Rental Solutions. I will be very brief, Your Honor. You read our papers, and a lot of the issues that I intent to be covering this morning were gone over by Mr. Schonbrun. But I would like to make a few comments.

Mr. Schonbrun alluded to the recently controversy with Mr. Grasso. That was what immediately came to my mind when I saw the requested fee award. Counsel for the Class has done a fine job here, but I think when one looks at the sheer magnitude of the fees it sort of shocks the conscience.

Class counsel in their papers urge the court to use the contingency method of determining fees rather than the lodestar method. While that is certainly appropriate, the reason that the lodestar crass check exists is to make sure that there is not the huge windfall to the Class.

So if you have a settlement value of historic proportion like you have here, even if you have a percentage of that, the percentage that is typically given out in cases where the fees are figured on a contingency, that still should not result in a windfall.

In fact, in the Goldberger case and in Granell the courts have said that there should not be a benchmark. There shouldn't be this concept of a benchmark in jurisprudence. It says that, well, 25 percent of the common fund is appropriate in every case.

I think when you really look at the numbers, regardless, I know that there has been a lot of debate about how various figures were arrived at, and there have been some questions about Mr. Fisher's calculations and Mr. Coffee's calculations. I don't question any of that.

What I say is if you look at the actual lodestar that is going to Class counsel here, it is either I think 61 hundred dollars en hour going to Mr. Constantine's firm, or if you use the blended rate and figure in paralegal time, and legal assistance time, I think it works out to be about 27 hundred dollars an hour.

I don't know of any client who would agree to pay 27 hundred dollars an hour for paralegal time. So I just urge the court to give careful consideration to the lodestar cross check when evaluating the requested fees in this case.

One procedural thing I would like to add as an aside, Class counsel raised in its papers the question about the Class members status of my client Rental Solutions. I just wanted to clarify for the record that Rent-Tech is the successor in interest to Rental Solutions. As it said in its affidavit it is asserting claims on behalf of Rental Solutions for any claims that arose prior to the transfer from Rental Solutions to Rent-Tech.

I just want to add one more thing. I would like Class counsel to address and for the court to consider, and that is the time line for payment of the benefits to the Class. I know there has been a lot of talk about cost reductions. May be I missed something, but I still don't think that we know when the money is actually going to go to the Class.

I think it is commendable that Class counsel has taken extraordinary efforts to identify who the Class members are, and to make sure that they get relief without having to file a claim form. I have been involved in cases where there are exceptionally burdensome claims processes, and I commend Class counsel for addressing that in this case. But I think we need to know exactly how and when the payments are going to be made especially in light of the magnitude of the requested fees.

Because it seems to me that Class counsel may receive all of their fees before a substantial amount of benefits flow to the Class. Sort of like when you have a mortgage and you pay interest first, and then the principle later. I wouldn't want to have that.

THE COURT Yes, I have a mortgage. I know that phenomenon.

MR. DAVIS: For the sake of brevity, Your Honor, I would merely adopt the --

THE COURT: Good because I am reaching for this bottle.

MR. DAVIS: Thank you, Your Honor.

I will adopt all of the other objections.

Thank you, Your Honor.

THE COURT: Thank you very much.

Mr. Pentz.

MR. PENTZ: I am John Pentz on behalf of Round House, Inc., d/b/a Smuggler's Cove.

Your Honor, thank you for this time.

I have to first respond to Class counsel's position in their response to the objections that all of objectors are not giving them credit for the enormous amount of time they spent on this case, the high risks, the great result, the difficulty of litigating against two very well represented defendants.

Well, that is not true. In fact, In my objection I begin with the statement that Class counsel spent seven years and incurred 62 million dollars in legal fees pursuing this lawsuit. It resulted in a three billion dollar settlement. They pursued this case on a contingent basis, and received no compensation for this. They are clearly entitled to an attorneys' fee to be awarded out of the Class recovery. I think we can all agree on that

I think if you read my objections you know that my suggestion is a ten percent fee award. Which I think is at the maximum ceiling at least the one that existed prior to the filing of this case, and a multiplier of five.

I would like to point out that when this case commenced, it may have changed now but the Second Circuit was one of the last remaining lodestar multiplier jurisdictions along with the Fifth Circuit They had not accepted wholesale the Third Circuit's recommendation in the Task Force's report that the fees should be awarded on the percent of the fund bass.

So if we are going to talk about expectations and incentivizing counsel, than we have to look at the status of that at the time that the suit was commenced. I don't think there was any reasonable basis for these attorneys to expect at the time that they filed the case that the Second Circuit was going to go for the percentage of the fund, and that this was going to be limited by the lodestar.

As Mr. Schonbrun mentioned, fee shifting, this was brought under a fee shifting statute. Presumably, had it been successful the Class counsel would have been awarded their lodestar but no more. That is the rule that the Supreme Court established in fee shifting cases that are tried to a successful verdict.

Now, when they are settled it is my understanding that you apply a percent of the fund. But that still should be tempered by the rules governing lodestar multiplier jurisprudence. I don't think there has ever been a case where a court applying the lodestar multiplier method awarded a multiplier of greater than five. I can't think of one.

It is an incidental result when the court awards a percentage fee award. They will do the math, and divide the fee by the hours, and say this is the multiplier of seven or nine or twelve. That is completely arbitrary. That is not a principal way of making fee decisions.

I think the fee request in Professor Coffee's affidavit, in my opinion, are positivism gone wild. The reason I say that is it is not a principal way of awarding a fee. Just because a prior court has approved a fee of “X”, to argue that this court should award a fee of “X”.

Because understand that method and, for instance, they are using the Busperon case as kind of tendering that to you as a safe harbor. Here, Your Honor, is post Goldberger. Goldberger called for a moderation in fees. Yet in the plaintiffs, here is a District Court from this Circuit that said it is okay to get a multiplier of eight. So that must be moderation.

Wait a second. Under my standard, which is the normative standard, we judge the data and we throw out the data because it is not consistent with the case law. One indicator would be whether there was an interested defendant negotiating the fee with the plaintiffs or an interested powerful lead plaintiff directly negotiating the fee with Class counsel rather. ?? whether there was a presence of serious objectors and an appeal. Was it appealed up to the Second Circuit.

Now this ?? to my knowledge wasn't even published. I don't before there were fee objections there. If certainly wasn't appealed. So that doesn't count in my world. I wouldn't include ?? my date base.

Of course, as you know from my objection, I think Professor Coffee's date base is a bit selective. I have a little problem with including in your data base a case that is dearly based on an affidavit you filed in a prior case. I mean, you are creating the data.

The first rule of scientist is you don't interfere with the data, the empirical data. And you certainly don't create it to get where you want to go. So I think Professor Coffee should admit those cases where he has filed fee affidavits in the courts, follow those to an award of fees that Professor Coffee wants to get to.

I note that there are a few other case were omitted, Prudential, a two billion dollar fee -- I am sorry. A two billion dollar fund, and it wasn't all cash but it was a claim's fund, and 90 million dollar fee. That is 4.5 percent. I believe that went to the Third Circuit and was remanded with a ?? of five and ended up being a multiplier of two.

Phen-fen and Sulzer, I believe were also omitted. Cendent Prides was omitted from the Coffee affidavit. And Cendent Prides, although again that was an easy case. It didn't last very long. There wasn't much risk. The Third Circuit there went through an exhaustive process. They listed out all prior cases that they could find at the time, and they calculated an average for mega fund cases. It also calculated an average multiplier.

The Third Circuit concluded that no court had ever awarded a multiplier greater than three. So that conflicts with Professor Coffee's affidavit.

Using the data base that Professor Coffee used form Moore and Logan's study, which I have in front of me, if you look at the entire study it studies cases in all different categories. For cases less than $1,000,000 the fee award is 31.4 percent. For every category going up it goes down a little ??. The greatest category is greater than 100 million. Logan and Morgan break it down beyond that. There haven't been that many billion dollar cases.

It goes down from 31.4 to 15.1 in 99 million dollars. So when the fund moves from one million to one hundred million, the fee falls from 31 percent to 15 percent. Clearly, extrapolating out from there I don't see how you can conclude that a mega fund above a billion dollars is twenty percent. It clearly has to go down.

A billion dollars extrapolating out from 15.1, I say you are at ten percent by the time you get to a billion. So Professor Coffee's conclusion that this is a sub-benchmark fee request isn't correct. I think it is all premised on the benchmark being 22 percent which is based on his selective ch??e of data.

His basic rule, what I call the high flow rule is if you have a high fee percentage. A high fee percentage is justified by a low lodestar multiplier and visa versa. I will accept that. I don't think that a huge multiplier of nine or ten or a double digit multiplier is ever justified just because you have a low percentage. I think that is an alternate ceiling on fee no matter how high the fund is.

I just want to talk about the level of risk that would justify a multiplier of ten is almost bordering on recklessness. To hear the plaintiff's Class counsel tell it, and I know this is the case in every Class action settlement that they always want to under value or maybe exaggerate the risk of their case and the difficulty of trying.

Number one, they are trying to justify a settlement and they don't want -- they certainly won't concede that the case can be easily won at trial.

Number two, they also want to make it seem like this was a long shot. What kind of case would justify a ten to one return? What kind of risk is that, and is that risk lawyers should be taking and the courts should be encouraging by awarding fees of that magnitude.

To me that would encourage frivolous reckless long shot cases. What Class counsel did here seems to me to be a little bit crazy. They risked the firm. It was a bet the firm case on a case that really to be a negative lawsuit. It really looked like a huge long shot.

I want to also reinforce Professor - he wishes. Larry Schonbrun's argument that the purpose of a common fund fee award is to avoid unjust enrichment and not to provide an incentive to lawyers to file these kinds of cases. We don't need to encourage the more filing of these kinds of Class actions. There is already enough of an incentive.

In the cases where Congress clearly desires to encourage more litigation, where it is provided for fee shifting, civil rights, Fair Debit Collection Practices Act, FCRA. In those case the lawyers don't get a risk multiplier if they are successful.

So in cases where Congress dearly hasn't identified the need to encourage litigation with greater attorneys' fees, it certainly is not present in this kind of case. Especially where the lead plaintiff could afford to pay for this thing by the hour.

Thank you, Your Honor.

THE COURT: Thank you, sir.

Mr. Cochran.

MR. COCHRAN: May it please the court, my name is Edward W. Cochran.

C-O-C-H-R-A-N.

I am here representing objectors, 710 Corp. and Leonardo's Pizza By The Slice, Inc.

Your Honor, our objections contain matters as to the fee. I will not speak on that at all fully. I will incorporate the comments of other objectors so that they are not repeated.

More to the point, Your Honor, Mr. Constantine I believe mentioned or said something to the effect in his presentation that there were no real objections to the core injunctive relief in this case. I don't believe that is the case. My objection contains about three pages of objections to Paragraph 10 of the settlement agreement with Visa.

Your Honor, within the last two weeks, and by the way, Your Honor, I may represent the only substantive antitrust objection here and the court has suggested the limitation of five minutes. I would informally request an additional five if the court will indulge me.

THE COURT: Go ahead. You got it.

MR. COCHRAN: Several weeks ago, within the last several weeks, Your Honor, the United States Second Circuit has confirmed in a ruling that the agreements of Visa and Mastercard to keep out the credit card services of Discover and American Express are violative of the Sherman Act.

Yet, Your Honor, on that subject in this case which is dealt with only in the Visa agreement in Paragraph 10, Visa is permitted to continue to have agreements restricting their member banks from dealing with these regional competitors except for the next two years.

Furthermore, Your Honor, they are permitted to continue in the meantime in the enforcement of the current agreements during that time with no disclosure to anyone as to the term of the current agreements.

For example, Your Honor, if they have a current agreement with a member bank that is more than two years, clearly the paragraph means absolutely nothing.

If the agreements are annual agreements, then the restriction limiting Visa's activity to two years means almost nothing. Furthermore, Your Honor, there is no such restriction on Mastercard. Why is it if as Mr. Constantine said, and I think I am quoting here, “One of the goals of this case is to encourage competition in the credit card and debit card area.”

Why would they negotiate a settlement that permits Visa and for that matter Mastercard to agree with their member banks to keep out the competition of the regional networks?

This particularly on appropriate objection Your Honor can consider in light of the fact that the Second Circuit's decision occurred after the signing of this settlement agreement, after the preliminary approval of the settlement by this Court.

Your Honor, my written objections go into more detail about why this is such a glaring gap in the settlement agreement. I would submit that any settlement of this case whose announced objective is to encourage real competition and real competition in this area, that also contains a provision that permits Visa and Mastercard to enter into agreements with their member banks that completely exclude these regional members is not an agreement that should be approved by this Court or the Second Circuit.

Thank you, Your Honor.

THE COURT: I like that move. You asked for five more minutes and you give it back at the end.

MR. COCHRAN: Well, Your Honor, I am known for that around the country.

THE COURT Mr. Griffis.

MR. GRIFFIS: Thank you, Your Honor.

Since several attorneys talked about attorneys' fees and I filed a brief in the case, I will probably be very succinct.

I am Stephen Griffis. I represent Sound Deals, Inc. and Digital Playroom, Inc. I am also here for a client represented Mr. Charles Thompson and Ms. Dee Hutsler.

Basically, Mr. Schonbrun made reference to this, and I think the most telling thing in the entire fee application is that nowhere in the submission by the plaintiffs counsel, and nowhere in the 37 page submission by John Coffee Is there ever mentioned of the dollar amount to resolve this case.

According to my calculations it is just under 610 million dollars. I don't think this is an accident, Your Honor. I think when Class counsel and their experts were sitting around and discussing this fee, they knew that we needed to put it in context Because to put it in the notice that we were seeking 600 million dollars, which is 24 percent of the compensatory fund, I think you would have seen this Courtroom filled with objectors.

Naturally, if you don't advertise that fact and you disguise the amount of the dollars and the percentages, there is going to be a lot less controversy about the case.

Basically, in reviewing Mr. Coffee's submission, if you view those cases there is absolutely no support for a fee of 24 percent or a ten times the multiplier in cases where the recovery exceeded 10 billion dollars.

Mr. Coffee tries to distinguish the Cendent case, because in Cendent you had to have a fee agreement between the lead counsel in the security case and the lead counsel from it. But Cendent is a very thorough analysis of the fee setting in these type of case.

In Cendent they looked at three cases where the recoveries were over a billion dollars. In those cases all of the recoveries were under tan percent. In fact, one of the cases - let me get those numbers. I misplaced my notes.

In all three of those case - in one of the case looked at by Cendent there was a billion dollar recovery. The fee was 8.2 percent. Another one was five percent. And the other case was seven percent.

One of the leading cases in this area is in Re: ??. That was a settlement of slightly over one billion dollars. The fee was 14.4 percent. In all of these cases that discussed fees in the mega funds of this magnitude, and there are only a few that talk about these kind of cases, must of them talk about the fees of the 100 or 200 or 300 million dollars range.

But every case in reasonable jurisprudence discusses the fact that as a general rule as the size of the fund goes up, the percentage of the fee comes down. It is only logical. It doesn't take that must more work to take the case from one billion to the two b??lon dollars range than it does for these other cases.

If you look at the cases cited by Mr. Coffee, except that there are a few aberrations, but as a practical cutter as the size of the fund goes up, the percentage of the fee comes down. Certainly, you cross check that with the lodestar. Every study cited indicates that the range multiplier is between two and four and not ten. Those case are cited in my brief. I won't say anything more about that.

The other two concerns that I have about this fee in this case is as Mr. Davis pointed out. Certainly, the allocation plan is totally silent as to when these attorneys fees will be paid. That is a big concern. The Class members should not be put at a disadvantage by having the attorneys' fees paid out of the first available funds. If the full fee is awarded it can be two or three years before any money goes to the Class members. That is certainly not fair and reasonable.

The other concern is the outpatient man is absolutely clear that there will be attempts to secu??e this obligation and reduce this to a present value amount before any payout of the funds. I think that would be a very beneficial result. But what is not clear and I think what is the intent of Class counsel in this case, is that all Class members claims are going to be reduced and discounted.

Whatever fee is awarded by this Court they don't intent to discount. I think it is absolutely essential that this Court address that issue. Because if the Court sets the fee based on the payment over ten years, and everybody else has to be discounted, it is not fair and reasonable to allow Class counsel to have an advantage over Class members on that.

Thank you.

THE COURT: Thank you, sir.

THE COURT: Mr. Dippel.

MR. DIPPEL: Thank you, Your Honor.

William Dippel here on behalf of Preston Center Personal Training Incorporated, from Dallas. My thanks for admitting me pro hac vice.

THE COURT: You are welcome.

MR. DIPPEL: And giving me the opportunity to appear here. I appreciate both my place in fine as well as the significance of the court's water bottles. So I will be quick.

I am confident it was inadvertent but I have been lumped into a group pejoratively known as professional objectors. I think my practice history would show that could not be possible. Particularly, since more than half of it has been spent representing companies the size of the plaintiffs in this case.

THE COURT: As long as you are professional about ??, I don't really care if you are a professional objector.

MR. DIPPEL: I will be much more professional than I will be objectioning, Your Honor.

A couple of factual issues to consider in supplementation of our brief. The original separate memorandum of understanding between the parties was actually reached on April 30th of ??03. I suspect at that time there was consideration being given to the amount of fees that would be requested if not specifically certainly generally.

The court's notice goes out on June 13th. ?? is not until August 18th that any request for fees is actually published, and it is done so on the web site. Which then gives the Class only three weeks within which to lock at that requests, also look at the allocation plan, and then get a legitimate objection in the mail having hired counsel and trying to digest the program.

I suggest that that time frame and the lack of substantive notice is important in this case. In that regard, Your Honor, in the affidavits of Class counsel it is interesting to note that the web site, quote, “has always been lead counsels intention as the communication mechanism for the allocation plan, the sec?? zation issues, and the fees.” But interestingly that web site from the time it went up in June until August 18th, when the fee issue was presented, only 10,700 hits went to that web site out of the millions of merchants.

More interestingly, once the fee request, the securitization, prioritization, and allocation Issues are on the web site on August 18th, depending which affidavit you look at, and I think it is a typo, either 5197 or 5797 hits had been made to that web site. It is less than 6,000 hits were made had been made to the web site where the information actually rests about fees and the allocation program.

That is less than the number of merchants who have opted out of the Class, which are over 62 hundred. Again, a number that has not been mentioned and I think is appropriate to consider.

So I would ask the Court as you consider the reasonableness of the notice and the quality and substance of the notice, as well as the reasonableness of the fees, less hits had been made to the web site by merchants than people who have opted out of this Class.

On the issue of fees, I read Goldberger to say the test is not lodestar. The test is not percentage. The test is what is reasonable in the context of this particular case. I don't think there is anyone in a better position than Your Honor to make that decision, given what has gone on in this case.

But in that regard I would point to the fact that, and it has been mentioned here in the hearing, and it has been conspicuously mentioned in the Visa and Mastercard briefs that without being overly cynical, there has not been any objection by any merchant of any significant size. That issue keeps being brought to the forefront, to the court.

I think what is being communicated is that small businesses just aren't important enough in the end to really be heard. As this court noted in its certification opinion and it was reiterated by the Second Circuit, millions of small merchants will lose any practical means of obtaining damages for the defendant's allegedly illegal conduct.

The fact that these merchants are small, I think is the whole point of this case. The fact that the fees will reduce the amount of their recovery is in fact important.

Lastly, Your Honor, I would point to something that Mr. Constantine said that I wholeheartedly agree with. I would ask you to carefully consider when you look at how much you will reduce the corpus of the settlement by fees and expenses in the case. The one thing is the fact that the fees and expenses apparently keep running passed today in the administration of the fund.

But more importantly, as Mr. Constantine pointed out, any percentage whether it is one, two, three, or the four percent used in Goldberger, any percentage of 3 billion dollars is a whole lot of money

Thank you.

THE COURT: Yes.

Thank you.

THE COURT: Mr. Grossman.

MR. CONSTANTINE: Your Honor, can we take a break.

THE COURT: Eventually we will take a break.

Do you need one now?

Is that a yes?

MR. CONSTANTINE: Yes, it is, Your Honor.

THE COURT: Do you people want a break to stretch your legs?

Do you mind if we take a break before you orator?

MR. GROSSMAN: I predicted that you weren't going to take a break before I spoke.

THE COURT: I usually don't break this early. We only just started. We have some people of less fortitude in the room, apparently.

So lets take a ten minute break.

(Recess taken at 11:10 a.m.)

(Continuation Time: 11:24 a.m.)

(Matter continued on the next page.)

THE COURT: Good morning.

MR. GROSSMAN: Good morning, Your Honor.

I am Stanley Grossman from the Pomerantz law firm. I am the court appointed liaison counsel in the membership rule antitrust litigation pending before Judge Jones in the Southern District

Nu-City, our client here, is a plaintiff in that case, and it is a Class member here.

Our case, Your Honor, is based solely on the defendants exclusionary membership rules which prohibit banks which issue the defendant credit cards from issuing other credit cards.

Our case piggybacks the government case which was successfully tried before Judge Jones. Her decision finding that the defendants here, the defendant's conduct here violated the Sherman Act was upheld just last week by the Court of Appeals.

Our case has nothing whatsoever to do with debit cards or time claims. Which as Mr. Constantine said, and as we all know, is the centerpiece of this litigation. First, let me say that in my 33 years of practicing Class actions this is the first time I have ever stood up as an objector.

THE COURT: How does it feel?

(Whereupon there was laughter.)

MR. GROSSMAN: I will let you know, Your Honor.

First, let me say that we do not object to the fairness of the settlement of the entire case. Nor do we object to the fees requested by the plaintiff's Class counsel. What we do object to is the release of the very strong claim on our action. Claims which as a result of the Second Circuit's ?? last week may very wed give rise to the Class having summary judgment there on the issue of liability.

Now, ?? of our serious concerns is a failure of the notice of the settlement here to inform Class members that their claims in that case before Judge Jones will be dismissed if Your Honor approves the release language of this settlement as presently drafted.

We further submit that on the well established precedent in this court, the parties have no right to dismiss our claims, and Your Honor should not sanction ?? if those separate claims are to be dismissed, then the whole settlement should fall because factors that the court must consider under Granell are not present with respect to our ??.

Now, first list me deal with the notice, if I may. As we all know, and people have commented here today about ??, the notices in Class actions have come under great ?? because of the way they are often written Class members can ber??y understand them.

I am sorry to say that with respect to the notice in this case, as respects our objection, that seems to be the case. Paragraph three of the notice summarizes the claims and, of course, the claims are debit card claims regarding the kind which is what this case is all about. Then this settlement notice sets out the release language in verbatim which is pure legalese.

There is absolutely no reference in that notice to the separate claim, the separate action pending before Judge Jones. There is no mention that that is based on a successful government prosecution before Judge Jones.

THE COURT: Is there anything that would survive this release?

MR. GROSSMAN: I am sorry, Your Honor?

THE COURT: It is a very bread release. It seems to me that anybody reading it would think that you can't possibly have a claim that survives it.

MR. GROSSMAN: Well, they have to know -

THE COURT: May be it is too broad. I understand that is your other point.

MR. GROSSMAN: That is exactly right.

THE COURT: On the notice issue it says the claims that have or could have been asserted in this litigation which arise under or relate to federal or state antitrust, unfair competition, unfair practices, or other law, or regulations, common law.

What is left?

MR. GROSSMAN: Well, I think that is probably close to the exact language that the Court of Appeals condemned in the Super Spuds case, Your Honor. Because what they did there was the same ting that they did here. They put in verbatim very broad release language. What the Court of Appeals said that they failed to do was to disclose to the Class members that there was a separate case pending and that case would be dismissed.

The Class members in this case know that there is a Class action -

THE COURT: Let's just move to the merits of it. Let's move to the merits of it. Why is Nu-City and the people that Nu-City seeks to represent similarly situated to the folks with the unliquidated contracts in Super Spuds.

MR. GROSSMAN: Your Honor, they have a separate and Distinct claim. That under the Second Circuit opinion can not be dismissed without separate consideration unless, unless those claims are based upon the identical facts supporting the entire case. They are not. It is not merely a question of a different theory. They are totally different claims.

How do we look at that to determine what the Court of Appeals means by the identical facts. Judge Friendly says it in Super Spuds. He says you look at the same type of analysis that you would look at if there was a res ju??cata dismissal.

If the judgment in this case, this entire case in rendered in favor of the defendants, it would not have disposed of the claims in our case. Then what they can't do by judgment, they couldn't do by a release in a settlement. That is exactly what they are doing.

Now, if this case were tried and there was a judgment. would there have been a res judicata as to our case? No. The reason for that, Your Honor, is because the predicate facts underlying the claims in this case are essentially different.

Number one, in our case we would have to establish that the exclusionary rule had adverse substantial effects upon competition. They do not have to establish that in this case. They had to establish that at the time the conduct had adverse substantial effects.

THE COURT: But you are looking at elements of your claim. If a separate legal theory can be wiped away by a release, as long as it is an identical set of facts --

MR. GROSSMAN: That is right.

THE COURT: Then the facts that there are different elements shouldn't matter. The question is the factual basis, is that correct?

MR. GROSSMAN: It has to be the same predicate facts that support both claims There can be different legal theories. That is what the Court of Appeals held in TDK. There was a federal claim challenging the fairness of the merger, and there were state claims on different legal theories. But the same underlying facts supported each claim, and the Court of Appeals said at least it is proper.

It is not proper if the predicate facts that are essential to the first claim are not the same as the second. Now, in our case we would have to proof Impact from the exclusionary rule. They don't prove that at all. They have to prove impact from time. That is totally different We have to show, as I said, substantial adverse effects on competition as a result of the exclusionary rule. They don't have to show that. They have to show that with respect to the time.

If we establish that in our case, and the defendant would come forward and they would show that it was necessary to pursue that type of conduct for legitimate reasons. If they did, we would have to show that they had other ways of doing that without violating the antitrust laws. They didn't have to prove that in this case, Your Honor.

So the very essential elements of our case were not present in their case. They would not have proven them in their case. If the defendants prevail in their case, that would not have barred our claim under res judicata. If they couldn't bar our claim under res judicata my judgment, if they won, they can't do it here without consideration.

Now they say well, there is consideration going to the credit card Class. There is 600 million dollars or so. But that is consideration on a totally different clam. It is a totally different impact. It is totally different damages. That is not consideration that is resolving our claim that we have. Under those conditions they cant release it.

If you read the language as broadly as you say Your Honor, or the defendants say, the complaint relates to the whole history of Visa and Mastercard. The complaint sets forth the nature of the transactions between merchants and the defendants. Well, if anything related to those transactions will be dismissed, the hundreds and perhaps thousands of disputes that presently exist between merchants and these defendants regarding claims between them will all evaporate.

That can't possibly be the case, Your Honor, and it is not the case. It is not the case because the predicate conduct in those cases and this case are different. The court has made clear that they have to be identical.

Now the defendants say, well, we paid a lot of money here. We were entitled to a piece. That is what we are paying for. I have negotiated hundreds of the releases and that is the most important point always to the defendants. They want as much of a piece as they possible can get but you can't always get what you want.

In the Auction House case Judge Kaplan made that theory, Your Honor, well known. In that case, too, there were separate claims that the Class members had. One claim was for the transactions in the United States, and one was for foreign transactions.

The Class members under the settlement were told that if they wanted to receive the very substantial consideration there, almost 200 percent of the single damages, if they wanted to receive that consideration they had to release the right to go after the foreign claims in the United States court.

The Court held, and the Court of Appeals upheld in an unpublished opinion, the fact that the defendants couldn't do that. They could not release those separate claims without separate consideration even though in that case, in that case the conspiracy which gave rise to both the foreign damage and the domestic damage all rose out of the same conspiracy. There were different predicate acts. They couldn't do it. In order for the defendants there to get the piece that they wanted, they had to come back in and they had to separately settle their claim.

Now, I would just like to mention, Your Honor, one thing. I think I pretty much exhausted my fifteen minutes. There has been reference to the fact that there were other plaintiffs that were in our case that have abandoned our case, and abandoned the arguments that we submitted.

I should point out to the court that those plaintiffs are also plaintiffs in the case before Your Honor, and they will share in it The lawyers will share in the defendant fee that are awarded here. I should also point out that they, apparently, those lawyers did not think the case is so related, Your Honor, and that it was necessary for them to file the second case.

So, Your Honor, In closing I would just like to say -

THE COURT: Are all of the folks in the Class that you seek to represent included within the Class here?

MR. GROSSMAN: Our Class is a shorter period. It may not be, Your Honor. It may not be the same. In any event, because our Class is limited to merchants who did the credit card transactions behind the case with respect to the merchants who did both. So I am sure there is a very substantial overlap, but I don't think that it is Identical.

Clearly, it is not identical to the extent that the time case is broader by several years as well.

THE COURT: Thank you.

MR. GROSSMAN: Thank you, Your Honor.

THE COURT: Mr. Flamm.

MR. FLAMM: Mr. Archer will be speaking.

THE COURT: Right.

Come on up Mr. Archer, Please.

MR. ARCHER: My name is Richard J. Archer. Mr. ??amm is local counsel, and has moved for my admission pro hac. I assume that has been granted.

THE COURT: If I have not granted it already, I grant it right new.

MR. ARCHER: Thank you, Your Honor.

THE COURT: Your welcome.

MR. ARCHER: My name is Richard J. Archer. I have represent the plaintiffs in the California action, civil number CO2-3003-JSW. Both Visa and Mastercard are defendants in that case but also three banks, Wells Fargo Bank of America and United States Bank.

Our Class we have not moved for Class Certification because the case is not at issue. The defendants filed one motion to dismiss, which got rid of our Section VII claim, and the bank's service company claim. The Court's opinion on that is attached to our motion or our objections.

Our basic claim is a Section One claim. Which the claim assents that the interchange fee try agreement becomes the minimum of the merchant discount on all transactions. We are not limiting this to the entire transaction. In fact, our complaint specifically disavows making any claim on the time case.

Our first objection, and I will outline the first objection is based as a procedural one. That under the Local Rule, if the defendant's claim that the California action was on the same significant facts as the Walmart action, it was necessary for them to file a notice in the Court.

This is part of the multi-district. I think most district courts have rules like this because this is how the multi-district litigation results. In other words, we knew of this action and other actions, and would we be multi-district. So we had specifically in there that we were not claiming time.

Secondly, as a matter of common law, it is not mentioned in the Federal Rules but you can have a defense of another action pending. That could have been done.

The third thing is the notice in this case which came out before the defendants in the California case, the Class notice in this cases says If you are going to sue on the claims which are pending in the Walmart case, you got to opt out. Because if you are a member of the Class, you can't bring an action on those claims. It says that in no uncertain tennis.

So when the defendants came to respond in our case the defendants, Visa and Mastercard, they had the option of making that defense. Now, what is their reply? They say, one, the defense of another action pending is not compulsory. That is true it can be waived, but they didn't make it. The requirement of the Local Rule, which is the multi-district. Which has the multi-district aspect is the compulsory rule. That is something you don't waive.

They say, well, we substantially complied with that. We didn't come out and file a notice like the rule says. But we talked about the Walmart case in our papers. I don't think that is any compliance at all. I don't know how you want to look at that, Your Honor. That could be a waiver. It could be an estoppel. Or you could even get cynical about it because you have not only Visa doing this, and not only Walmart, but you have half a dozen individual lawyers on both sides for both defendants on the papers.

So I don't think you have to be too cynical to say that they must have considered this. We have this new case out in California which is going after the merchant discounts, all of them, and they are claiming that it is a conspiracy. Shouldn't we just throw that back to the Walmart case, and have the multi-district back there? Or should we wait and see how it develops and then, while our best chance will be, we will make the settlement with Walmart and hope it covers it.

Well, I don't think we will ever know the answer to that. I don't think we need to know the answer to that. But I think we can consciously say that they made a determination that under the Local Rule the case in California was not sufficiently like the significant facts in this Walmart case to file the notice. That I would say is a procedural argument.

Now, I think everybody has agreed, Your Honor has indicated the familiarity with Judge Friendly's opinion in Super Suds.

THE COURT: Spuds.

MR. ARCHER: Super Spuds.

THE COURT: It is about potatoes.

MR. ARCHER: Oh, yes, Super Spuds. Right.

And TDK Partners was a subsequent case with Judge Newman. I don't like reading the case. It maybe indicated or maybe the court hasn't read it. I don't mean to say that --

THE COURT: It is okay. Do what you think is necessary. Go right ahead.

MR. ARCHER: They are very clear. They say that you can exclude it if it is the very same set of facts. The very same set of facts in one place.

In the other place it says that the identical factual predicate. That is pretty strong stuff.

The third place they say, they make another statement that the settlement can't be made with the uncompensated sacrifice or claims of members, whether few or many. I say --

THE COURT: Why aren't the claims in your case compensated?

MR. ARCHER: Because they are not tieing claims.

THE COURT: Was that after the time that you allege in your case - I am sorry. The result of the price fixing that you allege in your case is what?

MR. ARCHER: What?

THE COURT: What is the ill effects of the --

MR. ARCHER: The merchant discount, period. I don't care whether it is tie, on-line, off-line, or wherever it goes. The merchant, it is a very simple thing. The merchant makes a deposit at the end of the day. He has got cash. He has got checks. He has got credit cards, debit cards, or whatever. From the credit cards and the debit cards there is a percentage taken off. It is not from the cash or from the checks.

THE COURT: That percentage is way too high as a result of the illegal -

MR. ARCHER: That percentage is fixed by agreement. I am not familiar with the evidence but I read Your Honor's certification opinion. I read the affirmance of it. Nobody in there states what Judge White stated. I must prove in my case that there is a nexus of price fixing between the merchant discounts. You see, that Is why in the California case we are suing the banks. Because these merchant the merchants here, they as we allege in our Class are people who have contracts with banks. It is right in the definition of the Class as is in the definition of tieing in the Class here.

That is a factual difference, price fixing from tieing. Tieing is the new all by Itself. Morton Salt, this case I think the tieing is alleged that Mastercard does it by themselves and Visa does it by themselves. It is two kinds of check cards that are right in the definition of the Class.

The price fixing that I will have to prove is something that has to be done together by the banks with Visa and the banks with Mastercard. That is the nexus. Which, as I say, was not proved in this case so far as I know or not said they would proof. But if it had been certainly the relief here would have been altogether different. The court wouldn't be giving relief which says for a certain period of time the interchange fee will be lower. It wouldn't make sense in terms of what we are claiming.

If we are successful we will say that we don't care what the interchange fee is. The interchange fee can be anything that you want. What we don't want is that there is this nexus from the interchange fee down to the merchant discount which establishes a floor. So the kind of relief that is here would not make sense in our case.

So I believe I pointed out that, obviously, they were compensating for what is in our case. Because in the plan of allocation in this case at page ??, it says the Class is made up and the merchants claim that these Visa and Mastercard rules being debit acceptance to credit acceptance, damaged merchants in three ways. It lists it and it is definitely tieing.

I would say that if it is tieing, the factual predicate for tieing in an annum plus sense is wholly different from the factual predicate of price fixing. In the simple case you got to have two to price fix. Tieing you can do all by yourselves. We are claiming you will see, again in the California case, not only do the banks have the agreement with Visa and the banks have the agreement with Mastercard, but that Visa and Mastercard under the case that we have cited of Freeman against the San Diego Board of Realtors. That the agreement, that the group itself is illegal.

That is why they bring up the issue there that there is the DeBanco issue. They brought it up once and they are bringing it up again. They are saying that DeBanco said the interchange fee is legal because it is necessary for this thing to work.

The opinion of Judge White attached to our objection has a rubric. It says DeBanco is not controlling. The reason he says it is is because we allege something more than in DeBanco. We allege that there is a nexus between this interchange fee and the merchant discount which sets the floor and which has nothing to do with tieing.

One other thing that I point out. As far as the banks are concerned, the banks have appeared in the California case. The Court has jurisdiction over the California court. Ordinarily, the Court first to acquire jurisdiction retains jurisdiction. So that I think it should be left to the California court.

Actually, it will come before the California court. There is a motion to dismiss pending the first part of October 4th or 5th or something like that The defendants are claiming, again, that DeBanco controls and that our case out there should be dismissed.

When they made that motion they had a footnote reference here, saying that part of our claims might be disposed of by the settlement here. So we attached out there in our response, we attach our objections that we have file here. So that that is in effect.

The court out there is informed. I guess that is what I want to say. The Visa, at least, said in the footnote that they wanted the hearing out there to go ahead even of the release here is approved, because they are so confident our case is going to be dismissed.

Thank you, Your Honor.

THE COURT: Thank you, Mr. Archer.

Mr. Constantine.

MR. CONSTANTINE: Your Honor, I would like to address the objections in reverse order. I would like to address the issue of the release first, and then go very briefly the other objections which ??manly relate to our application.

Your Honor, from the day that we filed this case, which is October 25th, 1996, in the complaint that we filed, in every iteration of that complaint, and in the second amended consolidated Class action complaint, which is the operative complaint in this case, a lot of facts were alleged.

Among those facts which were alleged I think on multiplier places in all of those complaints were two which are pertinent to this discussion. One fact that was clearly alleged was that Visa and Mastercard each had exclusionary rules, and they were specifically denominated I believe in Vita's case rule, 2.10E and in Mastercard's case the competitive program policy.

Whether or not the numbers were in there, there was an allegation of these exclusionary rules and, of course, they were specifically alleged in the exhaustive motion practice in the summary judgment practice.

The other allegation that was clearly --

THE COURT: What role would that have played at a trial, because the mere fact that they are in a complaint to me doesn't do much to advance the inquiry. Lots of stuff is in complaints, and lawsuits mature, and issues new, and there is a focus.

What role would the facts underlying - you are addressing No-City at the moment.

MR. CONSTANTINE: Yes. I am addressing both.

THE COURT: What role would the facts underlying the claims in that case have played in the resolution of the claims that were actually going to trial?

MR. CONSTANTINE: You may recall and the record will reflect, Your Honor, that those exclusionary rules and the fixing of prices, which is the issue raised by Raines ??. Those facts were alleged as being the part of the tieing arrangement, exacen?? conduct under the ??eing arrangement, conduct which reirforced and made more and-?? and more ?? the tieing arrangement.

The tieing arrangement that we alleged in the case was not simply the on and all cards requirement that if you take --

(whereupon the Marshal's door opens.)

THE COURT: Are you expecting anybody from the pen?

MR. CONSTANTINE: No, Your Honor.

The on and all cards rule requirement if you take our credit cards, you have to take our debit cards as well. As you recall, we allege additional conduct.

In that additional conduct were the exclusionary rules and the price fixing activity, which we said was part and parcel of the tieing arrangement, it was exacerbating conduct which reinforced the effectiveness of the tieing arrangement, and it increased the damage clause from the tieing arrangements. The same thing with the price fixing activity.

On the section two side, the attempt to monopolize, we said that the exclusionary rules were a barrier to enter the debit card market or a barrier to enter the credit card market. Which also raised the barriers to enter the debit card market, because it was insufficient for a payment network to enter on only one tevel of the market place.

So that since these exclusionary rules excluded American Express and Discover completely from the debit card market, and also precluded them from being multi-payment networks and, therefore, it also raised barriers for entry into the credit card market.

We said that several years later, and Judge Jones also said that in her opinion in October of 2001. The first allegations about the anti-competitive effect of the exclusionary rule and the fixed interchange of price fixing, which is raised in Raines Popsibello is made in our complaint in October of 1996. Both of those allegations and those facts which were alleged early, and often, and persistently, were part and parcel of both the Section One tieing claim, the Section Two attempt to monopolize the claim.

I would like to read something from your decision in January of 2000, Your Honor, where the United Sates Government sort to intervene in this case for the purpose of getting hold of the discovery in this case, and for the purpose of getting access to the work product, which Class counsel had created in this case.

In granting that intervention motion and in [Text redacted in copy.] granting the United Sates access to the work product, you say, “The government notes the following common issues between its case and Walmart's previously filed case. That the member banks collectively restrained network level competition by enforcing exclusionary rules that prohibit Visa members from issuing cards on a competitive network other than Mastercard, and prohibiting Mastercard members from issuing cards on a competitive network other than Visa.”

Indeed, Your Honor, as we have indicated as part of our fee petition we trucked down to Washington on numerous occasions prior to the Justice Department filing their case and helped them to formulate the theory of their case.

It was partially due to the efforts of Class counsel that that case was filed. It was always in our case. It was in our case from day one. It was part of the Section Two case. There would have been significant evidence about both price fixing and the exclusionary rules at trial

Indeed, if you did the kind of analysis that you can now do with a computer program of all of the papers that we filed in the case, you will see that you will never see a reference to the price that comes out of Visa and Mastercard and their banks without three adjectives, fixed, high, and super competitive.

The fixing is always in relation to the fixing of interchange, which is the basis for high fixed merchant discount rates. So it was there from the beginning. It was part of the proof of the case. It wasn't similar facts. Those identical facts were alleged throughout the case and were part of the proof in the case. They were part of our summary judgment, a very successful summary judgment motion, and would have been part of the trial.

Now, on the issue of compensation. The members of our Class are being compensated for claims that were not tried. But they were also compensated for the conduct that underlay those claims. I point out, again, that the members of our Class are receiving massive compensation, unprecedented compensation, and not just unprecedented compensatory relief but unprecedented compensation in the form of injunctions as well.

We are just focusing for now on the compensatory relief. They are explicitly receiving more than 600 million dollars presently valued at more than 500 million dollars for high anti-competively set credit card prices. Which includes the very conduct that we are talking about now.

I would like to make a couple of other points. There was some reference to the Super Spuds case by both Mr. Grossman and Mr. Archer. I would like to point out, and you asked Mr. Grossman a question. You asked are the members of your putative Class members, and please understand that that is a putative Class, never certified, never moved upon, and the same with Raines Popsibello. The members of your putative Class, the members of the Class of In Re: Visa Check?

Every single member of the Nu-City Class s a member of our Class. Every one of the 17 or 18 Class representatives in our case is a member of that putative Class.

The release provisions were put verbatim, verbatim into the notice in the Super Spuds case.

THE COURT: Will they have an uncompensated horizontal boycott claim if I approve this release? Is there an uncompensated claim that those folks have even though they are in your Class?

MR. CONSTANTINE: Your Honor, the members of our Class have received massive compensation for the claims that we have asserted and the claims which we could have asserted. It is appropriate and well settled that we have the authority in settling a case like this to grant a release which extends to claims which were asserted or could have be asserted, and they could have been asserted because of the facts underlying those claims.

We are not sort of alleged or, you know, they were specifically alleged. They were specifically and constantly and frequently alleged as part of the proof of the case and part of our summary judgment motion. So there s massive compensation for the underlying anti-competitive conduct which includes the alleged price fixing activity and includes the alleged exclusionary rules.

Now, I would like to address the part of the arguments which deal with the issue of notice and the extent to which members of these putative classes were or not put on notice of the potential extinction of these other claims in these other cases, in these putative class actions.

I want to point out, first of all, the notice that we provided was the notice that the court ordered. I want to point out that it would not only be improper but it would be extraordinarily confusing in a notice like that to try to anticipate and say to another group of lawyer's putative clients now, I will tell you about the settlement in this case. You are receiving 3.05 billion dollars. You are receiving 850 million dollars in reduced interchange. You are receiving all of this injunctive relief. Now, I want to let you know, there is another putative Class action out there. It may or may not ever be certified. They may or may not ever make a motion on that. And you have never heard from your lawyers about that case. But I am going to begin to explain that case to you.

Please look at the release provisions in this case and figure out or see your lawyer to see whether or not the release in this case potentially releases the claims in that other case where you may become a Class member if it is ever certified.

THE COURT: I understand the point.

Even if you are right about Nu-City and this California case, isn't the release as written too broad. It includes all of these other potential claims, unfair competition. Does this extinguish if there is a theft of proprietary information by Visa and Mastercard and someone out there brings an unfair competition claim, that is extinguished as well?

Doesn't it need to be limited to the legal theories that claims are brought on as long as they are on the same set of facts?

MR. CONSTANTINE: It needs to be limited to claims which were asserted or could have been asserted, and the construction of what could have been asserted relates to the specific facts alleged.

So if the specific facts were alleged, and they give rise to a claim which could have been asserted under the under competition law of the State of Iowa, then it is perfectly appropriate to grant a release of that scope.

THE COURT: isn't that an important qualification that it depends on the same set of facts?

MR. CONSTANTINE: Absolutely, Your Honor.

You have heard argument from two cases, from two sets of lawyers, where five years in one case and six years in the other case. The specific facts which they alleged five to six years later, were alleged in our case. They were alleged in our case two years before the Justice Department.

THE COURT: I am not talking about those two cases right now.

MR. CONSTANTINE: You are not going beyond that.

THE COURT: Yes.

I am just talking about what an appropriate release is even if you are right about those two cases. It strikes me that this is too broad.

MR. CONSTANTINE: Your Honor, it is not too broad in the sense that the releases which released claims which were asserted or could have been asserted are, it is well settled law that a release of that scope is appropriate.

THE COURT: As long as it depends on the same set of facts.

MR. CONSTANTINE: As long as it depends on the same set of facts.

THE COURT: That is my point.

MR. CONSTANTINE: The point being if there is this hypothetical unfair competition case in the State of Idaho, and if it arises from the same set of facts, then potentially it is released. If it doesn't, it doesn't. But the scope of the release - Mr. Begleiter is giving me something to read to you. I don't understand the significance of it. He can get up and explain it to you.

The release in this case and the scope of the release in this case is well settled. indeed, we have cited cases to you in which releases have been approved by the Second Circuit which go beyond the scope of claims which were asserted or could have been asserted.

We are not in that realm here. We are simply in the realm of claims which were asserted, could have been asserted arising from the very same facts.

THE COURT: But that is not what your release is.

Why shouldn't I, separate and apart from a determination with regard to the San Francisco case, and the Nu-City case, only condition approval upon an amendment to the release that specifies that those claims are dependent on the same set of facts?

That is my question to you.

MR. CONSTANTINE: Well, Your Honor, the proposed condition that you reflect is really what the law says. Because the term, as I understand it, claims which could have been asserted really reads into that arising from the same set of facts.

So if you were to condition approval by the insertion of those words, I think you would be accomplishing what the law construing such release and such language has already accomplished. So I think it would be redundant and unnecessary.

THE COURT: Okay.

MR. CANTOR: Also, just to point out to you, the limitations that you are suggesting is in the release. The release says that the release only relates in anyway to any conduct prior to January 1st, 2004 concerning any claims alleged in the second amended Class action complaint or any of the complaints consolidated herein.

So it has to relate to conduct that has been alleged in the complaint, in the operative complaint or other complaints, Your Honor.

MR. CONSTANTINE: I am corrected by my partner, Mr. Cantor. The fix which I continued to believe is unnecessary and redundant really restate what the law already says is actually more or less in the release which was found verbatim in the notice that we provided.

I would like now to turn my attention to some of the other objections. Do you want me to do that now?

THE COURT: That is fine.

MR. CONSTANTINE: Okay. Thank you.

I may cycle back to this because, in fact, one of the other objectors raises an issue about the provision of the settlement relating to Visa which implicates the recent decision of the Second Circuit and implicates Judges Jones' prior decision.

With respect to Mr. Schonbrun, and I will try not to be repetitive about this. Mr. Schonbrun talks about recent developments, the auctions. The one thing that I think is important for me to point out, Your Honor, there weren't any auctions in this case. One of the objectors refers to our decision to bring this case. That being a decision motivated by craziness.

There weren't a lot of takers for this particular representation This was a very very very difficult representation There weren't people belling up to the bar to engage in an auction in this particular case. But the decision to file this case was not the decision of counsel. The decision to file this case was the decision of sophisticated large merchants. Indeed, one of those merchants being the largest corporation in the world.

There has been several comments about the failure to put the actual number of the fee application in the notice or to publicize it or to write it anywhere. We proceeded pursuant to court order. Your order indicated that we should send out the notice which was approved by the court, and some six weeks later file our fee application. I can assure Your Honor and I think you have some personal knowledge of this, on April 30th, when the memoranda of understanding was entered into, the last think that any of the people on the plaintiffs side were thinking about was the subsequent fee application.

We were simply trying to do the absolute best job for our clients, and we think we did a heroic and unprecedented job. The consideration of the fee and the fee application, after due consideration of all of the work, and all of the factors, and all of the law which applied to it, and all of the learning which Professor Coffee, and Professor Miller, and Professor Furst gave us occurred way after the fact. It was way after the fact of these settlements. That was the appropriate time to raise it. That was the appropriate time to disclose it.

There cannot be a fee application which has been more scrutinized than this one. Indeed, the day after we filed this fee application, the precise number of 609 million dollars, which some of the objectors have mentioned, appeared in the headlines in the New York Times, and then was reprinted in numerous and indeed scores of other publications. So it is one of the most publicized figures.

There was another reason why we didn't put a specific number in. That is we understood that there would be a reevaluation of the interchange fee reduction component of the compensatory relief literally within days or weeks of the original fee petition.

Professor Fisher estimated the value of that We knew that the actual numbers from Visa and Mastercard would be forthcoming within a few weeks. They were forthcoming, and it showed that the actual value, the actual fee reduction was indeed 846 million dollars rather than 794.4 million dollars.

That is another indication of exactly how conservative Professor Fisher and, indeed, the plaintiffs have been in estimating values in this case.

One of the suggestions that Mr. Schonbrun makes to you is that the time is right because Dick Grosso may or may not have been overpaid. For you now to take his much rejected idea about a fee guardian and a special guardian, and now is the right time because you are sensitive to the publicity about all sorts of extraneous events.

What I would like to point out, and what Professor Coffee points out is that very specific idea of a special guardian was considered by the recent framers of new Rule 23 rules, and they declined to adopt it or even to recommend it.

So that is not only an idea that has been rejected by court after court, but it also recently has been rejected by the framers of the new rules to the point where they have not even recommended it.

I don't have a lot to say about Mr. Rasmussen's objection. What I would say is that I think it is clearly governed by the

Sovern Perez decision. We proceeded twice with notice last Fall and notice this Summer pursuant to court order, the court had the notice.

Now, I think there is something interesting about what Mr. Rasmussen says and the way he describes both his clients and the group of people, Hispanics and Latinos, who he purports to represent He says that a good portion of them are most comfortable with Spanish or they prefer Spanish -

THE COURT. Let me interrupt you on that. Because my take on that argument is it is a pretty good idea. If this had been brought to my attention before I approved the notice to the Class, and if it is true that there is a relative ease of making available Spanish translations of these documents by putting a banner on the top and having it available on a web site, that seems like a great idea to such a growing Hispanic and Spanish speaking population.

It just doesn't strike me as an objection that warrants not approving this settlement I mean, down the road that strikes me as a great idea. But we are at the approval stage.

As I say with all respect to the argument made by Mr. Rasmussen, I don't think it is a basis to upset this settlement but I think it is something to keep in mind.

MR. CONSTANTINE: I will keep it in mind, Your Honor. I think it is a nice idea. It doesn't rise to the level of a due process challenge.

THE COURT: I agree.

MR. CONSTANTINE: I think you should consider, Your Honor, if that nice idea were carried forward we might want to also have considered all of the other significant language groups in the United States involving other languages, and there are a significant number of people within this Class and Class members who might prefer to get their notice in some other language.

But that does not speak to the issue as to whether or not under dire process grounds they got adequate notice.

THE COURT: That is also true -- and I am sorry to interrupt, for the benefit of the objectors who have made many interesting, useful, valid, and on the end perhaps meritorious objections.

I think it is useful for me to point out because I was here, that the argument about the delay in the fee application in the context of how this settlement was reached doesn't strike me as persuasive. There is nothing quite like having a jury in the box to focus the minds of lawyers in cases like this. Assuming, and I don't have the experience that many of you have. Assuming that it is true that attorneys' fees are at the forefront when cases, when cases reach settlements in other contexts, maybe in the relative tranquility of the pretrial stages.

I have no doubt they were not on people's minds at the end of April. There was literally a jury in the box, people were literally about to begin their opening statements. It nether was a source of surprise or dismay on my pert that it took until August to post the fee application.

There are some other objections to the fee application, as I say, I am receptive to. I have questions for Mr. Constantine about, but that is not one of them. It has to do with the way the case developed, and when the case got settled, and the context of which the preliminary, the proposed settlement was reached.

What about the ?? of the disbursements to the Class members, relative to the ?? of the disbursements to the Class counsel, when those are approved?

MR. CONSTANTINE: As you know, Your Honor, and it is in the notice, we have clearly stated our intention. I think counsel has stated their intention to seek a sen??tion ?? a con?? of the settiement funds.

If we are able to present to the court a viable securitization or mon??oriza?? n procedure, which we are highly confidence of doing, the payment to the Class and the payment to counsel should be roughly contemporaneous

If on the other hand the court -- if we are unable to come up with a viable securitization plan or alternatively a viable agreement with Visa and Mastercard to make early single payments, and then the payments are going to come over a nine year period, we will be seeking payment from the court when the funds are available for attorneys' fees for costs and expenses.

It will be the court's determination whether that occurs or not.

THE COURT: All right.

MR. CONSTANTINE: I am sorry. I haven't had the time to consolidate all of this. I would like to quickly go through the other objectors, and then answer your questions as well. The only thing that I have to say with respect to Mr. Helfant's objection is that I do appreciate his comments that we have done a fine job, that this is a settlements value of historical proportions, and that these are commendable efforts.

With respect to Mr. Pentz, who has given the court similar sentiments about the quality of the work, the one thing that I find extraordinarily perverse about the argument that is made there, especially with respect to Professor Coffee's analysis, and I don't think that I need to go into any detail to credit Professor Coffee or his special role in this particular jurisprudence or how frequently he has been cited by courts. Those courts include on multiple occasions the United States Supreme Court, and the courts of virtually every Circuit.

To accept his suggestion and eliminate positivism gone wild, and simply exclude the cases in which Professor Coffee is either cited or he acts as an expert, essentially, would get rid of most of the cases. You would then be deprived of citing to numerous cases in the Supreme Court, in this Circuit, and virtually every other Federal Circuit. It just doesn't work.

This is from an objector who has referred to the courts, including the United States Supreme Court and the Second Circuit as a bunch of quote “sycophants who have been bamboozled by Professor Coffee.” I don't know. I have not read your decisions enough to know, Your Honor, whether you are in that club.

In any event I would like, Kevin, for you to put up the chart now, the up and down chart.

Several of the objectors, and I think Mr. Pentz have argued that it is absolutely the case and we failed to recognize that there is this sliding scale. That there simply is an avoidance of this.

Now, the cases that are here have not been carefully selected. They simply represent the entire universe of cases which Professor Coffee, Professor Miller, and Professor Furst, and we consider to be the most relevant.

I say that telling you that I don't think any of these cases give you complete guidance. Because it is both objectively clear and also I think qualitatively clear that the result in this case goes far beyond the result in any previous antitrust case in terms of compensator??ally, and in terms of the historic injunction, and the value of that relief, in terms of the risk factor which the courts for their own reasons have said what is the most important ??, and in terms of the difficulty.

You have that I think from everybody. Indeed, you have it from the objectors today to the point on risk and difficulty that one of the objectors referred to as “crazy for bringing the case.”

But here is the nonexisting sliding scale This is simply from low recovery of 107 million dollars in 2002 in the Methionine case, to the previous high compensatory recovery of 1.027 billion dollars in the Nasdaq case in 1998.

The compensatory relief in this case exceeds that by more than a factor of three. This is the entire universe. At least it is the entire universe going back to 1983. In the last 20 years. I am not aware. I don't know whether there were such mega fund cases prior to 1983, but we took the last 20 years.

As you see, a recent case Methionine, 23.3 percent. In 2002 the Cardizem litigation, 30 percent At 125 now the recovery goes down. The number goes down. The percentage goes down to 26.3 percent. But then the recovery goes up in Sumitomo Copper. The fee award goes up to 28.3 percent.

Then you have a still higher recovery of 140 million dollars down to 21 percent. Understanding that this line always represents 18 percent and the fee request in this case.

Then you go down to Plywood. Which is one of the two twenty year old cases here. Which was decided in the Fifth Circuit at the time where the lodestar method was not merely preferred but mandated by the Circuit.

Then another higher recover from 1999, Lease Oil 35.1 percent Buspirone, and I hope I have that pronunciation correct. It was quiet recent in April of 2003. It was Judge Cohn In the Southern District, 33 percent, and 34.6.

The Corrugated Container, again, from twenty years ago. It was in the lodestar required Fifth Circuit. A very very high award. A recover of over 700 million dollars in brand named prescription drugs in 2000 at 25.4.

Then in the Nasdaq case in 1998, 14.4 percent of one billion dollars. It is one billion and 27 million dollars.

There is no sliding scale. What there is from time-to-time a recognition, and I think an honest recognition by the courts that in some cases the higher recovery maybe a function of positive economies of scale, and it simply was just as easy to represent two million Class members, as one million, or three million, as two million, and etcetera.

That the size of the recovery reflects that and, therefore, there should be moderation as their always should be in considering the percentage to be applied. The cases are quite clear that the factors to consider are risk, difficulty, and result.

You have the uniform opinion, not just from the experts in this case who are the most esteemed experts within the field, within their field. They are within antitrust, and within fee jurisprudence with Professor Coffee and Professor Miller, but experts who have commented. I read some of their quotes before.

That the result in this case, these numbers all relate to simply the compensatory relief. None of these cases, none of these cases involved an injunction which, as you know, is the centerpiece of this case, was the centerpiece of this case from the day it was filed. It is the centerpiece of the result in this case. Which has been estimated to provide benefits to the Class of 25 to 87 billion dollars over the course of the next decade.

We haven't gone to the exercise. I suppose it is possible. We have not gone to the exercise of quantifying portions of the injunction which relate to issues such as the conspicuous rebranding of debit cards.

I don't want to place a value on the limitation or the ending of that confusion. I don't know how much it is worth to society that millions of consumers will no longer be confused about what card they are using.

You saw the documents during the case and during the summary judgment process which showed that in a very very significant proportion of the cases people used debit cards thinking they were a credit card. They only found out that they with debit cards when they got their bank statement or when they bounced a check and subsequent checks bounced.

I will not place a value on that. But, obviously, there is some extraordinary value on that. So the injunctive relief in this case approaches quantifiable 100 billion dollars over the next decade alone.

The courts have been very clear that this is not, and we have not argued to you about a benchmark. We have not thrown back to you all of the cases that ?? formatively talk about 25 percent is a benchmark.

What we said is look at the factors which the courts have over and over again said are the most significant factors. The risk and leaving aside the suggestion that you should not and I think the term was incentivize craziness. Leaving aside that, risk is clearly an important factor. Result is clearly an important factor. Difficulty is clearly the third most important factor.

I personally disagree with the jurisprudence. I don't think that risk is the most important factor. That was my problem, okay? I was never at any doubt that I was going to win this case, Your Honor. I thought from day one that I was going to win this case. Subjectivity there was no risk for me.

So I don't think that is really all that important. Although the courts tell you that that is the most important factor. I think the result is the most important factor. The result will redound to the benefit of this Class for many many years. I think it will ultimately redound to the benefit of the ??, redound to the benefit of consumers, ultimately redound to the benefit of ?Visa and Mastercard themselves.

I should ?? go into the objection that was made by Mr. Cochran. Where he began to explain the defe??nty on the a??eged defi?? in the settlement relating to how come we didn't prohibit going backwards the kind of exclusives with respect to Visa and their banks that would prohibited for a two-year term going forward.

Secause the Second Circuit just did that. Well, of course, the Second Circuit didn't just do that. Nor did Judge Jones do that. As I indicated before in my argument about the releases, we alleged that conduct years before the Justice Department alleged that conduct. I have one of my partners here, Ms. Mahoney, was in my antitrust class at Fordham. Part of her final examination was the analysis of those exclusionary rules.

WE knew about these rules a long time ago. That is why they formed the basis of the action that was brought here. But the relief in the Second Circuit and the relief in the Southern District has absolutely nothing to do with a contract between Visa and a bank for exclusivity or a contract between Mastercard and a bank for exclusivity.

What those exclusionary rules say, and if ultimately that decision is affirmed, is that Visa may not bar its banks as a Class, whether it is 6,000 or 8,000. And Mastercard may not bar its banks as a Class from doing business with American Express or with Discover, or with other competing card networks at the risk of losing their membership in Visa and Mastercard.

It is entirely different case. Indeed, If that was what was won in the Second Circuit case and in Judge Jones October 2001 decision, why in good conscience would I have demanded that provision in my settlement agreement? Because it is simply a fact of life that when I demand something in a settlement agreement, which is no value and which is worthless because somebody else has already gotten it, I would have to give up something of real value to the Class.

That is a luxury that I didn't have in negotiating this settlement. It is a luxury that the objectors have of simply trying to throw some mud up here and say why didn't you get this and why didn't you get that.

The objectors also says, well, why didn't you get the same provision from Mastercard? Well, as we indicated in our papers, there was no evidence that Mastercard was engaging in that particular activity. They might have been willing to agree not to engage in activity, but they hadn't engaged to in the past but, of course, there would have been an extraction of some real value. Some other provision that we got which really was for the benefit of the Class.

Mr. Griffis asked why the did present value, the relief. That is precisely what Professor Fisher did. We didn't come in with our application and say there is 3.05 billion dollars in this form of compensatory relief, and there is 846 million dollars in that form of compensatory relief. We have presented a present value of the 3.05 billion dollars. Which I believe was 2.589 billion dollars.

The point that the objector, and I realize these are not the objectors but these are counsel for objectors, that Mr. Dippel makes. It is that there have only been, and he cites a numbers of 10,700 hits on the web site. Our information is that there have been 30,000 hits on the web site.

As I indicated, there has been enormous publication of everything about this case. There are hundreds of articles. There have been scores of articles about the prepetition with the specific number in there. As you know, Your Honor, three of the named plaintiffs in the case were not members of the Class are Food Market Institute, the International Mass Retail Association, and the National Retail Federation.

They, in turn, have roughly one million members in this Class. They have constantly repeatedly notified their members virtually daily about these settlements, about the fee petition, about everything pertinent to the relief that they are going to receive in this case if there is final approval in this case.

I would like to make one last comment about Mr. Grossman's argument. In particular about his point that there are four, there are I believe 17 named Class representatives in his putative Class action. Nu-City is the one that has lodged this objection. The other 16 haven't. Four have specifically disavowed it.

He said, well, what do you think? What do you expect? They are lawyers and they are going to get something cut of the fees in this case. Well, Mr. Grossman is essentially saying that those lawyers are selling their clients down the river for their fee.

I have seen nothing in my group, in the 29 firms that assisted Constantine and Partners in this case, which gives any indication that any of those firms would do anything whatsoever against the interest of their clients. So I really do take exception at that.

I think that I have said what I want to say about what the objectors have said, and I would be glad to answer any questions thank you have, Your Honor.

THE COURT: I received something, I think last night. It looks like an internesting dispute among plaintiff's counsel.

Have you seen it?

MR. CONSTANTINE: Yes, I have. I would be glad to address it.

THE COURT: Would you want to respond to it now or in writing?

MR. CONSTANTINE: I would love to.

THE COURT: Go ahead.

MR. CONSTANTINE: I appreciate the opportunity.

COURT REPORTER: Your Honor, may I have a moment to change my paper?

THE COURT: Go ahead.

MR. ISQUITH: Your Honor, my name is Fred Isquith.

If you are referring to a document --

THE COURT: Please sit-down.

MR. ISQUITH: Yes, Your Honor.

MR. CONSTANTINE: The gentleman that you just directed to sit-down is Mr. Isquith. He is one of our able assisting counsel in this case.

As you know, Your Honor, as part of our fee, the petition and our fee application, my firm did an exhaustive audit of all of the time entries for the entire eight year period that we submitted times to the court, including our own, and including for all of the 29 other firms.

We then hi??ed an independent outside CPA firm to do another second audit. The result of those two audits was the reduction in the lodestar submitted to the court of some three plus million dollars. The elimination of thousands of hours of time which we felt was not properly documented, or not appropriate time to be thrown on the books for this case. It is such as time entered by Mr. Isquith firm for work on the fee petitions.

So we eliminated all of that. Mr. Isquith filed with the court an objection because doing that he wants you at the end, assuming that you will award some fees in this case, he wants you to do the allocation of that fee award as between Constantine and Partners and the other 29 firms.

Currently in the settlement agreement that obligation, that wonderful obligation falls upon my shoulders. We did what we thought was appropriate. We think we did very important work hare. I would like to think that the audits that we conducted were precisely what you would do if you determined that that was necessary. We did it ourselves. We did it independently. Obviously, we did it a little bit too harshly and too well. To the point where this, as you call it, the internesting dispute has reached this court.

I respect Mr. Isquith and his firm. They did important work. We felt that some of it was unwarranted. We reduced it. I think at the end of the day if you make a fee award in this case, nobody is in a better position than I and my firm to evaluate the relative contributions that have been made to this historic result than I and my firm.

I think you would be hard pressed, Your Honor. You personally would be hard pressed to recognize anybody from any other firm with the possible exception of Mr Sampson, who I know has appeared before you.

With that exception I think we are probably are in the best position to do that. I don't think that Mr. Isquith and his firm have standing as an objector. They are not members of the Class. This is an internesting dispute, which I do not think is appropriate of consideration here.

There is one other thing that two of my partners asked me to address. I think it is important to address it. It is germane to this issue about, are you guys going to get paid before the Class? As I indicated in my opening sentiments, the Class has already received significant compensatory relief. By the end of this year they will receive a value of roughly 846 million dollars in price reductions. They will receive new merchant signage. They will have gotten 25 million notices. They will already at the end of this year received value approaching a billion dollars.

That is probably prior to final approval of this. Because although even if you finally approved this, there will inevitably be an appeal of this, and you understand the motivation of such appeals.

This is a very special case. I don't know of any other case where you can say that the members of the Class have already received a billion dollars in compensation even prior to final approval.

Indeed, there is going to be an argument in the Second Circuit sometime this Fall from TCF. Where they are arguing that the interchange reductions constitute a horizontal price fixer arrangement between myself and my esteem colleagues Mr. Bomse, and Mr. Gallagher, and etcetera.

This is a very very different case. In considering our fee petition, the expense petition, and etcetera, I am sure that since you were there and you lived it as well, Your Honor, you are in the best position to assess how special this case was, how amazing the results were, how difficult it was against a formidable adversary, and how risky it was to do.

So we trust you to do this. Unless you have any further questions, I will sit down.

THE COURT: I don't.

Mr. Bomse, does Visa want to be heard?

MR BOMSE: Your Honor, obviously, we are interested in responding to the questions that the court might have about anything that would effect your decision whether to approve this release.

I have in mind your admonition that you have read our papers. You heard a great deal here. You did raise one or two questions with Mr. Constantine that go over the scope of the release.

To the extent that he answered to your satisfaction, I don't have anything to add but we would be happy to respond.

THE COURT: I have no particular questions.

Thank you.

Mr. Tringa??.

MR. TRINGALI: We have nothing, Your Honor.

THE COURT: All right.

Mr. Archer or Mr. Grossman, they are the only people from whom I care to hear any rebuttal.

MR. GROSSMAN: Yes, Your Honor.

THE COURT: Come on up.

MR. GROSSMAN: Your Honor, I think if what the parties here are trying to achieve, and I think Mr. Constantine said that is what they are trying to achieve with respect to the release, is what the law says they are entitled to. Then we ought to borrow the language from the Court of Appeals that says what the law is with respect to a release.

The Court of Appeals says in the TDK case, which is cited in our brief.

“We ?? that in order to achieve a comprehensive settlement that would prevent re??tigation of settled questions of quorum Class actions, a court may permit the release of a claim based on the identical factual predicate as that underlying the claims in the settled case.”

I think if that language is in there, Your Honor, that would satisfy us.

THE COURT: You are not suggesting that I should just dodge the issue and put that language in, are you?

MR. GROSSMAN: I think that is the language that should be there, and I don't think Your Honor should accept anything else.

THE COURT: Don't I need to decide, assuming that is the language, whether or not the release extinguishes your case?

You are not suggesting that I just tinker with the release language? You want a decision, right?

MR. GROSSMAN: Well, I would frankly be happy with that release language if the Court of Appeals says it is appropriate.

THE COURT: Isn't that what happened in Super Spuds? Didn't the court below just punt on it? It said the chips will fall where they may.

MR. GROSSMAN: I am not suggesting that, Your Honor. I am suggesting as the court did in the Auction House case to say to the parties, go outside and renegotiate that release to comport with the Second Circuit. I am not suggesting that you changes it. They should change it.

If they don't change it then Your Honor should reject it.

THE COURT: Thank you, sir.

Mr. Archer.

MR. ARCHER: Yes, Your Honor.

I am Richard Archer.

Your Honor, it occurred to me at the last discussion I think that Your Honor in a sense must decide these questions because of the additional provision that there is that this court retains jurisdiction forever to determine the scope of the release.

That is one way that we have brought up that when it comes to the banks, which are not before Your Honor, they are before the court in San Francisco. That court has first jurisdiction over it. But specifically again with the banks and the negotiation of the settlement the defendants here have put in the fact that my colleague Mr. Cox wrote a letter to Mr. Constantine saying, in effect, if you want to talk to as about it we will be glad to and, of course, that didn't occur

But in the memorandum of law in support of the motion for approval of the settlement, it is before your court and it is before Your Honor, it is submitted that one of the rubrics is the ability of the defendants to withstand the greater judgment.

In other words, they are looking at how much money did Visa and Mastercard have. What he is saying is this is a lot of money for those two entities to come up with. I think that is right. In Judge Jones' findings I think she found that the only money that Visa and Mastercard retain, and I think it was just Visa retains was enough in case there was an insolvent bank.

Which sort of amused me but be that as it may. It would indicate that there was some limitation on what they could pay. Which brings me to my point that in our case we have a defendant, U.S. Bank, Wells Fargo Bank, The Bank of America.

This little paragraph would not be in the settlement memoranda of Mr. Constantine, because with those three banks is there there wouldn't be any questions about ability. That goes to the point from Super Spuds, was this claim compensated for. I say that there was nothing. That there was no price foxing compensated for and especially there was no price foxing compensated for as to the merchant discount by these three banks.

Thank you.

THE COURT: Thank you.

Did you want to speak?

MR. CONSTANTINE: Yes.

THE COURT: I think I heard enough, though.

MR. CONSTANTINE: I just wanted to correct the record. Mr. Archer's partner did call me. He called me at a time after there was already a fully negotiated signed executed legally enforceable release.

Not that anything would have changed.

THE COURT: I don't need further argument on that.

All right. I will take the application for approval and the objections to it under advisement.

Thank you very much.

Have a good day.

(Whereupon court was concluded at 12:55 p.m.)

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# Exhibit G

The American Antitrust Institute

**AAI Working Paper No. 12-03**

**Date**: October 15, 2012

**Title**: Private Recoveries in International Cartel Cases Worldwide: What do the Data Show?

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**Abstract:**

In 2012 the global struggle to suppress price-fixing cartels reached a milestone. For the first time, U.S. monetary penalties exceeded $50 billion and worldwide antitrust penalties surpassed $100 billion.

This paper describes trends in private recoveries and their role in deterring cartels. The main findings are:

- Recoveries of cartel damages occur overwhelmingly in the United States.
- Similar compensatory suits are growing rapidly abroad.
- The largest U.S. settlements are for *private international* cartels.
- The time needed to settle fell from more than ten years before 1990 to less than three years in the 2000s.
- U.S. cartel recoveries are growing exponentially and will likely reach $60 billion in 2017.
- Every U.S. criminal cartel conviction is followed by a successful private suit, but half of private actions do not follow upon U.S. convictions.
- The average severity of cartel penalties is highest for Canadian fines (15% of affected sales for local to 17% for global conspiracies); moderate for U.S. and EU (4% to 13%) fines; and below 4% for private suits and other jurisdictions' fines.
- U.S. cartel fines average 40% of U.S. damages, and private settlements average 30%. Together, all U.S. monetary penalties average less than 100% of the illegal profits made by international cartels.

## INTRODUCTION

Despite being around for more than a century in the United States, the role played by "treble damages suits" in cartel enforcement is controversial (Foer et al. 2010: xii). Some think of them as exemplars of a hyper litigious society, while others perceive them as essential elements in a rational cartel-enforcement program. In the EU and other jurisdictions outside the United States, the desirability and ideal design of private rights of action are currently matters of intense debates (Foer and Cuneo 2010).

The purpose of this paper is to examine the size and role played by private damages recoveries[1] in antitrust suits directed at contemporary hard-core international price-fixing cartels.[2] After discussing the data source for this paper, I then describe the amounts and trends in U.S. settlements in private antitrust suits since 1990, the dominance of U.S. cases in the world, the extent to which private suits follow government investigations, and the severity of private recoveries relative to affected sales and to damages caused by the cartels. The last ratios can be used to judge the *ex post* deterrence power of current monetary cartel penalties.[3] This paper elaborates and extends a book chapter by the author (Connor 2010a).[4]

## DATA SOURCE

The data that are analyzed in this paper are derived from the Private International Cartels (PIC) data set. In terms of affected commerce, almost all of the larger cartels discovered and punished worldwide since 1990 are international in membership. Because some of the defendants' assets, executives, and documentary evidence are abroad, international cartels are more difficult to prosecute.

The author of this paper began collecting publicly available economic and legal information on all formally investigated international cartels more than ten years ago. Investigations in criminal

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[1] All but a very few of the recoveries were settlements.

[2] For a fine introduction to the issues addressed herein, see Calvani and Calvani (2011).

[3] The orthodox legal-economic *ex ante* concept of deterrence examines the minimum penalties necessary to prevent the formation of cartels; the size of these optimal penalties depends inversely on the conspirators' expectations of being detected and punished (see Connor and Lande 2012). However, if one assumes that the cartel has already been caught (i.e., the probability of detection is 100%), then the *ex post* optimal penalties are much lower, approximately equal to the monopoly profits made by the cartel.

[4] Readers are directed to a handbook containing the most comprehensive collection of papers on every conceivable legal-economic aspect of private antitrust litigation (Foer et al. 2010)

jurisdictions begin when suspected price-fixers are served Civil Investigative Demands, a grand jury is empanelled, subpoenas are served, search warrants are exercised (a/k/a "a raid"), or a private antitrust damages case is filed in court. Some of these actions are kept secret or go unnoticed by the press until indictments or convictions are announced. In other jurisdictions with civil administrative competition-law commissions, investigations begin with raids that used to be quiet affairs but that are now mostly announced by the commissions. While some of these alleged violations turn out to be incorrect or unprovable, roughly 95% of all cartel investigations result in consent decrees, fines, prison sentences, damages awards, or other legal sanctions against at least some of the suspects. Appeals of these adverse rulings can take ten years or more to be resolved.

This paper focuses on *private international hard-core cartels*. Private cartels are voluntary associations of legal entities – usually large multinational corporations -- that explicitly collude on the control of market prices or output with the aim of increasing joint profits of its members. Many government-sponsored international commodity agreements, such as OPEC, are not classified as private collusive schemes. Moreover, mandatory price-fixing arrangements, like USDA marketing orders, do not qualify as private cartels. Because private cartels (typically comprised of corporations or corporate associations) are not protected by sovereign treaties, they are subject to price-fixing sanctions under the antitrust laws now adopted in a hundred nations of the world.

"International" cartels are those with members headquartered in two of more nations. Thus, international is a membership concept and not necessarily a geographic concept. International cartels tend to be larger, better publicized, more injurious to markets, and geographically more widespread than the many more numerous local cartels. Many international cartels are virtually global in their operations.

"Hard-core" describes agreements that are knowingly made through some sort of direct communication among the cartelists about controlling market prices or reducing industry output.[5] In many jurisdictions cartel formation is a conspiracy.[6] Before cartels were made illegal, the association would be established by a written contract that in many nations were enforceable by courts; historical cartels often had a secretariat registered in Switzerland, London, or some other convenient business center. The business press of the day would follow developments of cartels and report on them. Nowadays, cartels generally are founded through face-to-face meetings, make solely oral contracts, and keep their existences secret. Operational decisions are handled by a management

[5] Cartels are one type of horizontal restraints of trade. Only cartels that overtly agree to control prices, output, or both are "naked" or "hard-core" violations. An agreement that, for example, illegally restricted access to a trademark would not be considered a serious, hard-core violation. In some jurisdictions, cartels are criminal violations, whereas other types of restraint of trade are civil violations.

[6] Both the United States and the EU have adopted the conspiracy theory of cartel infringement. As such, it is the agreement that is the violation, not whether the market or customers were injured. Agreements usually involve verbal conversations (containing the words "agree," "deal," "let's do it," "contract," or other synonyms) or handshakes, but may include more subtle body language.

committee[7] that meets at least annually, and disputes are resolved through frequent telephone calls, faxes, or emails in between meetings.[8]

The sample includes all international cartels which were either formally investigated by an antitrust authority or a complaint filed during January 1990 to August 2012. Much of the information on the composition, duration, size, and cartel sanctions comes from the press releases and decisions of the prosecuting antitrust authority (or plaintiffs' Complaints if they win in court). Supplementary information on affected sales is garnered from industry trade journals and reports by business consulting companies. Overcharge estimates are from publications by uninvolved economists, statements of antitrust authorities, judicial or commission opinions, or crude but conservative estimates prepared by the author from good quality market price data; in no case is an overcharge figure based only upon assertions by parties to the case.[9]

The lion's share of U.S. recoveries is the result of federal multidistrict litigation ("class-action" suits) and related damages actions in State courts. Opt-out suits are included whenever publicly reported, but recoveries from such suits that are kept confidential are underreported in this paper.[10] The dollar amounts of the recoveries are cash values claimed by plaintiffs in settlement documents approved by a supervising judge.[11] Non-cash distributions such as coupons or injunctive relief are excluded. A relatively small amount of recovery is in the form of court-ordered restitution; often the victims are governments (Connor 2009).

## RECOVERIES ARE LARGE AND GROWING

I found 130 settlements involving international cartels, of which 120 were U.S. court cases (Figure 1). The number of U.S. settlements over the 22.5 years averaged about five per year and ranged from zero to 22 each year. The numbers peaked in 2002-2008.

The 50 largest U.S. settlements are listed in Table 1, of which 49 are international conspiracies. These 49 comprise 97% of the dollar recoveries in the sample employed in this paper.

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7 Highly elaborate global cartels have as many as three layers of management committees.

8 These activities then leave a paper or electronic trail that is later used by prosecutors.

9 Inquiries about sources of information or computational methods on specific cases can be retrieved from the author's files upon request.

10 For the difficulties involved in evaluating coupons and in-kind recovery, see Lande and Davis (2012). Because these scholars have labored to refine the dollar values of several recoveries involving international cartels, I have substituted their (lower) amounts when available.

11 Where public, some opt-out recoveries are included.

| Table 1. Fifty Largest Private Cartel Damages January 1990-July 2012 ($ mil.) # | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Cartel/Market Name, Place** | US Direct | US Indirect | Canada | Other Nations | **Total** | **Total/ Sales** | Date Settled | **Total** |
| | *Nominal $ million* | | | | | *Per-cent* | *Year* | *$2012* |
| Bank cards' transaction fees 3 ("Merchant Discount"), US | 7,800 | 0 | 0 | 0 | **7,800** | 2.4 | 2012 | **7800** |
| Bank cards' transaction fees 2 ("AMEX & Discover"), US | 6650 | 0 | 0 | 0 | **6,650** | 11.7 | 2008 | **6775** |
| Bank cards' transaction fees 1 ("Wal-Mart" case), US | 3383 | 0 | 0 | 0 | **3,383** | 1.2 | 2003 | **4752** |
| Tobacco Leaf, auctions, US | 1850 | 0 | 0 | 0 | **1,850** | 11.9 | 2000 | **2839** |
| Vitamin E, Global * | 1467.0 | 140.83 | 21.30 | 0.0 | **1,629** | 34.40 | 2005 | **2143** |
| Natural Gas, California ("El Paso"), US [a] | 1427.0 | 0.00 | 0.00 | 0.0 | **1,427** | NA | 2003 | **2005** |
| Vitamin Premixes, Global * | 1024.0 | 86.40 | 33.50 | 0.0 | **1,144** | 16.00 | 2005 | **1899** |
| LCDs (Liquid Crystal Displays), TFP (thin film) type, Global | 825.62 | 796.7 | NA | 20 | **1,642** | 0.34 | 2010 | **1793** |
| Securities, NASDAQ market makers, US | 1027 | 0 | 0 | 0 | **1,027** | 3.12 | 1998 | **1663** |
| Vitamin C, Global * | 772.0 | 74.11 | 13.80 | 0.0 | **860** | 23.00 | 2005 | **1131** |
| Graphite Electrodes, Global | 676 | NA | NA | 0 | **676** | 10.7 | 1999 | **1097** |
| Hydrogen Peroxide, other industrial bleaches, Global | 79.4 | 2.1 | 20.5 | 835 | **937** | 6.8 | 2009 | **1040** |
| Vitamin A, Global * | 688 | 66.05 | 11.2 | 0 | **765** | 25 | 2005 | **1006** |
| Auction houses, art, buyers' & sellers' fees, Global | 592 | 0 | 40 | 0 | **632** | 73 | 2000 | **975** |
| DRAMs (digital random access memory chips), Global | 492.9 | 253.3 | NA | 0 | **746** | 2.6 | 2006 | **894** |
| High Fructose Corn Syrup, US | 531 | 80 | 0 | 0 | **611** | 5 | 2004 | **804** |
| Airlines, cargo, fuel surcharge, Global | 495 | NA | 72 | NA | **567** | 0.3 | 2006 | **679** |
| Diamonds, Industrial, Global | 30.35 | 250 | NA | 0 | **280** | 7.2 | 2000 | **660** |
| Methionine, Global | 439 | | 4.2 | 0 | **443** | 5.6 | 2003 | **622** |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Currency conversion fees, charge cards, US | 385.5 | 17 | 0 | 0 | **403** | 0.63 | 2006 | **542** |
| Digital telephone switches, Israel | 0 | 0 | 0 | 389 | **389** | 45 | 2004 | **512** |
| Vitamins: Beta Carotene, Global | 317.0 | 34.14 | 4.60 | 0.0 | **356** | 29.90 | 2005 | **468** |
| Airlines, passenger, fuel surcharge, Transatlantic Routes, Global | 196.4 | NA | 72 | 174 | **442** | 0.017 | 2008 | **450** |
| Buspirone anti-anxiety drug, US | 220 | 93 | 0 | 0 | **313** | 232 | 2003 | **440** |
| Rubber Processing Chemicals, Global | 319.9 | NA | NA | 0 | **320** | 4 | 2006 | **384** |
| Orthopedic devices, US | 311 | 0 | 0 | 0 | **311** | 5.9 | 2007 | **360** |
| EPDM synthetic rubber, Global | 270.2 | 0 | 3.4 | 0 | **274** | 10.9 | 2005 | **360** |
| Linerboard, US | 254.5 | 0 | 0 | 0 | **255** | 4.3 | 2003 | **358** |
| Diamonds, rough gem quality, Global | 22.5 | 272.5 | NA | 0 | **295** | 0.1 | 2006 | **354** |
| Gasoline trading, unleaded, US | 303 | 0 | 0 | 0 | **303** | NA | 2007 | **351** |
| Citric Acid, Global | 175 | 25 | 5.4 | 0.918 | **206** | 4.3 | 2002 | **321** |
| Lease oil, US | 193.5 | 0 | 0 | 0 | **194** | 0.87 | 1999 | **315** |
| Cardizem CD hypertension drug, US | 110 | 80 | 0 | 0 | **190** | 9.2 | 2002 | **296** |
| Anti-anxiety drugs, US | 132.29 | 77 | 0 | 0 | **209** | 134 | 2003 | **294** |
| Cosmetics, "prestige," U.S. | 199 | 0 | 0 | 0 | **199** | 0.34 | 2003 | **278** |
| MSG and Nucleotides (IMP, GMP), Global | 169.5 | 76.6 | 4.9 | 0 | **251** | 1.5 | 2003 | **253** |
| Choline chloride (vitamin B4), North America | 158.7 | 13 | 11.7 | 0 | **183** | 28.7 | 2004 | **242** |
| Vitamin B4 (choline chloride), Global | 154.0 | 15.65 | 7.70 | 0.0 | **177** | 12.10 | 2004 | **233** |
| Vitamin B5, Global | 150.0 | 15.50 | 2.10 | 0.0 | **168** | 29.10 | 2005 | **221** |
| Municipal Bond Derivatives, US | 58 | 134 | 0 | 0 | **192** | 0.024 | 2010 | **211** |
| Vitamin H (Biotin), Global | 128.0 | 13.74 | 0.40 | 0.0 | **142** | 29.60 | 2005 | **187** |
| Explosives mfg., commercial, Texas Group, US | 114.4 | 0 | 0 | 0 | **114** | 8.2 | 1998 | **185** |
| Sorbates, Global | 95.5 | 21.4 | 3.1 | 0 | **120** | 5.9 | 2000 | **184** |
| Vitamin B2, Global | 124.0 | 12.40 | 2.10 | 0.0 | **139** | 29.10 | 2005 | **183** |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Glass, flat 1, Global | 122.6 | 0 | 0 | 0 | **123** | 0.7 | 2005 | **162** |
| Polyester staple, US and CA | 107 | 0.975 | 0 | 0 | **108** | 7.4 | 2005 | **142** |
| Terazocine hydrochloride drug, US | 72.5 | 30.7 | 0 | 0 | **103.2** | 35.1 | 2005 | **136** |
| Wood, oriented strand board, US + CA | 120.71 | 9.94 | 0 | 0 | **131** | 1.1 | 2008 | **133** |
| Vitamin B3 (niacin), US+CA | 90.0 | 9.0 | 1.53 | 0 | **100.5** | 12.8 | 2005 | **132** |
| Automotive Refinishing Paint, Global | 105.75 | NA | NA | 0 | **106** | 0.27 | 2007 | **123** |
| | | | | | | | | |
| MEAN AVERAGE of 50 Cases | 700 | 66 | 6 | 49 | **809** | 18 | 2004 | **1002** |
| MEDIAN AVERAGE of 50 | 198 | 16 | 0 | 0 | **312** | 6 | 2005 | **412** |
| TOTAL U.S. Domestic Cases | 1,427 | 0.00 | 0.00 | 0.0 | **1,427** | NA | NA | **1,427** |
| TOTAL U.S. International Cases | 33,595 | 2,713 | 262 | 2,449 | **39,019** | NA | NA | **48,667** |

# Includes only cases in which horizontal price fixing (including bid rigging and market allocation) was the principal or important illegal conduct proven; one close call is the class action *Brand Name Prescription Drugs Antitrust Litigation* case settled for more than $717 million, but had vertical price discrimination as the principal conduct. Some cases are only partially settled.
a) This is the sole domestic cartel in the top 50.
NA = Not available or not applicable
* = Part of an overarching conspiracy in several bulk vitamins.

Sources: John M. Connor, *Private International Cartels Spreadsheet* (dated July 2012); Davis and Lande (2012).

Private damages recoveries worldwide between January 1990 and August 2012 totaled $41.8 billion (in nominal dollars), of which $38.7 billion (or 93%) were settlements in the United States (Figure 1).[12] Converted to 2011 dollars, the world and U.S. totals are approximately $52 and $48 billion, respectively.

The pattern of U.S. settlement amounts over time is quite uneven because of a few very large settlements. Settlements rose very slowly at first, reaching a cumulative total of $300 million in 1997. Recoveries accelerated sharply after 1997.[13] The year 1998 was the first time that recoveries reached

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[12] Many of the remaining $2.9 billion in reported recoveries are judgments announced in jurisdictions where the payouts may not be enforceable and information on litigation is difficult to access from the United States.

[13] Settlement amounts are classified according to the year in which the first company agrees to pay; sometimes every defendant agrees to pay in the same year, but more commonly these dates are staggered.

$1 billion in one year; records were broken again in 2000, 2002, 2003, 2008, and 2012. The catalyst for the record in 1998 was the *NASDAQ Market-Makers* case. That record was broken in 2000 largely because of the large *Leaf Tobacco* case (2.8 billion 2011 dollars). The bump in 2005 is attributable to the collectively huge *Bulk Vitamins* cases ($5 to $8 billion).[14] The final three record years (2003, 2008, and 2012) were the result of three bankcards' cases. They are known as the "*Wal-Mart*" ($3.4 billion in recoveries), "*AMEX and Discover*" ($6.7 billion), and "*Merchant Discount*" ($7.8 billion) cases.

Annual recoveries are rising exponentially (Figure 2).[15] If present trends continue, average annual cartel settlements will likely be about $16 billion by 2017. However, accumulated recoveries are smoother over time and more accurately predicted (Figure 7). This trend line predicts that the total 1990-2017 recoveries will be $60 billion in 2017 (about 75 billion 2011 dollars).

Settlement patterns are sensitive to the dates employed. In Figure 1 the data are arranged according to the year in which settlements were announced (usually the date of preliminary court approval). We are looking backward in time. However, because of the longer gestation period for such cases compared to criminal investigations, scores of current follow-on private cases are likely to be settled in the next few years. If the settlement amounts are arranged by the year the first cartel member is fined anywhere in the world (Figure 3) or the date the damages case was first filed (Figure 4), the temporal pattern is quite different. By looking forward in time, the settlements seem to peak and fall, but this is a distortion created by these lengthy suits.

Although time-consuming, settlements in international cartel cases appear to be taking shorter times to resolve in recent years (Figure 5). Prior to 1990, the average treble damages case took 11 years between the filing date and the date the first firm settled. In the 1990s, that lag dropped to a little more than five years, and in the early 2000s it was merely 3 years.[16]

Recoveries in North America are overwhelmingly awarded to direct purchasers, which are most commonly manufacturers. Available information suggests that 91% of recoveries go to direct buyers and the remaining 9% to indirect buyers. Settlements by indirect purchasers are typically smaller companies that distribute the cartelized products or are households. Indirect-purchaser suits are typically filed in state courts.[17] Economic theory generally posits that the majority of price-fixing overcharges are passed on to final consumers. Whether the low portion received by indirect buyers

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14 Sixteen vitamins' and provitamins' markets were cartelized by 22 companies during 1988-1999. All but one of these 16 markets had successful private damages suits, of which ten are listed among the top 50 recoveries in Table 1.

15 The exponential function fits the best of several other functional forms fitted to these data, but it explains only about 32% of the annual variance. Cumulative amounts of recoveries smooth the data much better resulting in a nearly perfect fit of 98% (Figure 7).

16 Data in the late 200s are too few to generalize with confidence.

17 Approximately 30% of the U.S. population lives in states where such suits are not permitted (Foer and Cuneo 2010: 101).

means that indirect purchaser cases are more difficult to litigate (because of pass-on issues perhaps) or whether indirect awards are systematically underreported, I cannot say.

Recoveries in private settlements in the United States are much larger than the fines imposed by the DOJ (Connor 2012). International cartel fines imposed by the DOJ totaled $11 billion and penalties imposed by the State AGs and other government agencies $4.8 billion. Settlements announced by private plaintiffs in North America total $41.8 billion – roughly 2.6 times penalties levied by government entities in North America. Because there are few private suits outside North America, it is premature to compare them to government fines for the same cartels; however, because these jurisdictions are constrained by single damages awards, private settlements are likely to be smaller relative to fines for the foreseeable future.

## PRIVATE ACTIONS ARE CONCENTRATED IN NORTH AMERICA

With a few notable exceptions and measured several ways, private international cartel damages suits have historically been highly concentrated in North America; over 90% of worldwide cartel settlements are collected in the United States (Connor 2012a).[18] In Canada, nearly all private suits filed against international cartelists run in parallel to U.S. suits. Only ten of 130 the sample recoveries were solely non-U.S. actions.

Besides private suits, the U.S. government has the power to seek treble damages for price fixing overcharges incurred by federal, state, and municipal governments. However, traditionally it and the state attorneys general seek only restitution for single damages. A case study of the sprawling and little-known federal *E-Rate* price-fixing cases is described in Appendix B.

Measured by publicly announced nominal settlement and restitution amounts, the United States is the leader with 93% of the worldwide total. Canada accounts for 1% and the rest of the world 6%.

## PRIVATE ANTITRUST SUITS OUTSIDE NORTH AMERICA

Although the private damages scene outside of North America is often characterized as moribund, there are stirrings of such activity in a few EU national courts and some notable successes.[19] First, courts in some jurisdictions have the authority to impose restitution requirements on cartels over and above fines incurred. For example, the *Hydro-Electric Power Equipment* cartel punished in Norway was fined $2.6 million and later ordered to pay $7.2 million in additional restitution payments.

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[18] Most cartels have multiple complaints filed in several courts by different plaintiffs; these are consolidated into one federal class action or a few state actions. Some larger buyers may opt not to join the consolidated suits and either settle out of court or file a separate "opt-out" complaint.

[19] See the country chapters in Foer and Cuneo (2011: 277- 571).

Unfortunately, such cases are often confined to bid rigging in which the government is the victim. (On this phenomenon, see Connor 2009). A second example is the *District Heating Pipes* cartel. This cartel was heavily fined by the EC, and a few years later several Danish municipalities successfully sued for damages in Denmark's first-ever private antitrust suit (Mollgaard 2006). In other jurisdictions in low income countries with new antitrust laws, restitution orders are so large that they appear to be uncollectable; moreover, they appear to be directed at foreign investors who may be recalcitrant followers of authoritarian governments. Such an example appeared in Kazakhstan in 2005, where a subsidiary China National Oil Co. was ordered to pay $730 million in antitrust restitution to resolve price-fixing allegations (World Markets 2005) (Appendix A).

Second, in Europe especially, the frequency of private damages actions may be underestimated because of the difficulty of locating public records about such suits. In the UK, for example, Rodger (2009) found a surprisingly large number of private price-fixing suits when he queried law firms rather than relying on press reporting or court records. In any case, there are some potentially large awards expected from private single-damages suits currently being decided in Belgian and German courts. The European Commission itself has brought suit in a Belgian court for compensation from members of the cartel that installed and maintained elevators and escalators in Commission buildings. In Germany, a private compensatory suit against members of a fined EU-wide cement cartel has survived many legal challenges.

Third, in jurisdictions with Common Law foundations, substantial progress has been made in launching the first direct purchaser suits. A few years ago, Australian farmers benefitted from a successful suit that paid out damages from the bulk vitamins cartel; consumers and other indirect purchasers have not fared so well. A large number of compensatory suits have been launched in South Africa, but notable successes have not yet surfaced publicly. The UK's National Health Service was awarded damages when generic drug suppliers colluded on tenders. More recently, an antitrust settlement was announced for UK direct buyers of marine hose. Several successful private suits were concluded in Israel.[20]

## TO FOLLOW ON OR NOT TO FOLLOW ON?

Critics of the U.S. treble-damages system of litigation suggest that private plaintiffs are free riders. That is, the work of plaintiffs' counsel is made easy because the difficult tasks of uncovering these hidden crimes and assembling the proof necessary for the facts of damages are carried out by U.S. government prosecutors. These are the proto-typical follow-on cases in private litigation. However, the law does not require private plaintiffs to wait for the completion of the Government's cases; indeed a large share of private cartel cases are not follow-on lawsuits. In this section, I examine the

[20] Israel has no constitution, so its judiciary seems to borrow legal principles from multiple legal traditions, including the United States.

followership status of private cartel cases filed in U.S. courts and whether the length of private litigation is affected by followership status.

There are three followership categories (Figure 9). First, *U.S. follow-on* cases are the most common type.[21] The proportion of private cases following earlier *U.S.* government sanctions is 51% of the total private actions in the sample. Looked at in a different way, of the 52 international cartels that were fined by the DOJ during 1990-2005, 100% were followed up with private damages actions (Figure 10).[22]

Second, a somewhat unappreciated fact is that 8% of U.S. private actions are filed after fines by the EC or other non-U.S. antitrust authorities. I will dub these the *non-U.S. follow-on* cases. Examples include two of the smaller bulk *Vitamins* products (B12 and Canthaxanthin)[23], *Methionine, Acrylic Glass,* and *Flat Glass.* All but one of these cases is global cartel. In some instances, the DOJ investigated the cartel but chose not to indict, while in other instances there is no public information that the DOJ formally investigated the cartel.[24]

Third, 41% of the treble-damages cases were *non-follow-on.* That is, they were not preceded by any known government sanctions in either the United States or elsewhere; a few may follow investigations by antitrust authorities that were ultimately closed.[25] Examples are three bulk *Vitamins* (folic acid, B1, and B9), *Sulfuric Acid, SRAMS, High Fructose Corn Syrup, Carbon Black,* and many others. Almost one-third of the non-follower cases are global cartels. One might expect that the latter two types of private actions would be more costly to prosecute and more difficult to win, in part because plaintiffs must develop all their own inculpatory evidence.

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[21] All follow-on cases are filed after a plaintiff or plaintiffs' counsel knows about an investigation. Nearly all U.S. follow-on cases follow upon one or more criminal guilty pleas negotiated by the DOJ; a few settle prior to the first guilty plea; and fewer still follow investigations by the U.S. FTC, SEC, or other federal agencies. Follow-on cases benefit from factual evidence of guilt contained in Web-published guilty pleas, "informations," sentencing memoranda, or government Complaints submitted to appeals courts.

[22] I stop at 2005 simply to allow enough time to elapse for all private actions to be completed.

[23] These two small cartels were prosecuted by either the Canadian or EU competition authorities.

[24] It is possible that a grand jury was empanelled to consider indictments but was disbanded without public notice. In the case of the six *Vitamins* cartels, it appears that the DOJ made a conscious decision to prosecute the nine bulk vitamins with the largest U.S. affected sales and to omit prosecuting the six vitamins with the smallest affected sales (Connor 2008). Each of the six products generated less than $150 million in sales during the collusive period (Ibid., pp. 370-374). Perhaps dropping charges related to these six products was offered as an incentive to plead guilty.

[25] Private plaintiffs must generate factual evidence of guilt largely on their own. Evidence obtained during criminal investigations – those involving subpoenas, searches, or grand juries – are usually kept secret by the government and the targets of the investigation. Evidence contained from leniency applications is normally not available to private plaintiffs (unless the leniency recipient voluntarily shares the leniency submission with plaintiffs). Other evidence obtained by the government in criminal investigations is usually not handed to plaintiffs for years after it is obtained. Even the fact that a criminal investigation was closed by U.S. authorities is usually not announced by the agencies, but may be revealed by the corporate targets.

The paragraph above measures the relative size of the three types of U.S. private actions by counting the *numbers* of such cases. An alternative metric is to use the monetary size of the recoveries. In terms of publicly reported *dollar settlements*, the U.S. follow-on cases garnered only 26%, the non-U.S. follow-ons a shrunken 2%, and the non-follow-ons an impressive 72% of the $39 billion total.[26] However, the reader must be cautioned that the non-follow-on category is strongly affected by the bankcard cases.

One indicator related to the size of prosecutorial costs of private plaintiffs is the length of the damages proceedings. While many alternative dates are available, I measure the length from the date that the first private suit is filed to the date that the first cartelist agrees to settle (Figure 12). The length of domestic follow-on cases averages 45.6 months and the non-U.S. follow-ons 44.9 months[27], whereas for non-follow-on actions the average length is 55.6 months.[28] The non-follow-on suits take almost a year longer (about 25% longer) to prosecute than both types of follow-on private suits. Thus, it appears that plaintiffs' in non-follow-on suits have informational disadvantages that typically prolong litigation.

## AWARDS ARE MODEST RELATIVE TO AFFECTED SALES

In this section, I discuss the *severity* of cartel sanctions (private recoveries and government fines), that is, the size of sanctions relative to a jurisdiction's affected commerce. Recall that all the cartels in this paper's sample are "international," a DOJ concept that refers to the *membership composition* of the conspiracies; all of these cartels are relatively large in terms of affected sales or fines.[29] However, many of these international cartels were geographically local operations in the sense that they operated inside one jurisdiction.[30] A large minority of the sample was geographically widespread:

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[26] Federal class actions are fairly well reported in the press or in Internet postings, state class actions less so. Joint suits by State attorneys general are fully reported by the National Association of Attorneys General. The settlements of many opt-out private suits are missing, though the largest ones tend to be picked up by the business press, especially when the recipient is a publicly listed company. For this reason, the total settlements reported are less than the actual payouts. On the other hand, the dollar totals may be inflated because of exaggerated values placed on in-kind product distributions or coupon values. Whether these two contradictory forces affect the *distribution* of settlement amounts is unknown.

[27] The range is quite wide, from 5.5 to 173 months. The median numbers of months for the U.S. and non-U.S. follow-ons are 40.7 and 26.0, respectively.

[28] The median is 54.4 months. Therefore, the median non-follow-on suits last approximately 40% longer than the median follow-on suits.

[29] The purely domestic price-fixing cases prosecuted by the DOJ involve markets for products sold in one or a few adjacent states. Examples are ready-mix concrete, magazine wholesale distributors, scrap metal recycling, and plastic pilings for piers.

[30] To be more precise, only one jurisdiction succeeded in convicting a cartel and decisions of antitrust authorities did not contain facts or language suggesting a wider geographic conspiracy. DOJ plea agreements are fairly consistent in describing the geographic area of a cartel as either "in the United States" or "in the United States and elsewhere." It is possible that some local cartels unbeknownst to the authorities in fact had activities outside the jurisdiction.

cartels that operated across two or more continents are termed "global." Because global cartels are different[31] in many respects from more localized cartels, I discuss each type separately. Moreover, I choose to report *median* average severities, because the distribution of severities contains a small number of very large ratios that bloat the mean averages, making them inaccurate measures of central tendency.

For the non-global cartels, there are 294 severity ratios available. The denominators are affected sales only within the jurisdiction, and sometimes only sub regions of those jurisdictions. For example, the EC fines may cover violations for the entire European Economic Space (the European Union and the associated EFTA nations) or for conduct within just a few of the Member States. U.S., Canadian, and Rest of the World (ROW) severities generally refer to national or sub national geographic areas. The "World" severities I report generally refer to all of the above.[32]

For non-global international cartels, the fines imposed by the U.S. DOJ and EC tend to be equally severe, both averaging about 4% of affected sales (Figure 14). Canada, by contrast, has a long-standing policy of imposing fines that are about 20% of Canadian affected sales and then rewarding a couple of early confessors small discounts; the median Canadian fine severity is almost 15%. The Member States of the EU (the "NCAs") and competition authorities in the ROW nations are relatively timid in assessing fines; their averages are below 0.3% of sales. Private settlements average 3% of affected commerce, which is not far from the world median severity of 2.7%.[33] (The "world" ratios divide all types of sanctions by affected sales in the appropriate jurisdictions).

The fines impose on global cartels are somewhat higher (Figure 15). Canada again leads the pack with median fines of 17.5%, but U.S. fines (13.2%) and EC (8.7%) fines are not far below. There are relatively few examples of fines on global cartels by EU Member States or authorities in ROW, but the median averages are very low (0.3%). As in the case of non-global cartels, median settlements' severity for global conspiracies is about the same (3.9%) as that of the 191 "world" ratios (4%).[34] (Note that the denominator for almost all the settlements is North American sales, whereas for the world ratios total worldwide sales are used when available; total sales might be restricted to a sub national region).

Discussion of averages for long periods of time might obscure important temporal changes. With 21 years of data available, it is possible to examine trends in penalty severities (Figure 16). Trend analyses in show that EC fine severities have a distinctly upward trend since 1990, whereas U.S. fines

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[31] Global cartels are more durable, have larger affected sales, and higher percentage overcharges than non-global international cartels (Connor 2008).

[32] However, most of the ratios sum U.S. and Canadian settlements for the numerator and use sales in the U.S. and Canada for the denominator.

[33] Note that mean average severities for private and world are much higher, 54% and 36%, respectively.

[34] Mean severities for private and world are much higher, 23% and 11.5%, respectively.

appear to have peaked in severity around the year 2000. U.S. policy has since about 2000 tended to emphasize individual penalties as a substitute for corporate penalties (ibid.). The mean average severities of U.S. private settlements are about 22%, the median 4.7%. Severity rose from 1990 to about 1996 (when the trend peaked at 40%) but has since slid to a nadir in 2008. from close to zero in the 1990s to about 17% in the late 2000s. However, time alone explains only a very small percentage of the variability in settlement variation.

## DETERRENCE POWER OF PRIVATE ACTIONS

Severities of sanctions have limited value for assessing the deterrence power of cartel penalties. More relevant are the sizes of sanctions relative to the injuries caused. These injuries tend to be about as large as the cartel's illegal, monopoly profits, so the ratios of sanctions to overcharges also reveal the extent to which *ex post* profits were disgorged through legal actions. Full disgorgement is also called restitutive. Reliable estimates of overcharges are hard to come by, so sample sizes are lower than for severities.[35]

Nevertheless, penalty/damages ratios are available in sufficient numbers for the most common forms of cartel sanctions to say something about price-fixing deterrence. For example, there are 45 international cartels that were fined by the U.S. Government for which both overcharge estimates could be obtained (Figure 17). The median average overcharge for these 45 cartels was 20% of affected commerce. Dividing U.S. fines by single damages in the jurisdiction results in a 42% ratio.[36] Put another way, U.S. fines alone disgorged at most about 42% of the cartels' illegal U.S. monopoly profits.

However, in the dataset all fined cartels and others that were not fined paid private damages in North America. Information on settlement amounts and damages are available for only 33 international cartels. For this small sample, the average overcharges were a bit higher – about 25% of sales – and the reported settlement awards were 30% of those damages.[37] The distribution of the private recoveries/damages ratio is quite dispersed. Ten of the cases (31%) recouped less than 10%

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[35] For a discussion of sources and methods of calculating overcharges, see Connor (2010c).

[36] All figures are in nominal dollars (i.e., expressed in dollar values during the collusive period for overcharges and on the day the guilty pleas were announced). Typically, cartels last about six years and extracting guilty pleas occurs at least two years after collusion ended. So, the denominator of the ratio (overcharges) lags by about five years the time of the numerator of the ratio (the fines). If one were to adjust for the time value of money, the proper ratios would be 20% to 40% lower than the unadjusted ratios.

[37] The mean and median averages were 33% and 25%, respectively. As in the case of fines/damages ratios, the settlement/damages ratios are also inflated by monetary depreciation, but because the lags are even longer, the settlements/damages ratios are even more overstated. Thus, the deterrence effects of corporate sanctions are weaker than these ratios suggest.

of the overcharges, and six (19%) recouped more than 50%[38]. The remaining half was in the 10% to 49% range.

For deterrence purposes, it is legitimate to sum the corporate fines and private settlements imposed in North America. We conclude that on average about 90% or less of the monopoly profits international cartels doing business in the United States were disgorged as antitrust penalties (Figure 18).

Average EC fines imposed on cartels operating in the EU historically are less intense than those in the United States, and cartelists there have little fear from private actions. For a sample of 55 cartels, the average ratio of EC fines to damages is also about 42%. [39] However, suppose that a global cartel was caught in the snares of both U.S. courts on the EC. Then, this unlucky cartel might well have to disgorge some of its illegal gains in two non-overlapping jurisdictions. In this instance, the sanctions are *not* additive from a deterrence perspective, because the sanctions/damages ratios are calculated on a strictly jurisdictional basis. So, roughly speaking, the typical global cartel gets to retain at least 10% of its North American illegal gains plus about 58% of its EU-based illegal profits – not to mention *all* of its ROW profits. And the limited deterrence power of contemporary antitrust sanctions is not merely an artifact of averaging: the present author shows that deterrence was illusory in the specific case of the *Vitamins* cartels, which is widely regarded are the most heavily sanctioned global cartel in history.[40]

The analysis above is a snapshot of a 21-year period. Are trends during 1990-2010 favorable to improved deterrence in the future? Regrettably, trends in the cartel penalties/damages ratios are not all favorable. For example, in the United States, the average ratio declined by 40% during 2000-2010 compared to 1990-1999. The trends in the EU are more favorable, with the ratio rising by 25% -- but from such a low level that future increases will have to be impossibly rapid to achieve full disgorgement. Sanctions in the rest of the world are likewise rising rapidly but from a low base.

Keep in mind that the analysis so far has been entirely *ex post*. That is, it is looking backwards from known fines and achieved cartel overcharges. However, deterrence concepts are inherently prospective – looking forward to possible but uncertain future sanctions from the vantage point of the day on which a cartel agreement is first reached. This *ex ante* view is the appropriate one for deterrence of future conspiracies, and it turns mightily upon the chances that hidden illegal cartels will be discovered and punished. Most observers believe that discovery rates are rising, but are nowhere near even 50%. As is the case with most property crimes, it appears that the probability of

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[38] Only two recouped a bit more than 100%.

[39] Under the EC's new 2006 fining guidelines, the rise in the severity of EC fines has indeed been extraordinary (Connor 2010b).

[40] Connor and Bush (2008) show that taking into account the absence of monetary sanctions in most jurisdictions in which the cartels operated, general inflation, and the pre-judgment
time value of money, only about one-third of the monopoly profits were disgorged.

discovery of price-fixing schemes is most likely around 15% to 25%. If this is correct, then to deter cartel formation, penalty/damages ratios must exceed 400%.

## WHAT WE DO NOT KNOW

Corporate fines are usually fully reported on the Web pages of the world's antitrust authorities, though occasionally smaller firms are offered confidentiality. Federal class-action settlements are generally well reported in the press or on special Web sites in North America, but the outcomes of state-level indirect suits are often unreported. Following class-action or representative-action developments elsewhere is quite challenging. Each year hundreds of opt-out suits are concluded without fanfare. Thus, unlike government-imposed sanctions, there is a significant amount of underreporting of private settlement amounts, and under-reporting may grow more severe as private suits become more common abroad.

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World Markets. Court Upholds US$730-million Fine for PetroKazakhstan "Monopoly Profits". *World Markets: Research Centre* (December 6, 2005).

**APPENDIX A: PetroKazakhstan**

In the aftermath of the dismantling of the Soviet Union, newly independent oil-rich Kazakhstan began to attract foreign investment in its petroleum sector. In 1996, for $120 million a small Canadian company, called Hurricane Hydrocarbons at the time, somehow became the winning bidder for a 650-million-barrel oil field and a refinery in southern Kazakhstan (MacKinnon 2004). Hurricane, renamed PetroKazakhstan Inc. ("PetroKaz"), became the second largest producer in the country on its way to becoming the fifth largest oil produced on earth.

By the middle of the 2000s world oil prices were high and the country's authoritarian leader Nursultan Nazarabayev had second thoughts about having sold these assets at what in retrospect seemed like a sweetheart deal. In 2003, a speech in which he praised Russia's President Putin for attempting to re-nationalize the Yukos petroleum company. In that year a new law was passed the required the state-owned petroleum company to own 50% of all new petroleum ventures.

The government kicked off a campaign of legal harassment against PetroKaz. The weapon of choice was the nation's new criminal antitrust laws, which are administered by the Kazakhstan Anti-Monopoly Office (*Calgary Herald*, October 4, 2003). Blaming PetroKaz for a spike in fuel price in southern Kazakhstan, it levied a $6.3 million antitrust fine. After a decision of the Supreme Court in January 2004, PetroKaz paid a $3.6 million fine. A second criminal investigation was launched by the Financial Police and the Anti-Monopoly Office in December 2003; PetroKaz was charged with making monopoly profits of $96 million on domestic fuel sales. After an appeal, it paid a second fine of $35 million. A third investigation in July 2004 charged PetroKaz with orchestrating a scheme to raise fuel prices by $96 million for a few months in late 2003. PetroKaz paid a third fine of $91 million in February 2004. In April 2005, two top Canadian executives of PetroKaz were charged with criminal price fixing and a civil damages claim of about $96 million was filed against PetroKaz. By October the damages claim had risen to $530 million and by December a court ordered PetroKaz to pay $720 million.

PetroKaz had been a profitable company, making more than $100 million in quarterly profits in mid 2004, but its owners threw in the towel in the summer of 2005. It was courted by Russian, Indian and Chinese oil companies. In October 2005, PetroKaz agreed to be sold to the China National Oil Co. (CNOC) for $4.2 billion. CNOC soon agreed to sell 33% of its stock to the Kazakhstan government oil company. A fourth antitrust fine of $57 million was paid by CNOC in February 2006. CNOC was liable for the $720 million in civil restitution, but there is no public record of it having been paid.

## APPENDIX B: CASE STUDY

### The E-Rate Program Cartel

The E-Rate Program was created by Congress in 1996 and administered by the Federal Communications Commission to accelerate the adoption of computer equipment at the Nation's neediest K-12 schools. In recent years, funding has been at the level of $2.25 billion annually. Schools and school districts with the most impoverished student bodies paid as little as 10% of the cost of equipment, software, and services purchased. Many schools hired educational consultants to assist them in designing a system, preparing applications, and ordering the equipment. These consultants were required and did promise schools to obtain several competitive bids from equipment suppliers, but in fact rigged those bids and inflated the invoices in collusion with the supplier(s) or by bribing school officials. Other consultants were hired by equipment manufacturers to pretend to be advisors to schools while in reality acting as corrupt sales agents for the manufacturers.

News of a DOJ investigation was first made public in an August 2003 press release announcing the guilty plea of an individual for bid rigging against West Fresno public schools.[41] Up to June 2011, 33 individuals and nine companies[42] have been indicted or pled guilty in connection with *E-Rate* conspiracies in at least eight states. The first company to plead guilty was NEC-Business Network Solutions, a subsidiary of Japanese manufacturer NEC (f/k/a Nippon Electric Corp.). It agreed to pay $20.66 million in criminal fines and restitution worth at least $66.9 million to the San Francisco School System; NEC admitted rigging many E-Rate bids through two sham consultants in its employ.[43] Eight other companies have been indicted or pleaded guilty.[44] Total corporate fines and court-ordered corporate restitution now totals $40.3 million.

In addition, fines and restitution have been paid by 20 individuals that so far total $15.3 million.[45] The number and length of prison sentences handed down in the E-Rate case are records in the annals of the history of price fixing. As is true in some previous cases, additional charges for bribery and fraud have amplified these sentences. No less than 20 guilty consultants and a few school

[41] This investigation was preceded by a *qui tam* suit by the City of San Francisco filed in 2002. Some school officials have been indicted for bribery, fraud, and conspiracy.

[42] In addition, most of the consultants operated one or more proprietorships or partnerships with virtually no assets. Thus, the DOJ has mostly focused on seeking fines, restitution, and long prison sentences for the consultants. The nine companies sold computer equipment of electrical contracting services.

[43] Details of this *E-Rate* episode can be found in Congressional testimony by George M. Cothran, Investigator for the City Attorney of the City and County of San Francisco (U.S. Congress 2004). He testified that the cost of the computerization project was inflated by 103% after the sham consultants rejected lower-cost bids.

[44] Three companies had charges dropped because they were liquidated by charged consultants who owned them, and one company's sentencing is pending in late 2011.

[45] Eight individuals were awaiting sentencing and four were imprisoned with no monetary penalties as of June 2011.

officials have been incarcerated. They have been sentenced to a total of 961 months in prison, including a record high antitrust incarceration of 90 months by Judy N. Green, who lost her case at trial.[46]

What is somewhat unusual about this case is the great difficulty we have had in tracing the affected sales of these highly local and oftentimes poorly reported events. However, we have been able to obtain affected sales from the posted plea agreements of most of the indicted companies and individuals.[47] Our estimate -- surely on the low side – is $442 million. Note that, as is conventional in bid-rigging cases, the values of a few tenders that were not won by the conspirators are included as affected sales.

Finally, 12 sentencing documents contain provable or minimum losses. These data permit overcharges to be computed for nine of the bid-rigging schemes. The range is from 4.8% to 51.7% of affected sales. The mean is 22%, and the median is 16.7%. If we use the median estimate and apply it to the conservative affected sales of $442 million, then the dollar overcharges were $73.8 million. Therefore, total monetary sanctions amount to at most 75.3% of the overcharges.

What about incarceration? Can it be boiled down to a monetary value? While hard to do, economists would argue that jailed executives (or their employers, if legal) have subjective values that they would be willing to pay to "get out of jail free" These amounts might vary by age, salary, and wealth. The highest such actual payment of which I am aware involved the middle-aged CEO of a large German manufacturer convicted of criminal price fixing in the graphite electrodes market; the company paid $10 million to the U.S. Government to help him escape a probable six-month sentence in a low security U.S. federal prison. I believe that $1.67 million per month is a bit too generous an amount for the opportunity cost of prison for most CEOs, not to mention lower level employees.

Connor and Lande (2011) considered six different ways of evaluating the costs to executives of incarceration. The highest disvalue figure was $1.5 million per year. To be conservative they adopted $2 million per year and then trebled that to allow for other costs besides incarceration *per se*. Suppose we apply this generous incarceration-equivalent value to all the E-Rate incarcerations. That is, at a rate of $500,000 million per month times the 961 months imposed to the 20 imprisoned E-Rate executives, the possible monetary value is an impressive $480.5 million. When the total penalties of $536 million are compared to the $73.8 million in overcharges, we seem to have a clear case of over-deterrence. However, if the executives' (subjective) probability of being apprehended was less than 14%, then these penalties may well be optimal. Most surveys and studies of the probability of detection place it well below 30%.

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46 Her husband and business partner Allen Green was sentenced to 36 months, which was later converted to supervised probation.

47 Because some individuals rigged bids together, we have tried to be careful to eliminate double counting of the bids.

# FIGURES

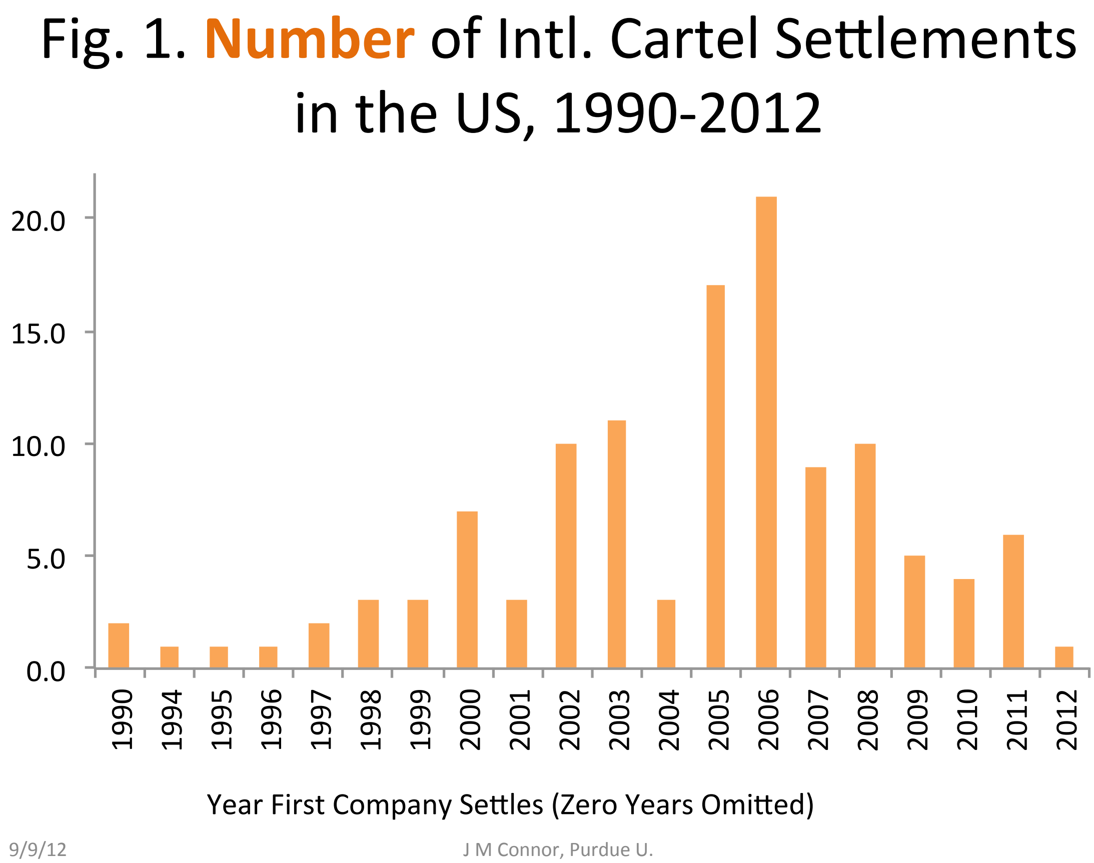
Fig. 1. Number of Intl. Cartel Settlements in the US, 1990-2012
20.0
15.0
10.0
5.0
0.0
1990
1994
1995
1996
1997
1998
1999
2000
2001
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2003
2004
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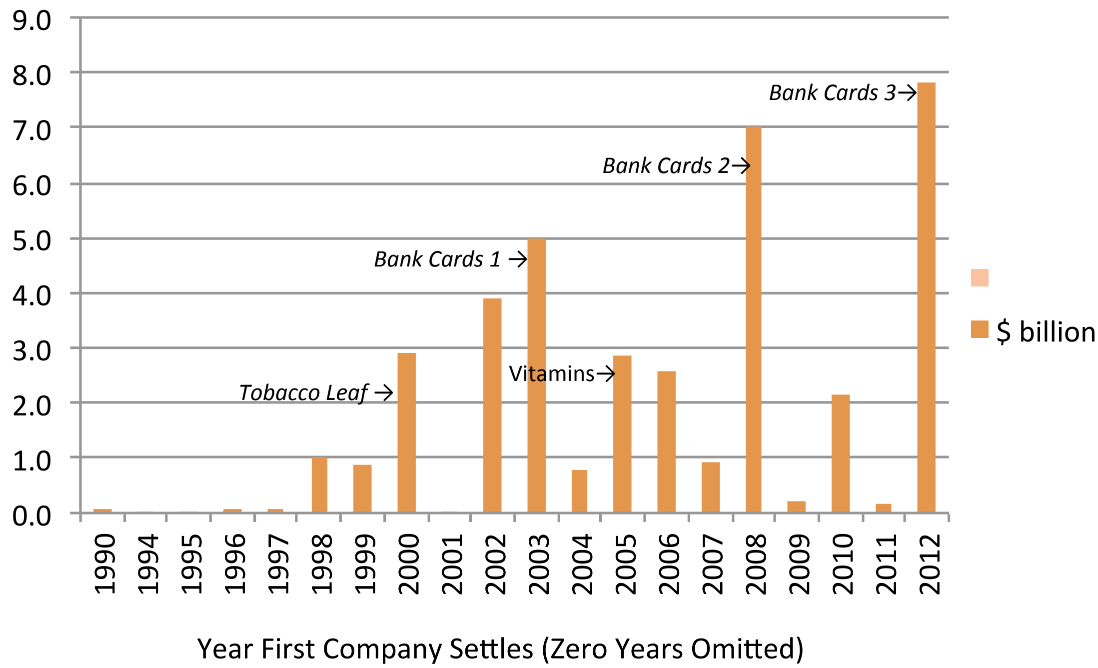
2006
2007
2008
2009
2010
2011
2012
Year First Company Settles (Zero Years Omitted)
9/9/12
J M Connor, Purdue U.

# Fig. 2. Private Recovery $ in the US Are Rising, but Unevenly

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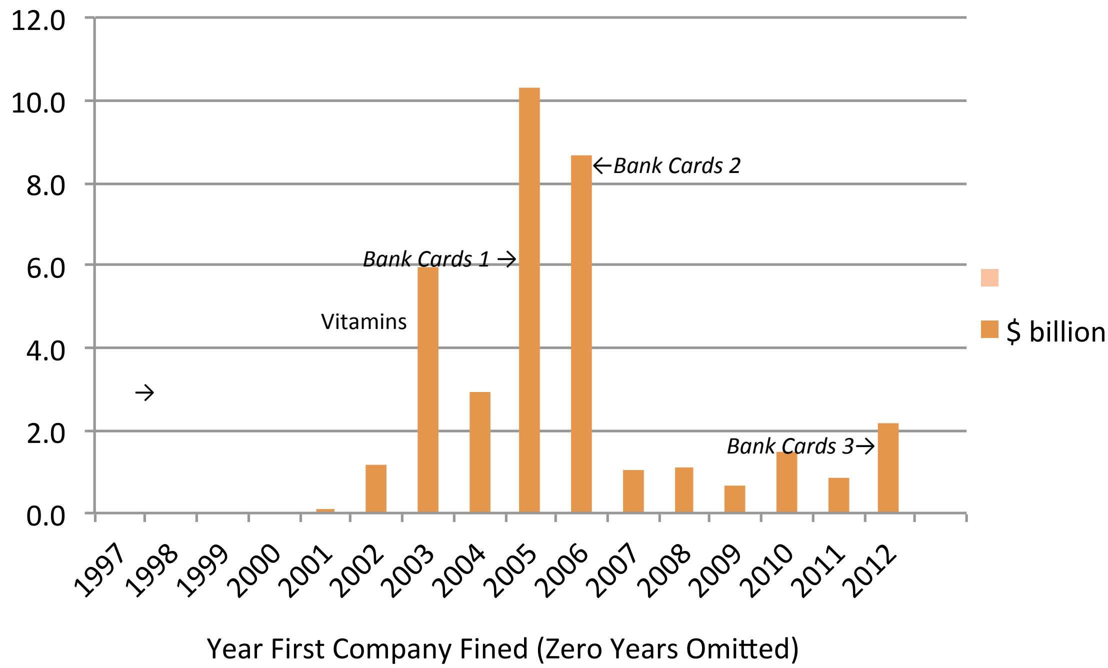
# Fig. 3. Private Recovery $ Lag Fining Dates

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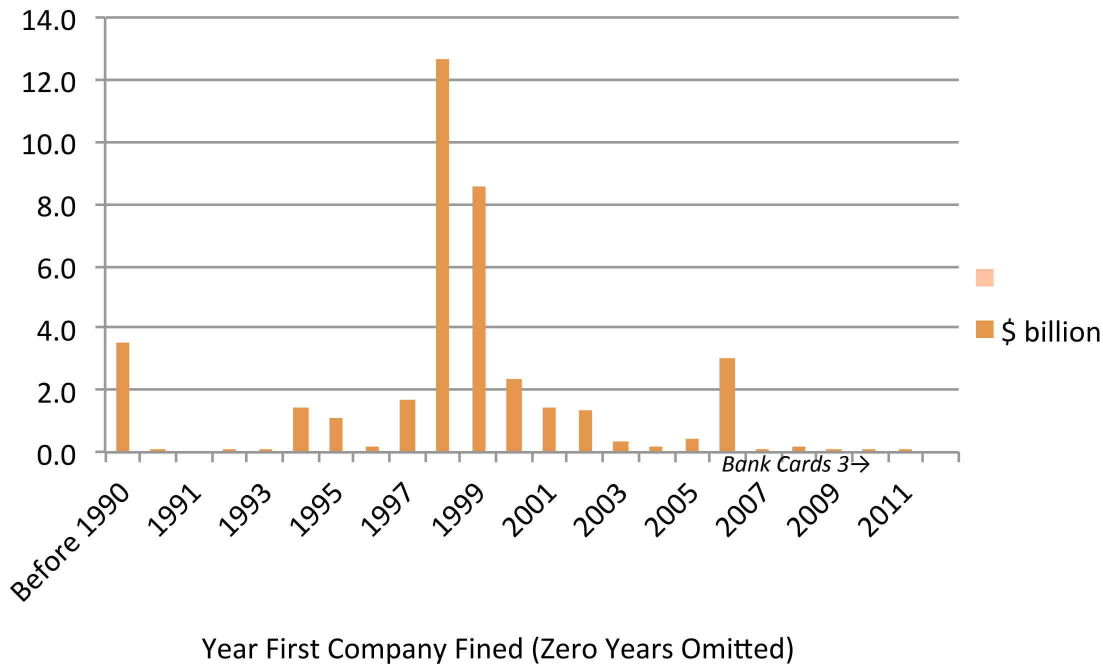
# Fig. 4. Private Recovery $ Lag Filing Dates

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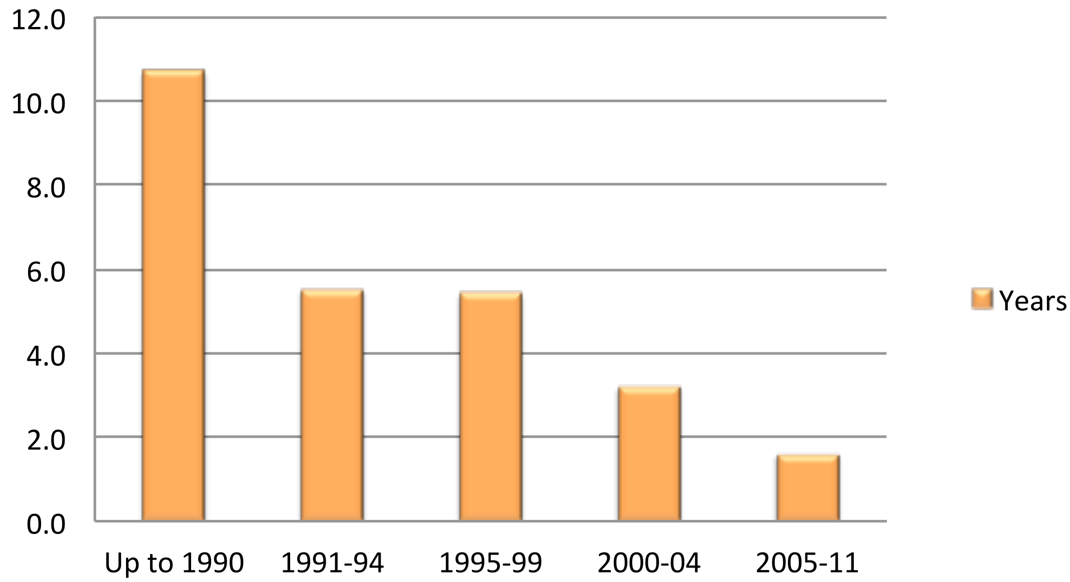
# Fig. 5. Discovery to Settlement Lags Appear to Be Falling

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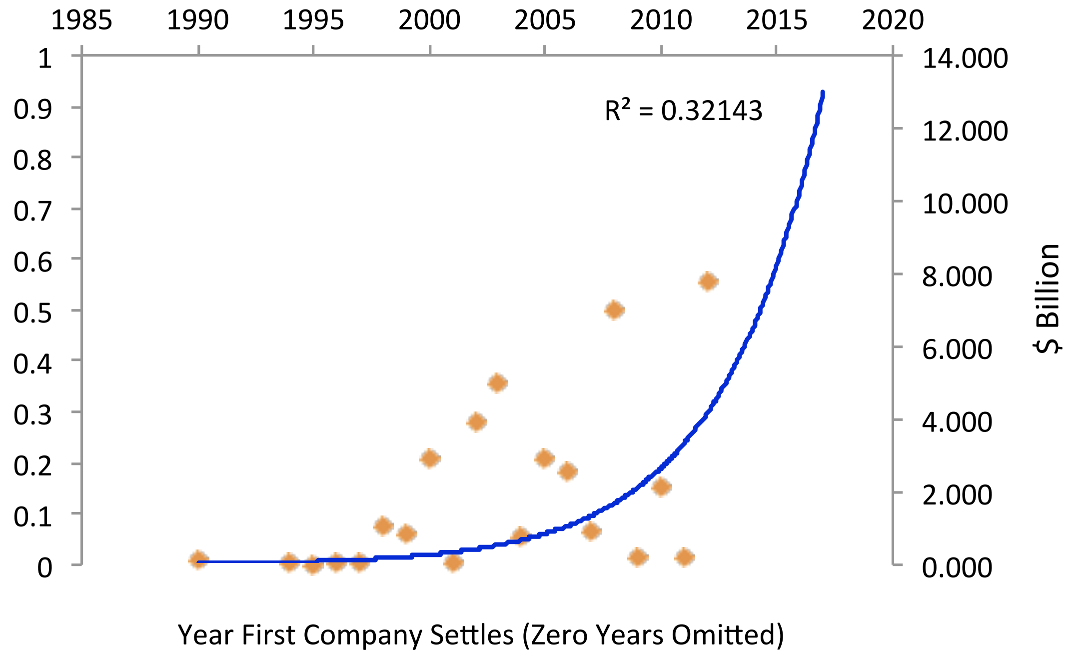
# Fig. 6. Private U.S. Annual Recoveries Are Rising Exponentially

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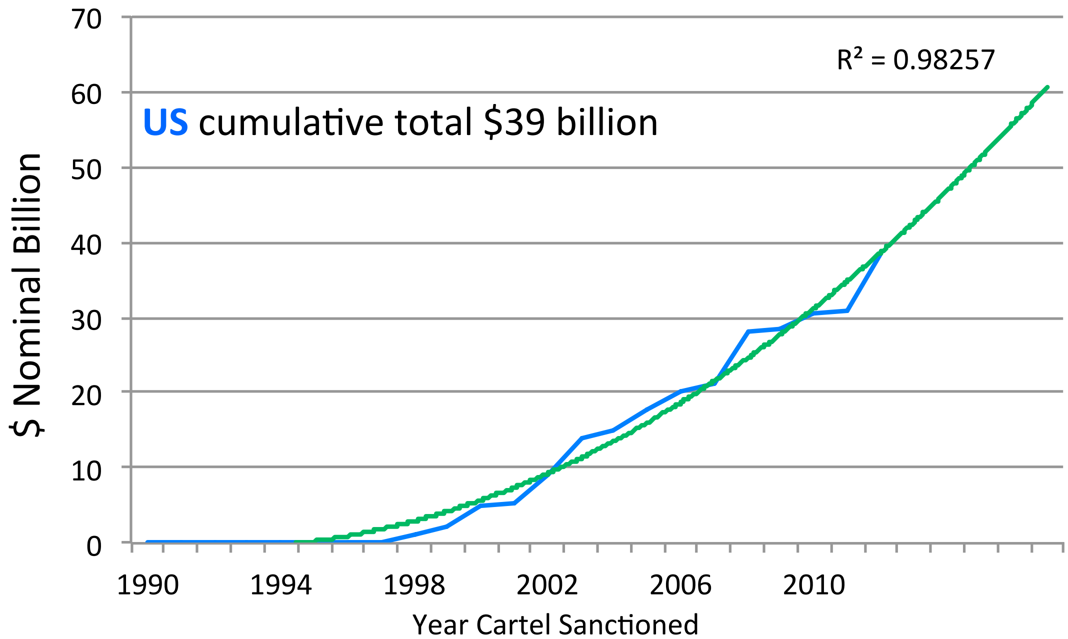
# Fig. 7. Trend in Cumulative U.S. Private Penalties, Intl. Cartels, 1990-2017

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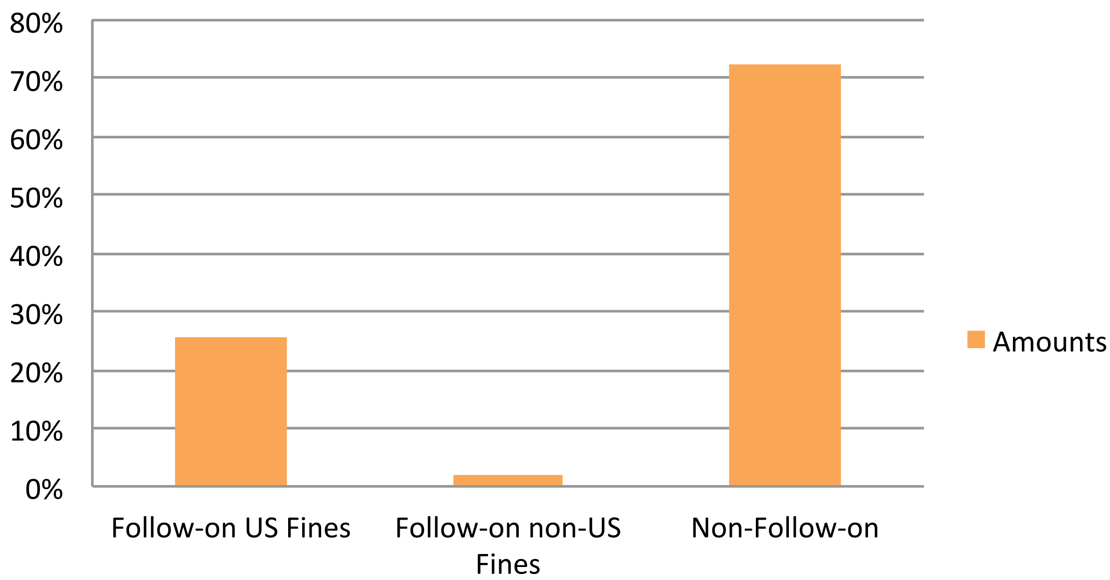
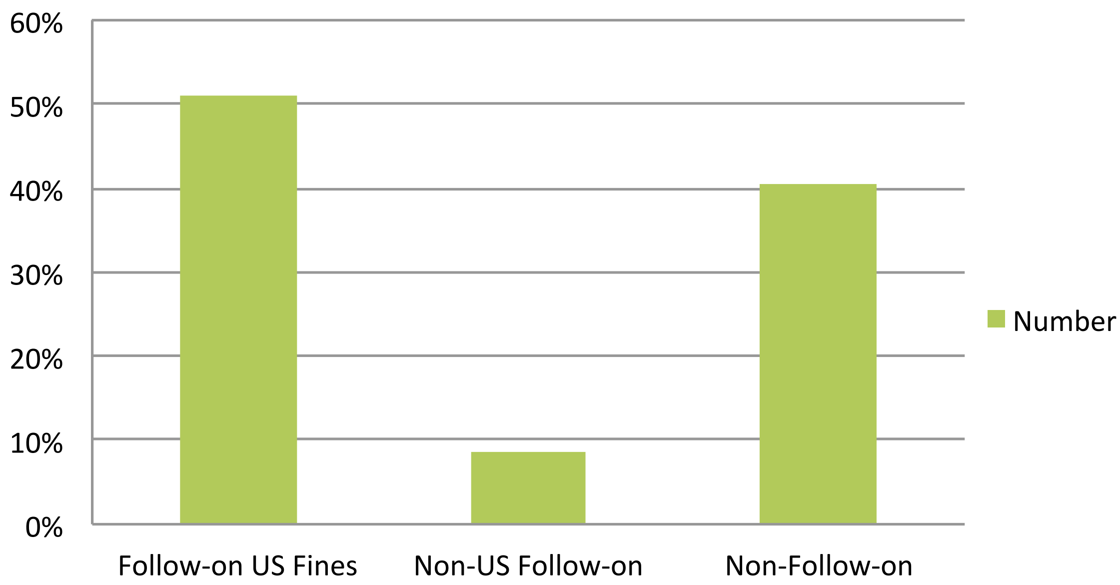
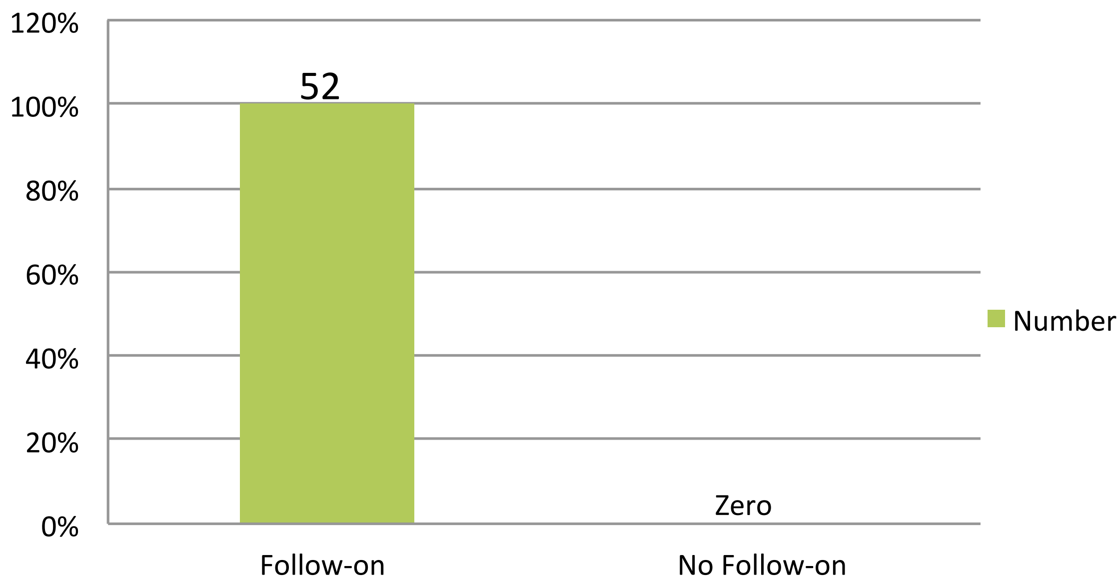
# Fig. 8. U.S. Private Actions on International Cartels (1990-2012)



# Fig. 9. Follower Status, Number of U.S. Private Actions

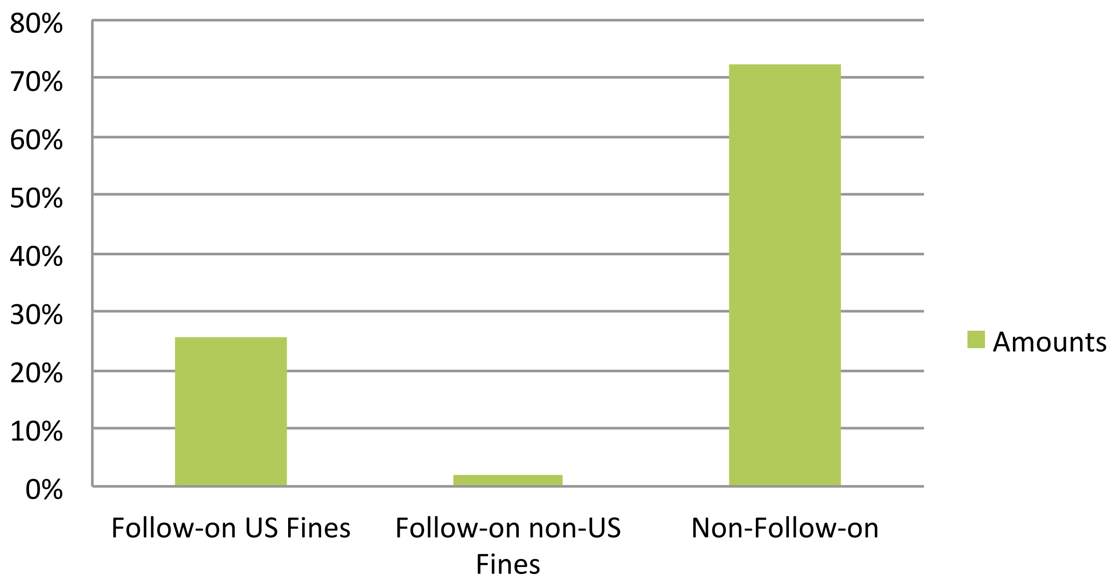


# Fig. 10. Criminally Fined Cartels, U.S. Private Actions (Fined 1990-2005)

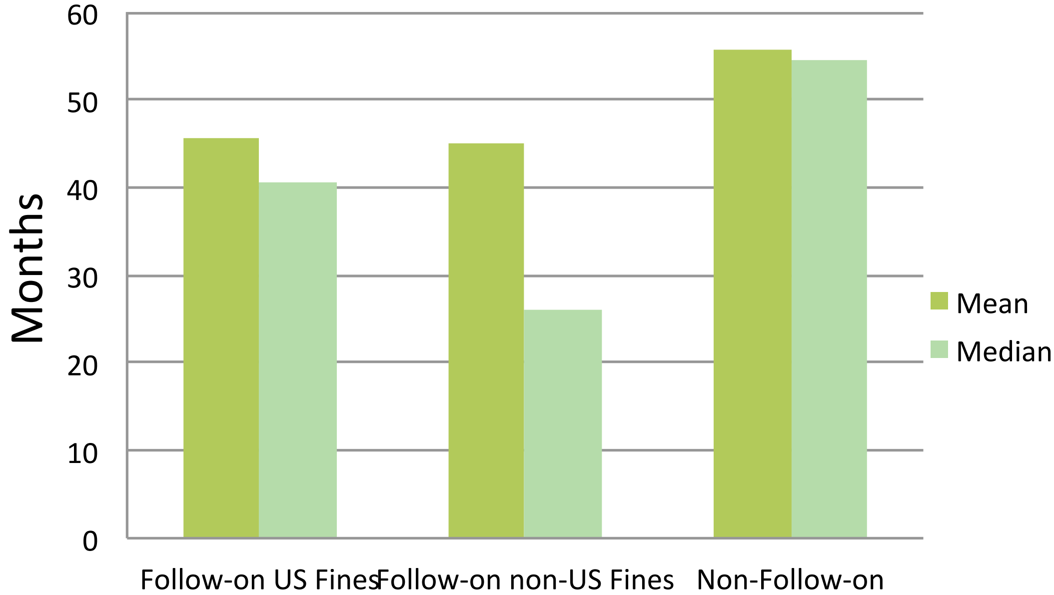



9/9/12 J M Connor, Purdue U.

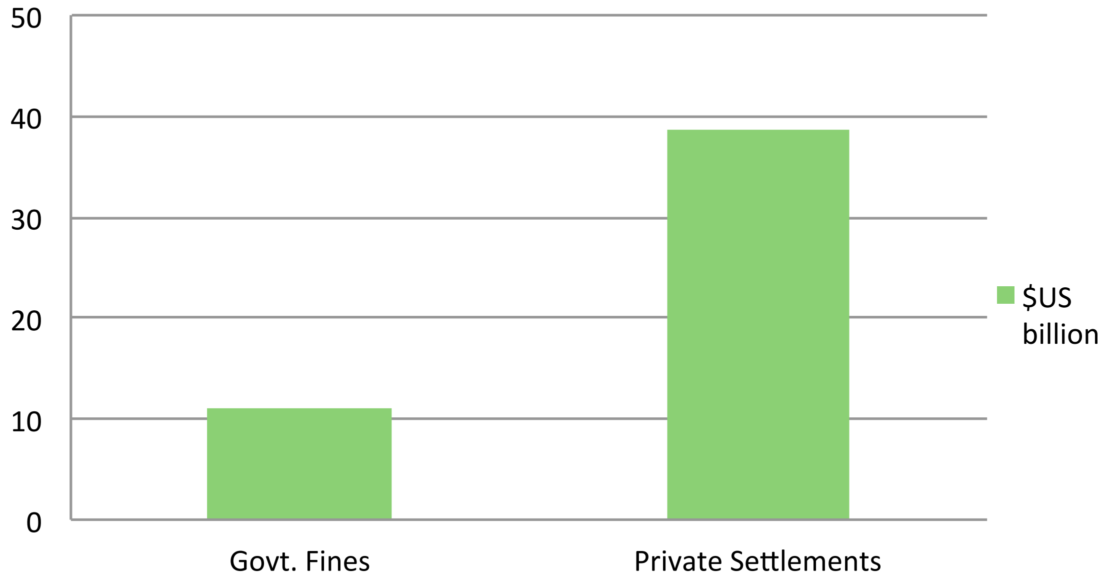
# Fig. 11. Follower Status, by Size of Private Recoveries



# Fig. 12. Length of U.S. Private Actions (1990-2012)



# Fig. 13. Total U.S. Penalties, $50 Billion (Intl. Cartels 1990-2012)

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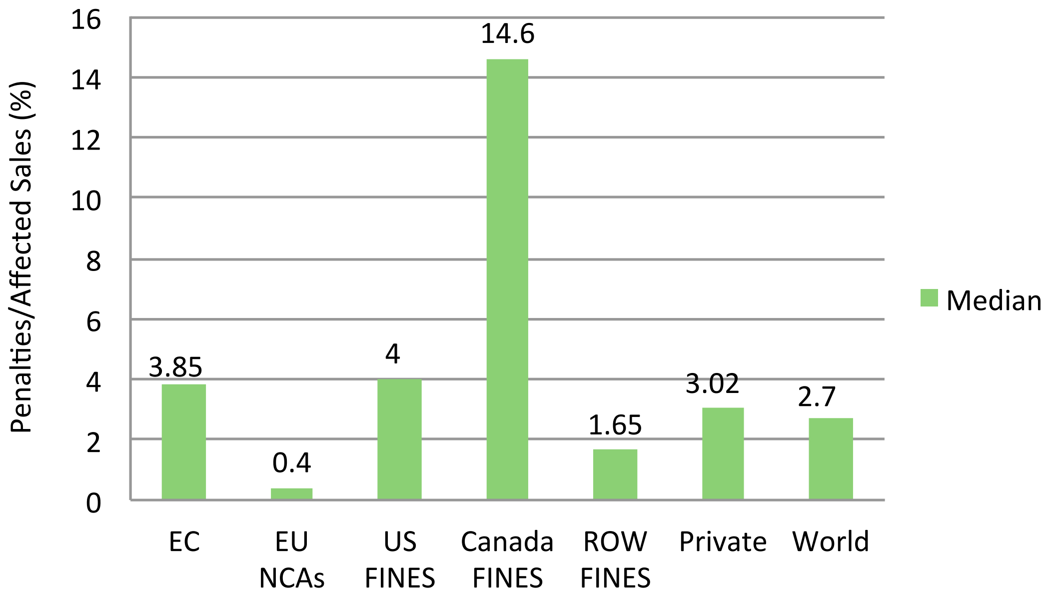
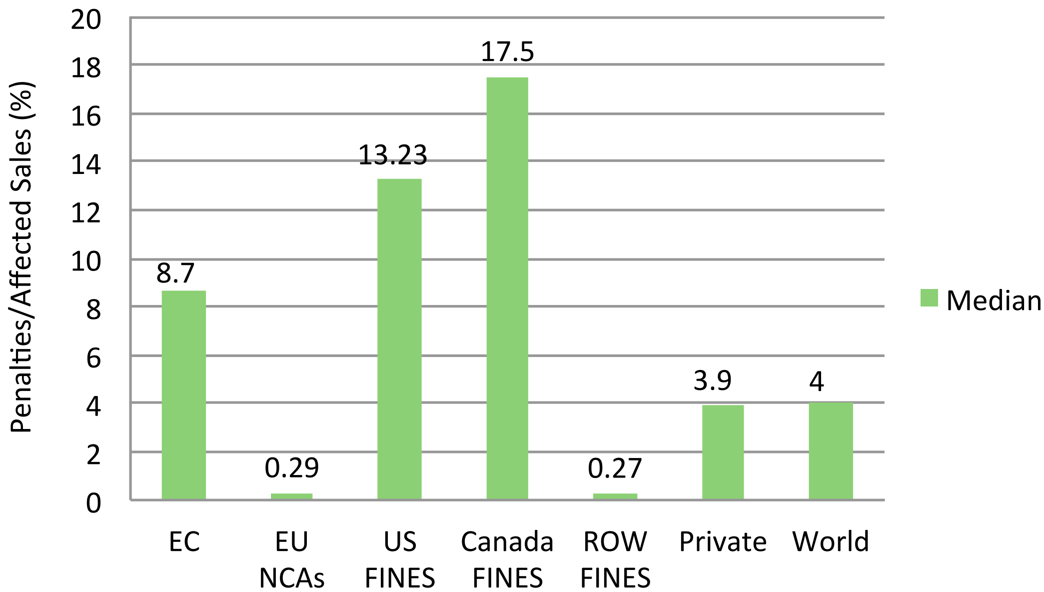
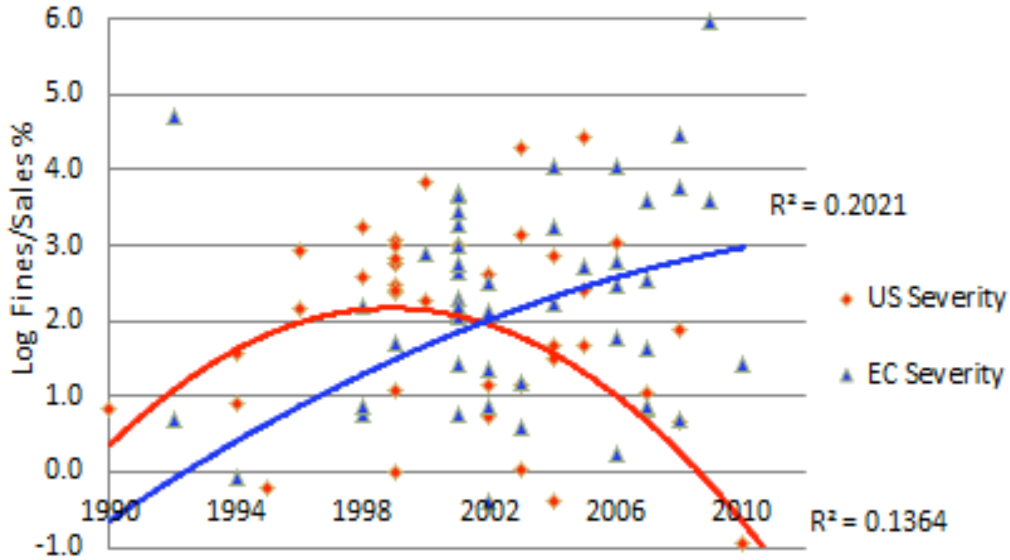
# Fig. 14. Severity of Penalties on Non-Global International Cartels



# Fig. 15. Severity of Penalties on **Global** International Cartels

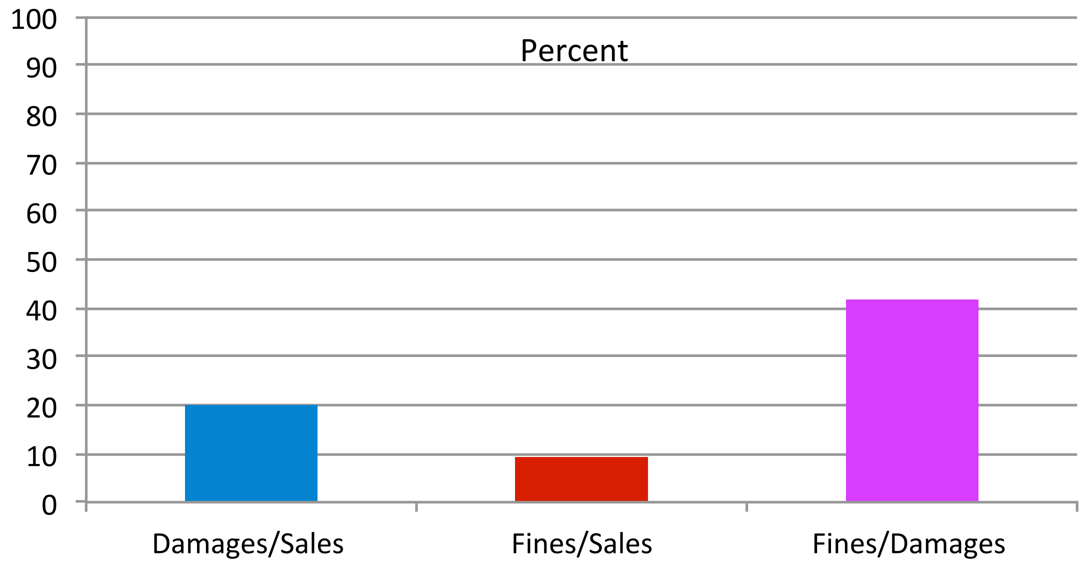


# Fig. 16. Trends in Severity of Fines, US Peaks and Falls, EC Rises



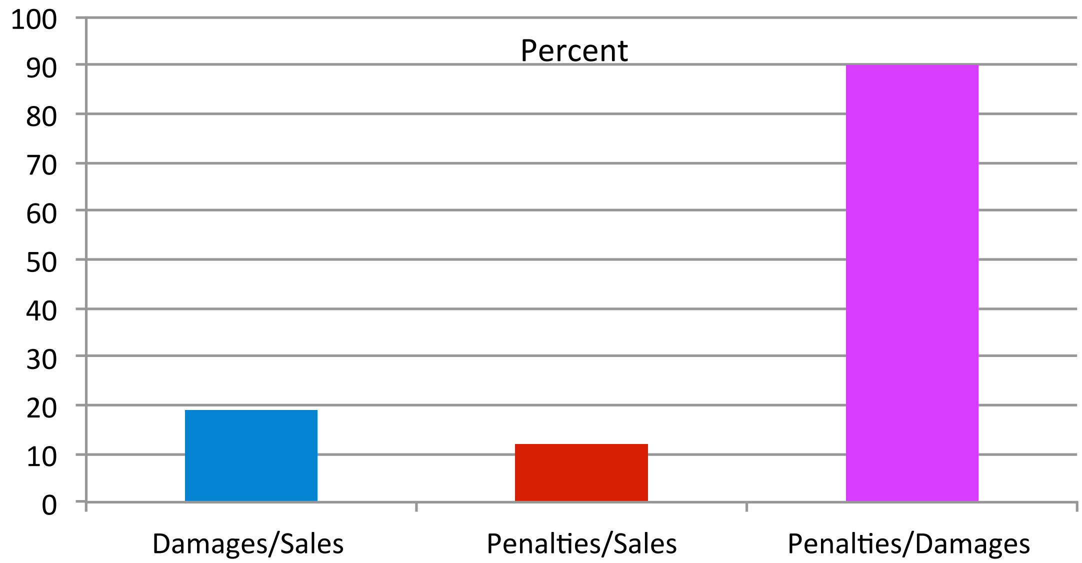

10/15/2012 J M Connor, Purdue U. 159

# Fig. 17. U.S. Overcharges, Fines, and Fines/Damages Ratio




Note: A 100% ratio means full disgorgement of profits.

# Fig.18. U.S. Overcharges, Total Penalties, & Penalties/Damages Ratio




Note: A 100% ratio means full disgorgement of profits.

# Exhibit H

FOCUS - 8 of 223 DOCUMENTS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**HEADLINE:** PANEL DISCUSSION II: CONSUMER ISSUES

**BYLINE:** MacDonald, Duncan; Shinder, Jeffrey; Manning, Robert; Felsenfeld, Carl.

WELCOME

Carl Felsenfeld1

Fordham University School of Law

MODERATOR

Duncan MacDonald2

Former General Council, Citigroup Inc. 's Europe & North American card business

PANELISTS

Jeffrey Shinder3

Constantine Cannon

Robert Manning4

Rochester Institute of Technology

**BODY:**

ABSTRACT

A panel discussion on "Consumer Issues" is presented. When you talk about a joint venture, one of the things to keep in the back of your mind is that a joint venture is a merger, of a kind. But sometimes when you create a joint venture -- and they are created, very often, by competing organizations -- they get together and merge any number of items and processes and operations to achieve a business objective. Visa and MasterCard are of that kind. Antitrust law has recognized, as a general proposition, that joint ventures are often pro-competitive. However, joint ventures also can be a device for anti-competitive activity, particularly when there are competitors involved. Most joint ventures are adjudicated under the so-called rule of reason. Networks are often formed through joint ventures, as with Visa and MasterCard. Such network joint ventures can raise significant antitrust issues, particularly in industries where, as with Visa and MasterCard, barriers to entry are high.

FULL TEXT

THE ANTITRUST ASPECTS OF BANK MERGERS[dagger]

PROF. FELSENFELD: As contrasted with this morning's session, this afternoon will be devoted to the effect of bank mergers on consumers. Our moderator this afternoon is Duncan MacDonald, who was the general counsel of Citicorp's international card business.5

MR. MACDONALD: Banks, as a matter of statutory law, are very highly regulated institutions.6 There are both limitations and favoritism in terms of regulation that affect how they behave. That is fairly important.

There is the safety and soundness doctrine that, in effect, says that bank regulators and banks themselves have to be cognizant of stepping over the line and stopping themselves or reversing themselves.7 They can do it any number of ways.

There are lots of mergers that have taken place over the years.8 Although there is a broad body of antitrust law that applies to both the regulatory industry, like banking, and unregulated industries, it has not been applied all that much in the last fifteen or twenty years against banks.9 A good part of the reason has to do with the Justice Department, in particular, paying deference to the so-called expertise of the bank regulators, like the Federal Reserve, the Comptroller of the Currency, and so on.

There is a decision, the Chevron decision, that goes back some time.I0 Basically, the Supreme Court of the United States said that the expertise of federal regulatory agencies ought to be given high deference in various kinds of lawsuits.11 To some extent, that may have had an effect.

In any event, the law, at least as I see it, is not being enforced. There are two ways to enforce antitrust laws: by government and by private action.12 Outside the United States, there is an enormous amount of antitrust or equivalent activity in various countries around the world with respect to bank cards.13 There is no public or government action against the bank card industry in the United States, but there has been a ton of litigation involving price fixing, misused market power, et cetera.14

The two speakers today are going to discuss both that issue and the consequences of antitrust misbehavior by banks, in particular with respect to joint ventures, like Visa and MasterCard.15 Banks created these joint ventures back in the late 1960s, and they have thrived ever since.16 Now suddenly they seem to be stumbling because they allegedly-and determined by courts-have stepped over the line and violated the Sherman Act.17

When you talk about a joint venture, one of the things to keep in the back of your mind is that a joint venture is a merger, of a kind. If Citibank or Chase merges with X National Bank of Chicago, that's the standard merger we think of. But sometimes when you create a joint venture-and they are created, very often, by competing organizationsthey get together and merge any number of items and processes and operations to achieve a business objective. Visa and MasterCard are of that kind.

We are going to start with Jeff Shinder. The major lawsuit brought against the bank card industry, when all is said and done-the paradigm-is the Wal-Mart lawsuit that turned into a class action.18 It was led by Jeffs firm, Constantine Cannon.19 They won a big settlement.20 He is going to talk about that. He is an expert on joint ventures, antitrust litigation, retail pricing policies, et cetera.

After he speaks, Robert Manning, a Ph.D and a professor at Rochester Institute of Technology,21 who wrote a book that is very important to the card industry-because they hate it-called Credit Card Nation: America's Dangerous Addiction to Credit.22 I have written about that topic, too, addiction to credit. So I am somewhat sympathetic to it. But, he is a four-letter word in banking, but otherwise a very honorable and good person. He is very much involved in litigation matters as an expert witness, and he has testified before House and Senate committees.23 He has a book coming out fairly soon called Borrowing the American Dream2" which should be out next year and which you should read.

Let's turn to Jeff.

MR. SHINDER: Thank you, Duncan, for that introduction. I am going to speak about joint ventures and antitrust treatment of joint ventures,25 and then I am going to apply some of the general principles to the experience of Visa and MasterCard. It's important to keep in mind that Visa and MasterCard were formed as joint-venture associations, purportedly nonprofit, by banks that competed both in the issuance of credit and debit cards and in the acquisition of merchants for Visa and MasterCard.

It's ironic; Visa just filed its preliminary prospectus, its S-I document, to go public, and is about to end its thirty-plus years as a joint-venture association.26 MasterCard went public a couple of years ago.27 It may be the case that a lot of the lessons that I am going to go through are in the past. I will address that towards the end.

Before I get to the specifics of Visa and MasterCard, let's outline some general principles about the antitrust treatment of joint venture. First and foremost, it's important to know that the antitrust laws recognize that many, perhaps most, joint ventures are actually procompetitive. Firms, even competing firms, get together and often produce something that they cannot produce by themselves.28 Integration is happening. They create something that the individual actors couldn't do themselves.

Visa and MasterCard are an example of this. Before Visa became Visa, there was BankAmericard, and there were restrictions on interstate banking that prevented Bank of America from acquiring merchants or issuing cards across the country.29 It limited the scope of what was then this emerging payment system. To construct something that BankAmericard could not do by itself, Visa was formed as an association of competing banks that issued cards and acquired merchants around the country and then around the world.30 All of a sudden, something that not one bank could do by itself was created. It's something we take for granted. You can go anywhere around the world and carry your Visa card and know that it's going to be accepted by the merchant.

Antitrust law has recognized, as a general proposition, that joint ventures are often pro-competitive.31 However, joint ventures also can be a device for anti-competitive activity, particularly when there are competitors involved. This can show up in a bunch of ways. It can show up in what's called a naked restraint of trade, where a joint venture is merely a disguised device to fix prices or allocate markets, where consumers are harmed by virtue of higher prices and less competition, or, in a more subtle example, where a joint venture, a restraint, created for purposes that are arguably pro-competitive, actually has harmful consequences outside the functioning of the joint venture.

Most joint ventures are adjudicated under the so-called rule of reason.32 In antitrust law, restraints are divided into two categories. Per se restraints of trade, which, from longstanding experience, we know that a restraint is almost always going to injure competition.33 When a per se restraint is set forth, no significant injury to competition needs to be shown.34 Price fixing/market-allocation schemes between competitors are classic examples of per se restraints of trade. Everything else is adjudicated principally under the rule of reason.35 The rule of reason, in the context of a joint venture, often simply comes down to whether or not there is market power at work. Does this joint venture comprise a significant enough portion of the market-the first criterion is, "What is the market?"-that it could harm competition by excluding competitors or raising prices?

Under the rule of reason, if there is a potential for harm to competition along the lines I just described, the joint venture or a restraint within the joint venture will be evaluated under the following criteria:36 (1) The agreement must be necessary to achieve the purposes of the joint venture;37 (2) If there is a pro-competitive effect, it must outweigh the anti-competitive harm;38 (3) The pro-competitive effect that is used to justify the restraint at issue must not be speculative, but something that can actually be verified;39 and (4) There may not be any significantly less restrictive means to achieve that purpose.40

Visa and MasterCard are examples of something that we are seeing more of in the marketplace today: networks-platforms that function to link two sides of a market. In the context of Visa and MasterCard, they link cardholders and merchants. But we see platforms all over the place. Network industries in the marketplace today, from the telecommunications industry to real estate listing services, to dating services, are all networks that link disparate constituencies of consumers.

Networks are often formed through joint ventures, as with Visa and MasterCard. Such network joint ventures can raise significant antitrust issues, particularly in industries where, as with Visa and MasterCard, barriers to entry are high. It's not easy to replicate what Visa and MasterCard did. It would take years. Many examined doing so and decided that the cost and the effort were too daunting. Network industries tend to tip, for example, in software industries, where once a leading firm gets sufficient advantage in the marketplace, the market tends to tip to them, where they become the standard. They can then exercise market power by virtue of being the leading standard. That is a classic example where standardization can have positive benefits, but could also lead to the exercise of market power that could hurt consumers by stifling innovation.

Network industries raise interesting and unique antitrust issues. For example, in a network industry where networks have essentially become the standard, membership rules can raise significant antitrust issues. In the case of Visa and MasterCard, then" rules were too inclusive, in that everyone who was a member of Visa was also allowed to be a member of MasterCard. The same banks owned, operated, and controlled both associations,41 which led to allegations, with some credibility, that their common ownership caused them not to compete.

Membership rules can also be too restrictive. A network that dominates the market and denies access to potential entrants can abuse market power and harm competition by denying something necessary for effective competition to a would-be entrant. So, membership rules can raise significant antitrust issues in the context of a network.

I didn't discuss ancillary restraints.42 A naked restraint is a restraint of trade that really has no redeeming justification.43 It is enacted in the context of a joint venture but is really simply an artifice to fix prices and exclude competition.44 There is obvious injury to consumer welfare. Most restraints in the context of a joint venture are ancillary restraints, restraints that could have pro-competitive benefits by being reasonably necessary for the functioning of the joint venture and are evaluated under the aforementioned criteria.45 Weigh the positive aspects of the restraint against the potential harm to competition and see whether there are other means that could have been applied to achieve the procompetitive benefits.46

The experience of Visa and MasterCard is instructive as to the various ways that a network joint venture can get into antitrust hot water. First, its membership rules. A common feature of the payments industry was something called duality, where virtually every member of one of the two leading associations was also a member of the other.47 That led to an allegation by the Department of Justice, in the late 1990s, that duality or, more properly, dual governance-the fact that the boards of directors were comprised of banks that ran Visa and MasterCard, and that banks sitting on the MasterCard board were leading members of Visa and vice versa-was anti-competitive. 48 That formed part of the basis of the DOJ lawsuit against Visa and MasterCard in the late 1990s.49

Another aspect of the DOJ suit was various rules of Visa and MasterCard that said every bank in the country can issue cards over our network, but those banks cannot at the same time issue cards over the Discover or American Express networks. Citibank, for example, could issue a Visa card or a MasterCard card, but if it wanted to issue an American Express card or a Discover card, it would do so at penalty of being thrown out of the Visa or MasterCard association.50 In that sense, the Visa and MasterCard membership rules were too exclusive. They said to their banks, "You have to stay in the club, but if you do business with Discover or American Express, we will throw you out." That comprised the other side.

There were two theories of the DOJ case: one, dual governance; the other, that these rules that prevented banks from doing business with Discover and American Express were anti-competitive.51 The DOJ lost the dual governance portion of the case, but won on the theory that the rules excluding banks from doing business with Discover and American Express were anti-competitive.52

What was the theory of competitive injury? Visa and MasterCard litigated the case all the way to the Supreme Court.53 Ultimately, the Supreme Court declined to review the decision affirmed by the second Circuit.54 They said, all the way up, there is absolutely no consumer harm here, period.55 Discover and American Express, as issuers, can issue to anyone in the country, and the fact that they cannot distribute through the banks that are members of Visa and MasterCard has not harmed consumers one whit.56

The theory in that case was not the typical consumer welfare, higher prices; this was a lost innovation case.57 The theory was that Citibank, partnering with American Express or Discover, would be able to offer something that was unique, differentiated, different for consumers, and not deprive consumers of consumer choice; but, the rules said Citi couldn't do that, or any of the other thousands of issuers of Visa and MasterCard.

Private lawsuits continue to be important terrain, and the loss by Visa and MasterCard in the DOJ case has spawned, as you would expect, the typical follow-on cases. American Express and Discoverin the spirit of full disclosure, I represent Discover in this case-have sued Visa and MasterCard for damages for lost profits as a result of those rules.58 American Express just settled its case with Visa.59

There was another important aspect that should be noted in the DOJ case, which was that joint-venture restraints, when they impact competition outside the joint venture, can have significant risk to competition, even if they have some kind of pro-competitive purpose.60 One of the theories of the DOJ case is that the banks who ran Visa and MasterCard were restraining competition between themselves.61 The idea was that Chase and Citi basically said to each other, through the rubric of Visa and MasterCard, "I don't want to let you have the advantage of issuing an American Express or Discover card, and so we will all agree not to do that." That impacted competition outside the joint venture in the market to issue credit cards and debit cards.

The various merchant cases provide a different example of how restraint within the Visa and MasterCard joint ventures had anticompetitive consequences-in this instance, outside the joint venturealthough the injury to competition outside the joint venture was at the network level. One of them was the so-called Wal-Mart case.62

What was the Wal-Mart case about? It was about Visa and MasterCard using their honor-all-cards rule, which is the rule that says to every merchant that accepts Visa and MasterCard, "If you accept Visa, you must accept every validly presented Visa card, no matter what you see. You can't choose between different kinds of Visa cards."63

This is a classic example of a restraint that was actually necessary for the functioning of the joint venture. When Visa and MasterCard were formed-think about this: You have thousands of banks across the country issuing these cards, thousands of banks acquiring merchants, millions of merchants accepting these cards-you need to have a seamless acceptance experience. We all take it for granted, but you needed to have a rule that ensured to you, as a consumer, that when you proffer the Visa card, the merchant is going to take it. It's not going to say, "I'll take a Chase Visa card, but I don't like Citibank, so I'm going to turn that one down."

The honor-all-cards rule, as applied to one product, which is what Visa and MasterCard were back in 1966-credit cards-was procompetitive. As Wal-Mart's lawyer, we never argued that, in that guise, it was anything other than pro-competitive. But something very interesting happened to the honor-all-cards rule over the years; it became an instrument to tie two distinct products.

There is a species of antitrust claim called a tying claim, which basically involves leveraging market power from one product to another by forcing the consumer to take an unwanted second product.64 The argument in the merchant case was that the honor-all-cards rule, when it was applied to debit cards and forced merchants to take debit cards at a very high price, allowed Visa, particularly, but MasterCard as well, to leverage their preexisting power in the credit card market into the distinct and very different debit card market, with anti-competitive effects in the debit market.65

The theory that was accepted by the court, in large measure, was that a superior platform for PIN debit-the same PIN that you use at the ATM, that you sometimes use in supermarkets at the point of sale, the platform that everyone thought was going to take off in debit in the early 1990s-was cheaper and safer and faster and more efficient, and was suppressed by virtue of the honor-all-cards rule. Thereby, consumers were harmed and competing PIN debit networks, who were not Visa and MasterCard, were suppressed.

That case, like the DOJ case, was largely litigated, although, unlike the DOJ case, we did not go all the way up to the Supreme Court on the liability issues.66 But, a score of findings emerged from these two cases that can be used against Visa and MasterCard in the future, findings about their market power; in the example of the merchant case, findings that debit cards and credit cards were distinct products for purposes of tying law, which sets up, potentially, future actions, where honor-all-cards policies are used to link distinct products.67 That precedent can be used. Debit is a market. Visa had market power in debit.

That leads me to the last example, and probably the most nettlesome of the legal issues facing Visa and MasterCard over the years, and that is interchange,68 a somewhat complex mechanism. Visa and MasterCard, through their boards of directors, have historically set something called interchange. Interchange is a fee that is ultimately paid by merchants as part of the discount they pay when they accept a Visa or MasterCard transaction that flows back to the issuer.69 If you go to a merchant with a Citibank-issued Visa card and you make a transaction, the merchant pays the interchange fee, and the fee flows back to Citibank as the issuer.70

Over time, interchange has become an increasingly critical proposition to the business for the issuance of payment cards, both in debit cards and in credit cards. The antitrust theory challenging interchange is that it is nothing more than a price; it's a price that is paid by merchants to competing issuers.71 That price is fixed by competing issuers who sit-I should say, sat-on the board of, at least, MasterCard, and they may continue, some of them, to sit on the board of Visa.72 Therefore, that's price fixing.73 Antitrust 101: price fixing harms consumers by raising price and is usually a per se violation of the antitrust laws when engaged in by horizontal competitors.

The first challenge against interchange was the so-called NaBANCO case in the mid-1980s.74 In that case, Visa succeeded to leverage a preexisting Supreme Court opinion-the BMI decision-to get the case treated under the rule of reason.75

Visa said interchange can't be treated like a normal price.76 Instead, it's a device that is needed to equilibrate two sides of this network industry.77 We need interchange for it to function.78 The side bearing the disproportionate share of the costs and the risks, the issuer, should receive a transfer from the merchant side of the equation.79 Otherwise, these systems won't exist.80 You can't evaluate interchange without understanding that this is a network platform with two sides to the market and a need for interchange to basically balance the two sides of the market.81 The court accepted that argument and Visa prevailed, on appeal, and it was allowed to continue to set interchange.82 This was in the mid-1980s, when interchange was applied to credit, and debit was a fairly minor part of the payments landscape.83

Going forward, Visa and MasterCard applied their ability to set interchange to debit cards, where they fixed very high credit card interchange to debit cards, a large part of the impetus for the merchant case.84 It was framed as a challenge to the honor-all-cards rule, but a subtext was that debit card interchange was just a disguised exercise of market power. They have set high interchange for commercial cards, for prepaid store cards, and have raised interchange over and over again, to the breaking point. It's at the breaking point around the world.

Let me note one other thing on this particular slide.85 Price fixing theory, a traditional antitrust attack, has so far failed in the United States on interchange.86 Some of the regulatory challenges are not framed on pure antitrust terms. Instead, they are framed that interchange actually funnels too much credit card use and that it leads to a regressive effect, where interchange is paid by merchants, it's too high, it's passed along in the form of higher prices to everyone, including the cash customer who is not paying with a credit card, and it finances all kinds of rewards cards for the very affluent, and too much credit.87

That was a large basis for the Australian challenge. I just cannot stress this enough-this was not a pure antitrust attack.88 Most antitrust lawyers would actually recoil, to some degree, at the analysis. The theory was, there is too much use of credit cards.89 Interchange is financing something that is socially problematic and something that is regressive. We are going to cut interchange down, and so be it if it leads to fewer rewards for the affluent.

This has been an ongoing battle. One of the things that Visa and MasterCard have said repeatedly, including to regulators in the United States, is that this was misguided, that it has had unintended and problematic consequences, and that regulators have no right getting into how much a particular payment form is used at the point of sale; it's not the province of a regulator.90 The Federal Reserve in the United States has accepted that its mission should not get into some of the things that the Australians were willing to get into.91

Europe was different. Europe has taken a more traditional price fixing approach to the issue of interchange, but then has superimposed a somewhat regulatory regime that I don't think an antitrust authority in the United States would ever countenance.92 They have essentially gotten into negotiations with Visa and MasterCard over what is actually the correct level of interchange.93 I cannot imagine the Antitrust Division doing anything similar here, getting into the mission of regulating what could be characterized as a price. Here are just some other examples of countries around the world that have looked into or are looking into the issue of Visa and MasterCard interchange.94

What about the United States? I went through the history of the NaBANCO case.95 There is another round of cases-this one, I will happily say, I am not litigating-where merchants have brought another class action based on a price fixing theory, based on a theory that the NaBANCO case and its factual underpinnings have proven to be wrong.96 That case is winding its way through the federal courts as we speak. If the merchants prevail, the entire system of collectively setting interchange will be rescinded in the United States.

One interesting question that merchant case will raise is whether or not the new corporate forms of Visa and MasterCard fix the problem, or at least fix the problem from the perspective of traditional antitrust analysis. Remember, the issue in antitrust terms is that you have competing issuers sitting on the boards of Visa and MasterCard fixing what could be characterized as a price that they receive, and a key price they receive.

MasterCard reformed itself. It's a public company.97 It no longer has banks sitting on its board.98 But one could argue-and the merchants, I assume, will argue-that banks essentially delegated authority to do what was done before to the staff of MasterCard.

The theory-I don't know if it's going to work-is that if you have ten people meeting in a smoke-filled room to fix prices and then decide, "We're not going to do this anymore, because the smoke-filled room is a magnet for antitrust cases; instead, we will designate Duncan as the agent of our price fixing going forward," that's still price fixing if there is an agreement that Duncan will carry forward the will of the banks. The merchants will have to prove that.

My only point is that I am not so sure that MasterCard has insulated itself from antitrust attack and price fixing by changing itself, but it has certainly improved its position and has an argument it didn't have before it restructured. One could argue that one of the main reasons it restructured was to protect itself against the interchange case.

Visa just filed its S-I document. Visa, though, is going to have banks still on its board, which will make it harder for Visa to make the same argument that MasterCard will be able to make.99

On that note, I think I will conclude.

MR. MACDONALD: Thank you. Before we turn to Bob, just to kind of round that out from an insider's perspective-he was the litigator; I was an in-house guy. By the way, all this happened after I left Citibank, but that's beside the point.

If you are an in-house guy, you have to prevent things from happening. You stay ahead of the curve, and you don't get yourself in a mess. You see the risks or the consequences of getting into a private antitrust lawsuit. The government is not ever a private party that can make a profit for themselves, in terms of damages. An antitrust loss in one case can be a disaster, and this has proven to be a disaster for the banking industry.100

One of the biggest dangers that came out of this was that everybody was asleep looking at the banking industry, and then all of a sudden there was an enormous knowledge transfer to the private bar about how the insides of banks work and how they collaborate. So firms like Constantine Cannon and others sprung up all over the United States with an enormous amount of knowledge about banking because of discovery, and because of the consequences of these lawsuits they build and create other lawsuits.101

What happened in this first loss was a tidal wave of lawsuits that is still tossing them. After they lost to the Justice Department, Wal-Mart was out there, and these guys got a $3 billion settlement.102 But that doesn't tell the whole story. The consequence of losing to the Justice Department, and then Wal-Mart-the biggest animal in the United States-was probably tens of billions of dollars in damages when it plays itself out.103

These lawsuits are not going to go away. Nobody knows how to make them go away. They have caused a reorganization of the industry.104 They have caused Visa and MasterCard to change. New competitors come out of the woodwork. None of this was managed by the banks themselves. They didn't have the foresight. They were macho. They thought they were going to be smart and win, and they didn't win.

One of the little things that came up just recently is the Super SIV, structured investment vehicle.105 Chase, Citibank, and Bank of America created this joint venture, in effect-I don't think they called it a joint venture-to deal with the subprime meltdown.106 The minute I saw the headline, I thought of this guy, and I thought of joint ventures and what would have been learned from all these cases. Is there somebody out there with a telescope saying, "Wait a second. These guys are getting together again. Is there any kind of antitrust rubric that will apply to this?"

The key point is if you are a bank and you get into antitrust trouble-just understand the evil that men do lives after them-these things can get very, very big.

With that, I turn to Bob. Take over.

PROF. MANNING: It's a pleasure to be here. I am coming with a little bit different perspective. As Duncan mentioned, my book Credit Card Nation101 did create a bit of a ripple. But I like to think of myself as a voice of prudence. We might not have had quite the subprime crisis if we had started thinking about some of the consumer issues and the exposure that banks have created, not only in terms of the anticompetitive aspects of the industry, but also the insulation of this industry in terms of consumer protections.

First, I would like to make very clear why this is a unique issue. Carl had asked for a particular focus on the Philadelphia decision108 and the Riegle Act.109 I want to look at the credit card industry as kind of a consequence of the emergence of deregulation in banking and the institutional form that it has assumed, what role credit cards play, and how profound the change really has been.

First, I want to look at the unique aspects of the industry. I come at it as a business school professor. I came in with some different slides.110 The second aspect is some of the specific negative consumer-related outcomes that have resulted in the era of deregulation, with tremendous consequences.

I have been an expert witness in about twelve class-action federal and civil suits in the last five years. The costs of litigating these suits are just extraordinary. We are not talking about the enormity of the Visa/MasterCard duality or the Wal-Mart suit, but just at an individual level, every single major issuer. There will probably be questions about some of the issues regarding predatory lending,111 deceptive marketing,112 and deceptive pricing practices113-and I will talk briefly about federal preemption and the role that has played, especially in terms of governance. Ultimately, when we talk about our dual banking system, we are talking about, largely, the fact that Congress, with the OCC and directives to the Federal Reserve and the FDIC, is the one setting the tone.114

As somebody who testifies to Congress frequently, with access to some discovery documents, the banking industry clearly has been listening to the signals of Congress. They don't want to be regulated. Yet, as soon as the pressure eases off, some of the most egregious policies occur again, and then, ultimately, these have to be settled through some very costly litigation.

I want to emphasize what has changed about this industry. Keep a couple of things in mind in terms of the postindustrial society. Today the most profitable aspect of our economy is financing production, not actually producing things.115

Second, in terms of the transformation of the banking system and community banking and the bundling of services at a local issuer and the nature of an expanded national market, the best customer in the banking system-and we are talking retail banking-has gone from someone who could pay off their loans to somebody who will never pay off their loans. When we talk about the issues of securitization and consumer rights, this certainly has an important place, both in terms of how these products are produced and the loss of consumer rights in that process.

We talk so much about competition. It is always striking to me that whenever there is a discussion about pricing and marketing policy, the American Banking Association116 always comes back and says, "There are 6,000 credit card issuers. This is the most competitive industry in the American economy."117 As we will see, in terms of the extraordinary pace of consolidation in this industry, it belies some of the realities that have occurred.

Remember when you would open up a savings account-this certainly isn't the students, but the faculty and the practitioners here-you would get a free toaster? One of the key points to keep in mind as we look at the evolution of this industry is that credit cards were essentially loss leaders to reward the most desirable customers, typically people who paid off their credit cards. This was a customer service to reinforce the use of the other bundle of services. In some cases, of course, in the 1960s and 1970s, the toaster-you can only have so many toasters, for affluent clients. Unlike getting a mortgage-you are only going to get one mortgage-you can get several credit cards. Credit cards then became a real effort to market as a status symbol for people who didn't need credit, but wanted to demonstrate that they had such high credit and such a favorable relationship with their banking institution that they were offered an unsecured loan with a relatively high line of credit.

This is a critically important issue to keep in mind. Until we see deregulation that occurs particularly in the late 1970s, where we are talking about state-regulated interest caps118-until the 1978 Marquette decision,119 banks were actually losing money in their efforts to mass-market credit cards.120 In fact, it's hard to believe today-Citibank was almost insolvent in the early 1990s-but between 1979 and 1981, my estimates are that the company lost at least $400 million in terms of scaling up to the problems of high interest rates and state interest rate caps here in New York City.

So a key issue is, what has happened and what have we done in terms of this industry?

I would argue that, as the national scope of the industry through consolidation occurred, credit cards became a crucial avenue for establishing a national marketing schema, not just in terms of vertical integration, in terms of particular markets, but the fact that the credit card, as we get to the end, in terms of personal consumer privacy issues, becomes an enormous opportunity to collect information for crossmarketing. The problem is that technology has grown and improved so much faster than the protection of consumer rights, to the point that identity fraud and exposure to our personal financial information is an epidemic.

I remember testifying in 2003,121 with the reauthorization of the Fair Credit Reporting Act.122 The major banks made it very, very clear that the quid pro quo of having a national, standard, uniform creditscoring system would be the protection of consumer privacy rights. In fact, if there is a price premium that has been passed on to consumers in terms of the national scale of this market, it has been that the burden of compromising personal private information has been passed on to consumers.

If we look just briefly at consolidation, both the number of banking enterprises and their scale have increased dramatically. On the one hand, credit cards as a cash-flow mechanism have helped drive the financing of consolidation, as well as the scale of its national operations. You had hundreds of different marketing associations in different states. There were efforts of franchising, which is essentially what happens with BankAmericard and Visa and MasterCard. But it was a chicken-and-egg phenomenon. You couldn't have a local credit card, because you wouldn't have the scale, if you went out of your town or locality, in terms of using it in another state.

Technology and geographic expansion meant that merchants weren't going to accept a credit card unless consumers were going to use it, and, of course, consumers weren't going to use it unless merchants could use it. Integral to this business plan is that there has to be an economy of scale that is going to be national.

I find this Life magazine astounding.123 This was a cover story in 1970, before any of the major deregulatory decisions-Marquette, of course, which allowed, through federal preemption, for nationally chartered banks to move to a state, in terms of its brick-and-mortar operations, and essentially import and then export that interest rate throughout the country.124 This is in 1970, when the outstanding credit card debt was less than $15 billion.125 Here, you see that the future of banking is retail banking, and credit cards were really the engine of that expected growth.126

There has been long-term planning, part of it, of course, in terms of globalization and the postindustrial economy. I have a chart about social inequality and the growth of credit card usage.127 Clearly, there was a view that if the cost structure of the labor-intensiveness of retail banking could be brought under control, and with the technology that would enable the scale to go nationally, credit cards were really the major future of retail banking. In 1977, the top fifty banks controlled approximately half of the credit card market.128 Today the top three banks control about 60% of the market.129

When I go back to that earlier comment about 6,000 issuers and it being the most competitive market, this is what those issuers look like. These are all credit cards that have now been purchased by Citibank.130 What is intriguing is the AT&T Universal Platinum Card that you see to the left.131 Notice that AT&T was actually losing money before it was purchased in 1997.132 Why? It had so many affluent, highly educated "deadbeats"-people who were paying off their credit cards. The price premium paid when Citibank purchased this card was because of the marketing base that it offered.133 It wasn't making money on credit cards; it could only make it in the one-stop-shopping business model that emerged when Travelers purchased Citibank.134

There are some very important issues here that bear on the question about consumer rights. If the profitability of some of these portfolios is driven by access to consumer information, what provisions are there in place to protect privacy and consumer rights?

Just to give you a sense of the evolution of the top ten credit card issuers-you really need a scorecard, because it happens so fast. Clearly, what we are seeing is an industry that will be driven, probably, by about five major players.

What is intriguing now is the growth of the debit card industry. Who would have thought that could be such an important, billion-dollar industry, to the point now that even Capital One has created a debit card product that decouples the debit card itself from the bank that you actually have your deposit account with? You can get a Capital One debit card that could access your funds from Citibank, and it will be accepted in a national network.135

The evolution of this industry is still continuing, largely technologically driven. It provides new, different opportunities.

I present this particular table in terms of outstanding consumer debt because it shows the shift as the profitability of credit cards became more and more central to retail banking.136 You see a shift in terms of the proportion of revolving credit card debt versus installment debt. The intriguing thing is, in the 1989-90 recession, we actually see for the first time that revolving credit card debt actually expands.137 We talked earlier about pricing through credit-scoring systems.138 Banks were beginning to recognize that there was an opportunity to dilute their riskaverse underwriting standards and begin to expand the debt capacity of individual consumers, which will then lead to other issues about collecting that debt.139

Credit card usage is exploding; tack onto this debit cards. Are we headed towards a cashless society? No, but we are certainly talking about a society where all our personal, private information is not only accessible to those that we are not aware of, but there aren't protections for it. They primarily argue that this is going to provide consumer benefits in terms of marketed products that the scoring system will say we are most interested in, but again that belies the fact that there just hasn't been enough investment in terms of protecting that information.

The top ten credit card-issuing banks, along with the two major associations, spent approximately $20 billion last year in marketing.140 How much has been spent in terms of protecting and upgrading the security protocol systems of our private, personal information? The $20 billion-I think we could see a little bit more taken out of that to protect our private information.

Similarly, credit card marketing solicitations exceeded 6 billion in 2005.141 Notice that the yield is continuing to diminish, all the way down to less than half a percent in 2005, with a slight uptick today.142 Part of this is reflecting the subprime crisis, people paying off credit cards with their refinancing and home mortgages.143 Now, they can't sell their homes; they can't refinance; they are now much more receptive to even less desirable credit card offerings.

Who the deadbeat is from the credit card industry is very clear. One of the reasons I want to emphasize this point is, what other banking product is there that is actually offered to lose money, in terms of administrative costs? If you pay off your credit card at the end of the month, you receive customer service and loyalty reward programs, as well as a free loan.

I like to explain the cultural history that underlies our cognitive views that are negative about being in debt. We essentially self-punish, each of us, over our debt because of the negative connotation that it holds. That is one of the arguments for why, if you pay off your credit card at the end of the month, you get rewarded with a free loan. This becomes a real problem to the industry, as we see that so many people were paying off their credit cards through refinancing. We are now seeing that uptick again. The question is, "What is the quality of the debt that is increasing at this point in time?"

Keep in mind, as you look at the statistics-and we are looking at the magnitude, in terms of risk assessment of these portfolios-there has been a big discussion about, "Gosh, the stabilization of credit card debt means that Americans are making better choices. They are more informed," et cetera. The reality is that this temporary plateau is largely based on refinancing of credit card debt into home mortgages and a significant uptick in discharge rates prior to the 2005 Bankruptcy Reform Act.144

Much attention has been paid to information and ease of understanding. Of course, anybody who has actually read their credit card contract knows that it has been written by a risk-averse lawyer. It actually has increased. In the Banking

Committee145 last year, there was a member who brought out some of his old contracts. He pointed out how ten years ago the contract was ten pages; today it's thirty-five pages. The assumption is that consumers are even more knowledgeable and informed than ever. The reality, as we look at the increase in consumer debt, and particularly the penalty pricing that emerges, is that we see a very high statistical correlation between the growth of economic inequality in America and the desperation of financially distressed groups of people that will accept virtually any financial terms for a consumer loan.146 Some of these deals are quite astounding.

In terms of where the major banks are headquartered today, there is only one major bank-and that's a nice trivia question-that is actually in a state that has an interest rate cap. That is Bank of America, at 36% APR.147 All the other banks are in states without usury law caps.148

This is a table,149 as we talk about pricing-and I want to show profitability-that is simply looking at the spread between a blue-chip loan,150 car lending, and credit card lending. It doesn't include fees. You can see how extraordinarily profitable this industry has become, exclusive of fees. The credit card industry became more profitable and became the engine of growth for retail banking. More and more resources were deployed to expand, not only in terms of depth of the average level of credit card debt, but also into less creditworthy markets-what is often referred to as "the democratization of credit." But, at what cost?

This is really the report card of the credit card industry. If we want to look at where the revenues come-Jeff was talking about interchange fees-you can see how extraordinarily important interchange is to the industry. Interest last year: $75 billion.151 Interest rate revenues are increasing again as the cost of bank funds continues to fall. Furthermore, what is most striking is the tremendous growth of late and overlimit penalty and cash-advance fees (over $14 billion),152 along with annual membership fees (over $3 billion)-totaling over $17 billion in 2006.153 That is just fees alone. I am talking about interchange fees. Transaction fees alone are almost net profits of the industry.

We were talking about information to consumers-if one focuses on interest rates, one is only scratching the surface of what pricing is all about.

One of the interesting subtexts about this discussion was that the credit card industry, for seven years, emphasized how the risk of expanding more and more into less financially strong markets required a much stronger bankruptcy bill. Yet, ironically, the profitability of the industry had its sharpest increase during 2005, when the bankruptcy law was passed.154 What does this mean to us in terms of issues dealing with consumers?

I am going to focus on the issue of safety and soundness of the banking system. Where is the balance of consumers in this process? For example, there was a lot of discussion by the OCC Advisory about increasing minimum payments.155 There was a lot of misinformation in the media, that increasing minimum payments was a way to help consumers regain control over their debt situation. The reality is that the intent of federal regulators was to purge unperforming credit card accounts from lender portfolios that were primarily associated with financially marginal borrowers that were entrapped in fee-harvesting, subprime credit card programs. Their goal was to cleanse bank debt portfolios so that regulators and potential investors could more accurrately assess the value of these assets.

The consensus that emerged from regulators was that negative amortization was certainly a practice that should be not only frowned upon, but not tolerated. 156 In fact, from my discussion with regulators, three months of negative amortization really becomes the litmus test of when it really smells bad. Yet, we are seeing the emergence of a subprime credit card market that is based almost exclusively on negative amortization.157

I have been on cases where top-five card issuers have issued lines of credit for $300, and they would charge $178 in fees.158 There is another major issuer who has a "multi-card harvesting practice," where as soon as the $300-to-$500 line of credit has been exhausted, largely with fees, then another card is issued.159 That way, you can have a low-income or distressed consumer with five credit cards, and you could harvest maybe four or five or six different fees each month. That is the way in which this negative amortization process continues.

Some of the other issues I find disconcerting include this effort of binding arbitration. There have been some cases introduced about collusion in arbitration contracts. This limits consumer options in terms of class-action lawsuits.

Federal preemption has focused on, as a national market, that we no longer have personal local relationships, and banks need larger empirical, objective information, like credit scores, to assess the quality of their customer so they can make appropriate risk assessments.160 Federal preemption limits price competition, because there aren't any kind of regulatory limits; the major states no longer have interest-rate caps. The 1991 Smiley decision extended that also to fees.161

Most disconcerting to me was the 2002 California Lockyer case.162 I was actually an expert witness on that case. Federal preemption was extended to disclosure.163 If we are trying to make sure that consumers make informed decisions, the real question is why can't we push for stronger efforts of compliance to improve disclosure at that level?

The last thing I want to emphasize is the rise of predatory lending, deceptive marketing practices, and the emergence of securitization, where servicer and investor relationships mean that when your credit card or other consumer debts have been pooled and resold into assetbacked securities, your consumer rights have dramatically changed, not only from the servicer in terms of who actually holds your debt and is processing your payment, but also in terms of the Class B and C tranches of investors who are now basically taking some fiduciary control over your debt. If you go to court and you are going into a settlement or a bankruptcy, sometimes people find that their debts have been sold into an asset-backed security, and they can't go through that process. It's a whole different ballgame, as more and more consumer debt gets repackaged into asset-backed securities.

Thank you.

MR. MACDONALD: Before we take questions, I come back to some of the points made at the beginning: Keep your eye on regulation. If you look at a timeline here, the woes that both speakers talked about arguably have gone in tandem with the consolidation of the industry. The bigger it has gotten, the more it has approached an oligopoly market, the more the bad behavior seems to come to the fore. That is important.

Banks have a responsibility, and the regulators have a responsibility, under safety and soundness standards, to protect their reputations. Consumers have to trust that banks are going to look out for them. Trust is important, fiduciary duty is important, and reputation is important. If we have seen anything in the last five years, it is, in fact, harm to all three of those. You should ask yourself, "Why is that happening?"

QUESTION: I have a question for Mr. Shinder about the private litigation surrounding the interchange fee. You mentioned, if the class claims are successful, this will lead to a change in how the interchange fee is set. I was wondering what you think will be the likely result.

MR. SHINDER: If I had to handicap the case, I think they are going to have a hard time getting the class certified. The first big moment in that case is the class motion-having lived this in the Wal-Mart case, where I think the hardest thing we achieved was getting the class certified.164 That went all the way up to the Supreme Court.165

Interestingly, the precedent that we used has been clarified by the Second Circuit.166 They are in the same courtroom. The standards are a little harder. I think we would have satisfied them-a little bias-but I think this class is going to have a hard time getting certified.

Whether the cudgel of antitrust and blowing the system up is the best way to deal with interchange is unclear to me. I don't like what happened in Australia either.167 I look at the numbers that Bob put up, and you can see how this industry probably could survive without interchange. It leaps right out from those numbers. The argument that was initially made to defend the system was that interchange is necessary to give issuers incentives. Obviously, it's not anymore. That said, to just eliminate it could have significant effects on the system that are hard to predict.

QUESTIONER: I know one proposal would be to have the issuing banks negotiate individually with the merchants, rather than having it set by Visa and MasterCard-perhaps a consortium of smaller issuers. Do you think that would be a workable solution?

MR. SHINDER: You are talking about a system of bilaterale, actually, with the issuers and the large acquirers. That could be the solution. Now you have a situation that you didn't twenty years ago-it sounds like you know something about this industry-where the First Datas of the world and large merchant processors aggregate millions of merchants and perhaps could cut deals where there is equal bargaining power brought to the table. As you have seen, the issuer side has consolidated significantly.

That could be a solution. That's one of the arguments that the merchants, I assume, are going to proffer, that they don't need this system anymore. Back in 1985, they were exchanging paper.

MR. MACDONALD: If I could add a couple of comments. If you are on the defendant's side, and you are the banks, at least as far as prosecution of the case goes, you don't want to class-certify it, because it puts relentless pressure on you. You want to settle maybe at a higher price.

On the other hand, if you want to privately settle with the plaintiffs, you want a class because you want a universal settlement. If there are 200 plaintiffs on the marquee of the lawsuit, you want 6 million plaintiffs when you do the settlement. What good is it for you? That's point number one.

Point number two: In price fixing, it gets back to reputation. I would argue that the central sacrilege in commercial law in the United States is price fixing. With the exception of, maybe, environmental damage, oil spills and what have you, price fixing is the worst thing. If a decision were to come out as a result of a jury in Brooklyn deciding that the banks engaged in price fixing, it is a terrible, terrible headline for the banking industry. You guys are not only scoundrels, you fixed prices.

Which again begs the question: Where the hell were the regulators? Where is safety and soundness? Where is regulation? Is it laissez-faire all the way?

And so it ended quietly. The world ends with a whimper, not a bang. Thank you very much.

**GRAPHIC:** References

**LOAD-DATE:** July 22, 2008

# Exhibit I

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

**CIVIL MINUTES - GENERAL**

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|---|---|---|---|
| Case No. | 09 MDL 2007-GW(PJWx) | Date | February 23, 2012 |
| Title | *In Re: Aftermarket Automotive Lighting Products Antitrust Litigation* | | |

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|---|---|
| Present: The Honorable | GEORGE H. WU, UNITED STATES DISTRICT JUDGE |

| | | |
|---|---|---|
| Javier Gonzalez | Pat Cuneo | |
| Deputy Clerk | Court Reporter / Recorder | Tape No. |

| Attorneys Present for Plaintiffs: | Attorneys Present for Defendants: |
|---|---|
| Jay L. Himes<br>Thomas R. Merrick<br>Jason Hartley<br>Bonny E. Sweeney<br>Michael P. Lehmann | Brian M. Hom<br>Shari M. Wollman<br>Thomas J. Lang<br>Aaron A. Kahn<br>Peter J. Carney<br>John E. Andrews |

**PROCEEDINGS:** **FINAL APPROVAL HEARING AS TO SETTLEMENTS WITH DEFENDANTS DEPO AUTO PARTS INDUSTRIAL CO. LTD, AND MAXZONE VEHICLE LIGHTING CORP., AND SABRY LEE (USA) INC., AND SABRY LEE LIMITED;**

**DIRECT PURCHASER PLAINTIFFS' MOTION FOR AN AWARD OF ATTORNEYS' FEES, REIMBURSEMENT OF EXPENSES AND SERVICE PAYMENTS (filed 12/16/11);**

**DIRECT PURCHASER PLAINTIFFS' MOTION FOR FINAL APPROVAL OF CLASS ACTION SETTLEMENT AND PLAN OF ALLOCATION OF SETTLEMENT PROCEEDS (filed 02/09/12);**

The Court's Tentative Ruling is circulated and attached hereto. Court hears oral argument. For reasons stated on the record, the Court grants in full the motion for final approval of the class action settlements with Defendants Depo and Sabry Lee. The Direct Purchaser Plaintiffs' Motions are continued to **March 5, 2012 at 8:30 a.m.** Plaintiff's supplemental brief re expenses will be filed by February 29, 2012.

: 12

Initials of Preparer JG

***In re Aftermarket Automotive Lighting Antitrust Litigation***, Case No. MDL 09-2007
Tentative Rulings on: (1) Plaintiffs' Motion for Final Approval of Class Action Settlement and Plan of Allocation of Settlement Proceeds, and (2) Plaintiffs' Motion for Award of Attorneys' Fees, Reimbursement of Expenses, and Service Payments

## I. Background

Before the Court is the Motion of Direct Purchaser Plaintiffs ("DDPs" or "Plaintiffs") for Final Approval of Class Action Settlements with Defendants: (1) Depo Auto Parts Industrial Co., Ltd., and Maxzone Vehicle Lighting Corp., (together "Depo") and (2) Sabry Lee (U.S.A.), Inc., and Sabry Lee Ltd., (together "Sabry Lee") (collectively "Settling Defendants"); and Final Approval of Plan of Allocation of Proceeds. Docket No. 440. Also before the Court is the Motion of DDPs for an Award of Attorneys' Fees, Reimbursement of Expenses, and Service Payments. Docket No. 396.

The lawsuits comprising this consolidated action - *Sabry Lee v. Genera Corp.*; *Dynacorn Autobody Parts, Inc. v. Genera Corp.*; and *California Customs, Inc. v. Genera Corp.* - were transferred to this Court for all purposes by the Judicial Panel on Multidistrict Litigation on February 20, 2009. Defendants are four sets of Taiwanese or Hong Kong companies and their United States subsidiaries: (a) TYC Brother Industrial Co. Ltd. ("TYC") and its subsidiary Genera Corporation ("Genera"); (b) Depo Auto Parts Ind. Co., Ltd. and its subsidiary Maxzone Vehicle Lightmg Corp.; (c) Eagle Eyes Traffic Ind. Co. Ltd. ("Eagle Eyes") and its subsidiary E-Lite Automotive Inc. ("E-Lite"); and (d) Sabry Lee Limited and Sabry Lee (U.S.A.), Inc., which was also partially owned by Eagle Eyes. On July 13, 2010, following a lengthy stay occasioned by an ongoing criminal investigation and the intervention in this action of the United States Department of Justice, Plaintiffs filed an Amended Consolidated Class Action Complaint ("ACCAC"). The ACCAC asserts a single cause of action against Defendants for violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, based on an alleged conspiracy to fix the prices of Aftermarket Automotive Lighting Products ("AALPs"). On July 25, 2011, the Court heard oral argument and expert testimony on Plaintiffs' class certification motion, and granted the motion. On July 27, 2011, the Court entered the order granting Plaintiffs' motion to certify the Direct Purchasers Class and appointing Interim Co-Lead Counsel as Class Counsel.

Settlement negotiations between Plaintiffs and Depo began in March 2010, and began to "progress meaningfully" after Plaintiffs filed their Motion for Class Certification along with a lengthy, detailed expert report and regression analysis in September 2010. Prelim. Hartley Decl., Docket No. 315-2, ¶ 2. In January 2011, Plaintiffs and Depo signed a Memorandum of Understanding, setting forth the framework for a final settlement, including the cash settlement amount and an agreement that Depo would cooperate with Plaintiffs' action against the non-settling Defendants. *Id.* The final Depo Settlement Agreement was executed on April 26, 2011. *See id.*, Exh. A (Depo Settlement Agreement).

Settlement discussions with Sabry Lee began in March 2011. *Id.* ¶ 4. Sabry Lee (U.S.A.) Inc., went out of business in September 2009, and sold its assets. Prelim. To Decl., Docket No. 315-4, ¶ 3. As of December 2010, it had an accumulated deficit of approximately $8.5 million with current assets of approximately $562,000 and a cash balance of approximately $434,000. *Id.* ¶ 6 It had, however, been pursuing its own antitrust lawsuit and predatory pricing claims against other Defendants, and was able to resolve those claims in late April 2011. *Id.* at ¶¶ 5, 9. The Sabry Lee Settlement Agreement was executed in June 2011. Prelim. Hartley Decl., ¶ 5, Exh. B (Sabry Lee Settlement Agreement).

Under the terms of the Depo Settlement Agreement, Depo agreed to pay $25 million for the benefit of the Class, which was deposited in an Escrow account pursuant to the Depo Settlement. Depo Settlement Agreement, ¶ 19. Sabry Lee agreed to pay $450,000.00, which also was deposited into an Escrow Account. Sabry Lee Settlement Agreement, ¶ 19. After deductions for fees and costs, the settlement funds are to be distributed to Class Members on a pro rata basis. Prelim. Hartley Decl., ¶ 8, Exh. C (Plan of Administration and Distribution). In addition, Settling Defendants agreed to cooperate with Plaintiffs in the prosecution of the litigation against the remaining Defendants by (a) making the appropriate current employees available for interviews, deposition and trial; (b) upon request, providing the last-known contact information for Class members; and (d) using their best efforts to produce at trial in person, by deposition, or by affidavit, representatives who can testify as to all matters relevant to claims asserted by the Plaintiffs in this Action and who can lay the foundation for admission into evidence of documents prepared or received by Settling Defendants, or as to which Settling Defendants are otherwise competent to testify. Sabry Lee Settlement Agreement, ¶ 18; Depo Settlement Agreement, ¶ 18. Depo is also obligated to provide Plaintiffs' counsel true and full information regarding the participation of Depo and other Defendants in the acts charged in the Action. Depo Settlement Agreement, ¶ 18(e).

The settlements were preliminarily approved by this Court on November 8, 2011 (Docket No. 391), after the Court conducted five hearings to address objections against the Depo Settlement Agreement levied by certain non-settling Defendants primarily centering on the "Most Favored Nations" ("MFN") provision therein, a provision which this Court ultimately allowed to remain in the settlement agreement. *See* Docket Nos. 355, 374, 384, 386, and 392. No other concerns as to either settlement's terms were raised at the preliminary approval stage. Now, at the point of final approval, no objections have been lodged to either the settlements or the DDPs' motion for attorneys' fees, expenses, and service awards. Moreover, only one class member has sought exclusion from the class with an overwhelming percentage of class members participating in the claims process, as discussed in more detail below.

## II. DDPs' Motion for Final Approval of Class Action Settlements and Plan of Allocation of Settlement Proceeds

### A. Legal Standard

Settlement of a class action lawsuit requires approval of the court. *See* Fed. R. Civ. P. 23(e). Thus, at hearings to approve final settlement, after notice is given to class members, a court is to entertain any objections by putative class members to (1) the treatment of this litigation as a class action and/or (2) the terms of the settlement. *See Diaz v. Trust Territory of Pac. Islands*, 876 F.2d 1401, 1408 (9th Cir. 1989) (holding that prior to approving the dismissal or compromise of claims containing class allegations, district courts must, pursuant to Rule 23(e), hold a hearing to "inquire into the terms and circumstances of any dismissal or compromise to ensure that it is not collusive or prejudicial"). The court must find that the proposed settlement is fundamentally fair, adequate, and reasonable. *See Staton v. Boeing Co.*, 327 F.3d 938, 959 (9th Cir. 2003) (*citing Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1026 (9th Cir.1998)). In making this determination, the court may consider any or all of the following factors, if applicable:

> (1) the strength of plaintiffs' case; (2) the risk, expense, complexity, and likely duration of further litigation; (3) the risk of maintaining class action status throughout the trial; (4) the amount offered in settlement; (5) the extent of discovery completed, and the stage of the proceedings; (6) the experience and views of counsel; (7) the presence of a governmental participant; and (8) the reaction of the class members to the proposed settlement.

*Molski v. Gleich*, 318 F.3d 937, 953 (9th Cir. 2003); *Officers for Justice v. Civil Serv. Comm'n*, 688 F.2d 615, 625 (9th Cir.1982), *cert. denied sub nom.*, *Byrd v. Civil Serv. Comm'n*, 459 U.S. 1217 (1983). This list is not intended to be exhaustive; the court must consider the applicable factors in the context of the case at hand. *See Officers for Justice*, 688 F.2d at 625.

Despite the importance of fairness, the court must also be mindful of the Ninth Circuit's policy favoring settlement, particularly in class action lawsuits. *See*, *e.g.*, *Officers for Justice*, 688 F.2d at 625 ("Finally, it must not be overlooked that voluntary conciliation and settlement are the preferred means of dispute resolution. This is especially true in complex class action litigation . . . ."). While balancing all of these interests, the court's inquiry is ultimately limited "to the extent necessary to reach a reasoned judgment that the agreement is not the product of fraud or overreaching by, or collusion between, the negotiating parties." *Id.* The court, in evaluating the agreement of the parties, is not to reach the merits of the case or to form conclusions about the underlying questions of law or fact. *See id.*

"It is the settlement taken as a whole, rather than the individual component parts, that must be examined for overall fairness." *Hanlon*, 150 F.3d at 1026. "The settlement must stand or fall in its entirety." *Id.* The Court may not delete, modify, or rewrite particular provisions of the settlement. *See id.* "Settlement is the offspring of compromise; the question ... is not whether the final product could be prettier, smarter or snazzier, but whether it is fair, adequate and free from collusion." *Id.* at 1027.

**B. Analysis**

Upon reviewing all relevant evidence properly before it, the Court would conclude that the settlements are not the product of fraud or overreaching by, or collusion between, the negotiating parties, but instead are fair, adequate, and reasonable under the circumstances of this complex antitrust litigation. First, the overwhelming approval of the settlements by class members supports their final approval. Only one objection to the settlement was received and that objection was withdrawn through stipulation. Docket No. 437. In addition, of the 773 prospective class member notified of the settlements, only one class member affirmatively sought exclusion from the class. Keough Decl., Docket No. 440-2, ¶¶ 4, 14. Moreover, as of the date of the DDPs' motion for final approval, class members compromising 87.6% of the dollar value of the AALPs purchased during the class period submitted signed claims forms. *Id.* ¶ 12. Such overwhelming support from and participation by the settling class weighs in favor of final approval.

Second, as this Court has noted previously, the settlement benefits here are significant. Regarding Depo, the $25 million settlement amount represents 5.6% of Depo's sales of AALPs during the class period, which is significantly more favorable than settlement amounts approved in other price-fixing cases. *See, e.g., In re Linerboard Antitrust Litig.*, 321 F. Supp. 2d 619, 627 (E.D. Pa. 2004) (granting final approval to settlement where recovery was 1.62% of sales); *In re Packaged Ice Antitrust Litig.*, MDL 08-01952, 2011 U.S. Dist. LEXIS 150427, *54 (E.D. Mich. Dec. 13, 2011) (granting final approval to settlement where recovery was 2.2% of sales); *Meijer, Inc. v. 3M*, No. 04-5871, 2006 U.S. Dist. LEXIS 56744, *53 (E.D. Pa. Aug. 14, 2006) (granting final approval where settlement was 2% of recovery). As to Sabry Lee, Plaintiffs made a legitimate choice to accept a monetary settlement of $450,000, based on Sabry Lee's precarious financial situation, as detailed above. *See Torrisi v. Tucson Elec. Power Co.*, 8 F.3d 1370, 1375 (9th Cir. 1993) (recognizing that a settling defendant's "precarious" financial situation can inform settlement proceedings). And Settling Defendants have also agreed to provide important continued support to the DDPs in their prosecution of this case against the remaining defendants.

Third, it remains undisputed that the settlement was reached as a result of zealous, arms-length negotiations. Prelim. Hartley Decl., ¶¶ 2,6; *Rodriguez v. West Publ'g Corp.*, 563 F.3d 948, 965 (9th Cir. 2009) (Ninth Circuit "put[s] a good deal of stock in the product of an arms-length, non-collusive, negotiated resolution . . . ."). Fourth, this Court has noted that class counsel's prosecution of this action has been "effective and efficient" (July 25, 2011 Order at 13), and therefore "[g]reat weight" should be accorded counsel's determination that the instant settlements are in the best interest of the class. *Nat'l Rural Telecomms. Coop. v. DIRECTV, Inc.*, 221 F.R.D. 523, 528 (C.D. Cal. 2004); *In re Paine Webber Ltd. P'ships Litig.*, 171 F.R.D. 104, 125 (S.D.N.Y. 1997). Fifth, it likewise remains undisputed that class counsel engaged in a thorough investigation of the alleged facts; reviewed and analyzed more than a million pages of documents produced by Defendants; took 19 depositions, including ten in Taiwan; and participated in extensive settlement negotiations where the strengths and weaknesses of the parties' respective claims and defenses were debated. Prelim. Hartley Decl., ¶ 7. Thus, the extent of the discovery and the stage of the proceedings supports final approval as class counsel no doubt conducted a sufficient inquiry into the facts of the case to allow them to adequately assess its value.

Sixth, despite Plaintiffs' belief in the strength of their case and in light of the adequate settlement consideration obtained, the settlements are fair, adequate, and reasonable when compared to the risk, expense, complexity, and likely duration of further litigation. This complex, antitrust litigation certainly would involve inherent difficulties and delays associated with most complex litigation, including the complications and expenses pertaining to appeal and the possible enforcement of foreign judgments (as the Settling Defendants are domiciled abroad). Thus, the Court would conclude that the circumstances of this case demonstrate that the settlements should be granted final approval as fair, adequate, and reasonable.

Moreover, the Court would agree that the plan of allocation is fair, adequate and reasonable. The Court's evaluation of a settlement's plan of allocation is assessed under the same standard applicable to the settlement as a whole - the allocation plan must be fair, reasonable, and adequate. *Class Plaintiffs v. City of Seattle*, 955 F.2d 1268, 1284 (9th Cir.

1992). "[A] class action settlement need not necessarily treat all class members equally." *Schwartz v. TXU Corp.*, No. 3:02-2243, 2005 U.S. Dist. LEXIS 27077, at *78 (N.D. Tex. Nov. 8, 2005). Instead, "'an allocation formula need only have a reasonable, rational basis, particularly if recommended by experienced and competent counsel." *In re Broadcom Corp. Sec. Litig.*, No. 01-275, 2005 U.S. Dist. LEXIS 41976, at *7 (C.D. Cal. Sept. 12, 2005) (internal quotations and citation omitted).

The plan of allocation, as reflected in the Notice (Keough Decl., Exh. A at 5) and Plan of Administration and Distribution (Prelim. Hartley Decl., Exh. C at 3-4), provides that the $25,450,00.00 settlement fund plus interest - but less all taxes costs, fees, and expenses provided for under the agreement and/or awarded by the Court - (the "net settlement fund") will be distributed to participating class members on a pro rata basis reflecting the class members volume of qualifying AALP purchases compared to the total volume of qualifying AALP purchases of all class members. To the extent there is any money remaining in the net settlement fund upon first distribution, then the remaining funds will be re-distributed to class members. Such a plan of allocation is fair, adequate, and reasonable because it attempts to compensate each class member based on the proportionate damage it suffered due to the Settling Defendants' anti-competitive conduct. *See, e.g., In re Packaged Ice Antitrust Litig.*, 2011 U.S. Dist. LEXIS 150427, *65-67 (approving a like allocation plan in the antitrust context). Moreover, to the extent the plan of allocation is considered to include the MFN provision from the Depo Settlement Agreement, the Court has engaged in a more than thorough analysis of the reasonableness of that settlement term during the repeated briefing process and hearings at the preliminary approval stage. Thus, the Court would conclude that the plan of allocation should be granted final approval.

Finally, the Court sees no reason to doubt that class notice adequately satisfied due process under the United State Constitution, *Brown v. Ticor Title Inc.*, 982 F.2d 386, 392 (9th Cir. 1992), as well as the requirements under Fed. R. Civ. P. 23, considering the representations in the Keough Declaration (Docket No. 440-2) and the Court's evaluation of the notice procedures at the preliminary approval stage (which led to minor revisions to the notice content). Indeed, the requisite notice forms were sent to class members via first class mail. Keough Decl., ¶¶ 4-6; *Silber v. Mabon*, 18 F.3d 1449, 1452-54 (9th Cir. 1994) (approving notice sent by first class mail as the "best notice practicable"). Those forms informed class members of the terms of the settlements, their right to object to or opt out of the settlements and associated deadlines, the plan of allocation of the settlement funds, and counsel's request for an award of attorney's fees and other expenses. Also, relevant notice documents were made available on a settlement website, Keough Decl., ¶ 10, the settlements were disclosed through publications, banner adds, and a press release, *id.*, ¶¶ 7-9, and a toll-free information line was set up to answer any questions related to the settlements. *Id.* ¶ 11. As a result, the Court is satisfied that notice in this case was sufficient.[1]

[1] However, the Court would confirm with the Settling Defendants that they provided notice of the settlements to the Attorney General of the United States, and the attorneys general of the states in which any class member resides, in compliance with 28 U.S.C. § 1715(b), as was represented to be undertaken following the filing of the the motion for preliminary approval.

## III. DDPs' Motion for Award of Attorneys' Fees, Reimbursement of Expenses, and Service Payments

### A. Legal Standard

"[A] private plaintiff, or his attorney, whose efforts create, discover, increase or preserve a fund to which others also have a claim is entitled to recover from the fund the costs of his litigation, including attorneys' fees." *Vincent v. Hughes Air W., Inc.*, 557 F.2d 759, 769 (9th Cir. 1977). In the Ninth Circuit, district courts presiding over common fund cases have the discretion to award attorneys' fees based on either the lodestar method (essentially a modification of hourly billing) or the percentage method DDPs and counsel alternatively propose here. *See Class Plaintiffs v. City of Seattle (In re Wash. Pub. Power Supply Sys. Sec. Litig.)*, 19 F.3d 1291, 1296 (9th Cir. 1994) ("[W]e restate the law of our circuit that, in common fund cases, no presumption in favor of either the percentage or the lodestar method encumbers the district court's discretion to choose one or the other."). "As always, when determining attorneys' fees, the district court should be guided by the fundamental principle that fee awards out of common funds be '*reasonable under the circumstances*.'" *Id.* (emphasis in original) (*quoting Florida v. Dunne*, 915 F.2d 542, 545 (9th Cir. 1990) (emphasis in original)).

Despite this discretion, use of the percentage method in common fund cases appears to be dominant. *See, e.g., Vizcaino v. Microsoft Corp.*, 290 F.3d 1043, 1047 (9th Cir.), *cert. denied sub nom., Vizcaino v. Waite*, 537 U.S. 1018 (2002); *Six Mexican Workers v. Arizona Citrus Growers*, 904 F.2d 1301, 1311 (9th Cir. 1990); *Paul, Johnson, Alston & Hunt v. Graulty*, 886 F.2d 268, 272 (9th Cir. 1989). The advantages of using the percentage method have been described thoroughly by other courts. *See, e.g., In re Activision Sec. Litig.*, 723 F.Supp. 1373, 1374-77 (N.D.Cal.1989) (collecting authority and describing benefits of the percentage method over the lodestar method). The ultimate goal under either method of determining fees is to reasonably compensate counsel for their efforts in creating the common fund. *See Paul, Johnson*, 886 F.2d at 271-72. It is not sufficient to arbitrarily apply a percentage; rather the district court must show why that percentage and the ultimate award are appropriate based on the facts of the case. *See Vizcaino*, 290 F.3d at 1048. The Ninth Circuit has approved a number of factors which may be relevant to the district court's determination: (1) the results achieved; (2) the risk of litigation; (3) the skill required and the quality of work; (4) the contingent nature of the fee and the financial burden carried by the plaintiffs; and (5) awards made in similar cases. *See id.* at 1048-50.

As DDPs points out, the Ninth Circuit has established 25% of the common fund as the "benchmark" award for attorneys' fees in the class action setting. *See, e.g., Paul, Johnson*, 886 F.2d at 272-73; *Six Mexican Workers*, 904 F.2d at 1311; *Powers v. Eichen*, 229 F.3d 1249, 1256-57 (9th Cir. 2000) ("A district court may depart form the benchmark but, [i]f such an adjustment [to the benchmark] is warranted, . . . it must be made clear by the district court how it arrives at the figure ultimately awarded.") (internal quotations and citation omitted).

### B. Analysis

As stated previously, no objections have been filed against the DDPs' motion seeking attorneys' fees, reimbursement of expenses, and service awards for representative plaintiffs Motoring Parts International ("MPI") and Sioux Plating Co., Inc. ("Sioux Plating"). Both the Depo Settlement Agreement and the Sabry Lee Settlement Agreement contemplate that the DDPs will seek attorneys' fees, reimbursement of costs and expenses, and service awards from the settlement fund. Depo Settlement Agreement, ¶ 27; Sabry Lee Settlement Agreement, ¶ 25. Under the agreements, the Settling Defendants are to take no position on the fees, expenses, and service awards sought, and the Court is to consider the motion for such fees, expenses, and service awards separate from the Court's consideration of the fairness, reasonableness, and adequacy of the agreements. Depo Settlement Agreement, ¶¶ 27-28; Sabry Lee Settlement Agreement, ¶¶ 25-26. The Court addresses the requests for fees, expenses, and service awards in turn.

**1. Attorneys' Fees**

Here, DDPs seeks the benchmark award of 25% of the common fund in attorneys' fees. The Court would probably find that under the circumstances of this case, such an award of fees is reasonable. First, counsel represents that it took this case on a contingency basis against worthy and well-financed opponents.[2] Thus, the financial burden carried by DDPs' counsel in pursuing this complex case without any assurances of payment militates in favor of awarding the sought fees. Moreover, while DDPs' counsel seek the standard 25% of the fund, that percentage is also less than the typically agreed upon percentages in private contingency fee arrangements generally. *See, e.g., In re M.D.C. Holdings Sec. Litig.*, No. CV89-0990, 1990 U.S. Dist. LEXIS 15488, *22 (S.D. Cal. Aug. 30, 1990) ("In private contingent litigation, fee contracts have traditionally ranged between 30% and 40% of the total recovery."). The Court also agrees that the results obtained by the instant settlements support the sought fee award. As already detailed when discussing the motion for final approval of the settlements and not repeated herein, the settlement consideration provides substantial benefits to the class. The Court would likewise agree with counsel's position that it is axiomatic that antitrust conspiracy cases are complex and difficult to litigate, also supporting the award of fees here. Indeed, substantial risk was undertaken when pursuing the instant litigation considering that when these civil proceedings were initiated, class counsel did not have the benefit of criminal guilty pleas or any pending criminal prosecutions by federal or state governmental authorities. Hartley Fees Decl., Docket No. 396-2, ¶¶ 3-4. Moreover, class counsel has vigorously litigated this case across three years up and through the point of settlement with the Settling Defendants. Substantial expense and time have been put into the case considering many of the defendants are domiciled abroad: 32 depositions have been taken, with 14 in Taiwan; six separate sets of interrogatories were served; 33 sets of document demands were served; Defendants produced over a million documents, most of which required translation; 22 different motions have been briefed and argued; and exhaustive work with an expert to support class certification completed. *Id.* ¶¶4-7. And the Court has repeatedly recognized the skill, efficiency, and high quality of the work performed by DDPs' counsel throughout these proceedings. Thus, these myriad factors weigh in favor of awarding the unopposed, 25% fee award.

[2] However, the Court would note that the DDPs have not included in their only declaration in support of the fees motion that the fee arrangements with counsel were on a contingency basis. While the Court has no serious reason to doubt that the parties probably entered into contingency fee arrangements, statements in motion papers are not evidence; the parties would be required to affirm that the fee arrangements here were in fact on a contingency basis if they want to use that fact in support of their fee award.

The Court also recognizes that the DDPs present it with a lodestar cross-check to demonstrate the reasonableness of the fees sought. Hartley Fee Decl., ¶ 15, Exh. 2. That is, they provide a summary chart purporting to represent the number of hours billed by each firm, the amount of fees associated with those hours, and a total calculation of approximately 15,300 hours worked for $7,618,057.23 in fees actually incurred. Thus, the DDPs point out that the sought 25% fee award represents a negative lodestar multiplier when compared to the actual fees incurred. The Court would find the DDPs' summary chart is not all that informative, especially because it does not even include billing rates utilized by each firm or any more detailed information for the Court to evaluate the reasonableness of the fees actually incurred. However, the Court acknowledges that the fees figures are presented merely as a cross-check, and under Ninth Circuit precedent - considering the Court finds the 25% award otherwise adequately supported by the record - the Court need not necessarily engage in such a cross-check to reach its conclusion that the sought fees are reasonable under the circumstances. *See Six Mexican Workers*, 904 F.2d at 1311 (The Ninth Circuit has "determined that the choice between the lodestar and percentage calculation depends on the circumstances, but . . . *either method* may . . . have its place in determining what would be reasonable compensation.") (emphasis added) (internal quotations and citation omitted); *In re Wash. Pub. Power Supply Sys. Sec. Litig.*, 19 F.3d at 1296 ("in common fund cases, no presumption in favor of either the percentage or the lodestar method encumbers the district court's discretion to choose *one or the other*.") (emphasis added).

**2. Expenses**

Separate and apart from their request for 25% of the common fund as attorneys' fees, DDPs also request that their *actually* incurred expenses of $835,566.26 be reimbursed out of the common fund. "Under the common fund doctrine, [c]lass counsel is entitled to reimbursement for reasonable out-of-pocket expenses and costs in obtaining a settlement." *In re Quantum Health Res., Inc.*, 962 F. Supp. 1254 (C.D. Cal. 1997) (*citing Vincent v. Hughes Air West Inc.*, 557, F.2d 759,769 (9th Cir. 1977)). The Court also acknowledges that no objections have been made to DDPs' counsel obtaining a reimbursement of expenses.

However, at present, the Court will not award the sought expenses. The DDPs have not provided the Court with sufficient documentation that counsel actually incurred the expenses sought; the summary chart provided for the lodestar cross-check will not do. In addition to providing the Court with no documentation of the expenses, the Court also wonders whether *all* of the sought expenses are properly sought from the instant settlement fund. That is, the Court recognizes that only a partial settlement of this litigation has been obtained, and the Court would be hesitant to have all expenses incurred by DDPs' counsel in litigating this case to this point taken out of a settlement fund that reflects settlements with only two of the defendants. The Court will address this point with counsel at oral argument, as well as the need for further adequate documentation of the sought expenses. On the current record, the Court would refrain from award the reimbursement of any expenses to the DDPs.

**3. Service Awards**

The DDPs also seek service awards for representative plaintiffs MPI and Sioux Plating in the amount of $15,000.00 each. The decision whether to award an incentive payment to a class representative, and the size of that award, is entirely within the trial court's discretion. *See, e.g.*, *In re Mego Fin. Corp . Sec. Litig.*, 213 F.3d 454, 463 (9th Cir. 2000) (approving $5,000 incentive awards to two class representatives in a settlement of $1,725,000). In exercising its discretion to award incentive payments, the district court nonetheless should evaluate "the actions the plaintiff has taken to protect the interests of the class, the degree to which the class has benefitted from those actions, . . . the amount of time and effort the plaintiff expended in pursuing the litigation . . . and reasonbl[e] fear[s of] [] retaliation." *Staton*, 327 F.3d at 977 (internal quotations and citation omitted).

The service awards here are modest in comparison to the overall settlement consideration of $25,450,000.00. Moreover, as DDPs represent, the pursuit of this action by representative plaintiffs has benefitted the class because their efforts lead to the settlements at issue here, and there is no indication that the representative plaintiffs have any conflicts of interest with members of the class. Moreover, the DDPs represent that MPI and Sioux Plating put substantial time and effort into this litigation through: 1) meeting with class counsel to discuss the factual allegations and legal theories pertinent to this case in preparation for drafting the operative complaint; 2) producing documents justifying their claim and helping otherwise to develop documentary evidence in support of the operative complaint; 3) preparing with counsel for depositions by Defendants and providing testimony during day-long examinations; 4) providing input and guidance during the negotiation and settlement process, including reviewing and approving the settlement agreements on behalf of the class; and 5) otherwise keeping themselves and other plaintiffs informed about the litigation's progress. Hartley Fee Decl., ¶¶ 20-21. Moreover, MPI and Sioux Plating stepped forward to fill these important roles despite facing possible risk of retaliation from Defendants, with whom MPI and Sioux Plating continued to conduct necessary business. Thus, with no objections to these service awards and in light of the additional circumstances addressed by the Court herein, the Court would approve service awards of $15,000 each for MPI and Sioux Plating.

## IV. Conclusion

For the foregoing reasons, the Court would grant in full the DDPs motion for final approval of the class action settlements with Depo and Sabry Lee. In addition, the Court would grant the DDPs' motion for attorneys' fees and service awards, but would deny the motion for reimbursement of expenses pending additional, adequate documentation and argument supporting such expenses as discussed in this order.

# Exhibit J

NOTICE OF CLASS ACTION SETTLEMENT

AUTHORIZED BY THE U.S. DISTRICT COURT, EASTERN DISTRICT OF NEW YORK

# A $6+ billion settlement will provide payments and other benefits to merchants that accepted Visa and MasterCard since 2004.

*A federal court directed this Notice. This is not a solicitation from a lawyer.*

- The Court has preliminarily approved a proposed $6+ billion settlement in a class action lawsuit, called *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, MDL No. 1720 (JG)(JO). The lawsuit is about claims that merchants paid excessive fees to accept Visa and MasterCard cards because Visa and MasterCard, individually, and together with their respective member banks, violated the antitrust laws.
- The monetary portion of the settlement consists of two funds. The first is a cash fund in the amount of $6.05 billion that will pay valid claims of any person, business or other entity that accepted Visa or MasterCard branded credit or debit cards in the U.S. between January 1, 2004 and November 28, 2012. The second fund is estimated to be up to approximately $1.2 billion in total and is equivalent to a portion of the interchange fees attributable to merchants that do not exclude themselves from the Rule 23(b)(3) Settlement Class ("Cash Settlement Class") and that accepted Visa and MasterCard credit cards during an eight-month period to begin by July 29, 2013. This fund will pay valid claims of members of the Cash Settlement Class that accepted Visa or MasterCard credit cards during the eight-month period.
- The settlement will also require Visa and MasterCard to change some rules for merchants who accept their cards, including to allow merchants to do the following:
    - Charge customers an extra fee if they pay with Visa or MasterCard credit cards,
    - Offer discounts to customers who pay with payment forms less expensive than Visa or MasterCard credit or debit cards,
    - Accept Visa or MasterCard cards at fewer than all of the merchant's trade names or banners, and
    - Form "buying groups" that meet certain criteria to negotiate with Visa and MasterCard.

  The rule changes are explained in greater detail below and in the Class Settlement Agreement.
- The settlement creates two classes: Cash Settlement Class (Rule 23(b)(3) Settlement Class) and Rule Changes Settlement Class (Rule 23(b)(2) Settlement Class).
- This Notice has important information for merchants that accept Visa or MasterCard now or that accepted Visa and MasterCard at any time since January 1, 2004. It explains the settlement in a class action lawsuit. It also explains your rights and options in this case.
- For the full terms of the settlement, you should look at the Definitive Class Settlement Agreement and its Appendices (the "Class Settlement Agreement"), available at www.PaymentCardSettlement.com or by calling 1-800-625-6440. In the event of any conflict between the terms of this Notice and the Class Settlement Agreement, the terms of the Class Settlement Agreement shall control.
- Please check www.PaymentCardSettlement.com for any updates relating to the settlement or the settlement approval process.

| LEGAL RIGHTS AND OPTIONS<br>MERCHANTS IN THIS CASH SETTLEMENT CLASS (RULE 23(B)(3) SETTLEMENT CLASS) MAY: | |
|---|---|
| **FILE A CLAIM** | This is the only way to get money from the settlement. |
| **EXCLUDE YOURSELF** | This is the only way you can be part of another lawsuit that asks for money for claims in this case. You will *not* get payment from this settlement. |
| **OBJECT** | If you do not agree with any part of this settlement, you do not agree with the requested award of attorneys' fees, or both you may:<br>• Write to the court to say why, or<br>• Ask to speak at the Court hearing about either the fairness of this settlement or about the requested attorneys' fees or both. |
| **DO NOTHING** | You will not get money. You give up your rights to sue about the claims in this case. |
| **DEADLINES** | See pages 9-17 for more information about rights and options and all deadlines. |

**Merchants in the Rule Changes Settlement Class (Rule 23(b)(2) Settlement Class):**

- You automatically benefit from the Visa and MasterCard rule changes described below. You do not have to file any forms.
- You cannot exclude yourself from the Rules Changes Settlement Class.
- You may object to any part of the settlement.

The Court has given its preliminary approval to this settlement. The Court has not yet given its final approval.

**Read this Notice to learn more about the case.**

# WHAT THIS NOTICE CONTAINS

## BASIC INFORMATION

### 1. Why did I get this Notice?

This Notice tells you about your rights and options in a class action lawsuit in the U.S. District Court for the Eastern District of New York. Judge John Gleeson is overseeing this class action, which is called *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, MDL No. 1720 (JG)(JO). This Notice also explains the lawsuit, the proposed settlement, the benefits available, eligibility for those benefits, and how to get them.

The companies or entities who started this case are called the "Plaintiffs." The companies they are suing are the "Defendants."

This case has been brought on behalf of merchants. The specific merchants that filed the case are the Class Plaintiffs and the Court has authorized them to act on behalf of all merchants in the classes described below in connection with the proposed settlement of this case. The Class Plaintiffs are:

Photos Etc. Corporation; Traditions, Ltd.; Capital Audio Electronics, Inc.; CHS Inc.; Crystal Rock LLC; Discount Optics, Inc.; Leon's Transmission Service, Inc.; Parkway Corp.; and Payless ShoeSource, Inc.

The companies that the plaintiffs have been suing are the "Defendants." Defendants are:

- "Visa Defendants": Visa U.S.A. Inc., Visa International Service Association, and Visa Inc.;
- "MasterCard Defendants": MasterCard International Incorporated and MasterCard Incorporated; and
- "Bank Defendants": Bank of America, N.A.; BA Merchant Services LLC (formerly known as National Processing, Inc.); Bank of America Corporation; MBNA America Bank, N.A.; Barclays Bank plc; Barclays Bank Delaware; Barclays Financial Corp.; Capital One Bank (USA), N.A.; Capital One F.S.B.; Capital One Financial Corporation; Chase Bank USA, N.A.; Chase Manhattan Bank USA, N.A.; Chase Paymentech Solutions, LLC; JPMorgan Chase Bank, N.A.; JPMorgan Chase & Co.; Bank One Corporation; Bank One Delaware, N.A.; Citibank (South Dakota), N.A.; Citibank N.A.; Citigroup Inc.; Citicorp; Fifth Third Bancorp; First National Bank of Omaha; HSBC Finance Corporation; HSBC Bank USA, N.A.; HSBC North America Holdings Inc.; HSBC Holdings plc; HSBC Bank plc; National City Corporation; National City Bank of Kentucky; SunTrust Banks, Inc.; SunTrust Bank; Texas Independent Bancshares, Inc.; Wachovia Bank, N.A.; Wachovia Corporation; Washington Mutual, Inc.; Washington Mutual Bank; Providian National Bank (also known as Washington Mutual Card Services, Inc.); Providian Financial Corporation; Wells Fargo Bank, N.A. and Wells Fargo & Company.

### 2. What is this lawsuit about?

This lawsuit is about:

- The interchange fees attributable to merchants that accepted Visa or MasterCard credit or debit cards between January 1, 2004 and November 28, 2012, and
- Visa's and MasterCard's rules for merchants that accept their cards.

The Class Plaintiffs claim that:

- Visa, MasterCard, and their respective member banks, including the Bank Defendants, violated the law because they set interchange fees.

- Visa, MasterCard, and their respective member banks, including the Bank Defendants, violated the law because they imposed and enforced rules that limited merchants from steering their customers to other payment methods. Doing so insulated them from competitive pressure to lower the interchange fees.
- Visa and MasterCard conspired together about some of the business practices challenged.
- Visa and MasterCard and their respective member banks continued in those activities despite that Visa and MasterCard changed their corporate structure and became publicly owned corporations after this case was filed.
- The Defendants' conduct caused the merchants to pay excessive fees for accepting Visa and MasterCard cards.
- But for Defendants' conduct there would have been no interchange fee or those fees would have been lower.

The Defendants say they have done nothing wrong. They claim their business practices are legal, justified, the result of independent competition and have benefitted merchants and consumers.

## 3. What is an interchange fee?

When a cardholder makes a purchase with a credit or debit card, there is an interchange fee attributable to those transactions, which is usually 1% to 2% of the purchase price. Interchange fees typically account for the greatest part of the fees paid by merchants for accepting Visa and MasterCard cards.

Visa and MasterCard set interchange fee rates for different kinds of transactions and publish them on their websites, usually twice a year.

## 4. Why is this a class action?

In a class action, a very small number of people or businesses sue not only for themselves, but also on behalf of other people or businesses with similar legal claims and interests. Together all of these people or businesses with similar claims and interests form a class, and are class members.

When a court decides a case or approves a settlement, it is applicable to all members of the class (except class members who exclude themselves). In this case, the Court has given its preliminary approval to the settlement and the two classes defined below in Question 6.

## 5. Why is there a settlement?

The Court has not decided which side was wrong or if any laws were violated. Instead, both sides agreed to settle the case and avoid the cost and risk of trial and appeals that would follow a trial.

In this case, the settlement is the product of extensive negotiations, including court-supervised mediation with two experienced mediators, chosen by the parties. Settling this case allows class members to receive payments and other benefits. The Class Plaintiffs and their lawyers believe the settlement is best for all class members.

The parties agreed to settle this case only after seven years of extensive litigation. At the time of settlement, discovery was complete and the parties had exchanged expert reports. During discovery, Class Plaintiffs reviewed more than 50 million pages of documents and deposed more than 400 witnesses, including Defendants' experts. Also, at the time of settlement, motions to dismiss, motions for summary judgment, motions to exclude expert testimony, and the motion for class certification had been fully briefed and argued, and were pending before the court.

## 6. Am I part of this settlement?

**If this Notice was mailed to you, the Defendants' records show that you are probably in the:**

Cash Settlement Class (Rule 23(b)(3) Settlement Class) "consisting of all persons, businesses, or other entities that accepted Visa-Branded Cards and/or MasterCard-Branded Cards in the United States at any time from January 1, 2004 to the Settlement Preliminary Approval Date, except that this Class does not include the named Defendants, their directors, officers, or members of their families, financial institutions that have issued Visa- or MasterCard-Branded Cards or acquired Visa- or MasterCard-Branded Card transactions at any time from January 1, 2004 to the Settlement Preliminary Approval Date, or the United States government."

Rule Changes Settlement Class (Rule 23(b)(2) Settlement Class) "consisting of all persons, businesses or other entities that as of the Settlement Preliminary Approval Date, or in the future accept any Visa-Branded Cards and/or MasterCard-Branded Cards in the United States, except that this Class shall not include the named Defendants, their directors, officers, or members of their families, financial institutions that have issued Visa- or MasterCard-Branded Cards or acquired Visa- or MasterCard-Branded Card transactions at any time since January 1, 2004, or do so in the future, or the United States government."

The Settlement Preliminary Approval Date referenced in these class definitions is November 28, 2012.

If you are not sure whether you are part of this settlement, contact the Class Administrator at:

Call the toll-free number: 1-800-625-6440
Visit: www.PaymentCardSettlement.com
Write to: Payment Card Interchange Fee Settlement
P.O. Box 2530
Portland, OR 97208-2530
Email: info@PaymentCardSettlement.com

# Settlement Benefits

## 7. How much money will be provided for in this settlement?

Under the settlement, Visa, MasterCard and the bank defendants have agreed to make payments to two funds:

- **Cash Settlement Fund:** Every merchant in the Cash Settlement Class that does not exclude itself from the class by the deadline described below and files a valid claim ("Authorized Cash Claimant") will get money from the $6.05 billion Cash Fund. This fund will be reduced by an amount not to exceed 25% of the Cash Fund to account for merchants who exclude themselves from the Cash Settlement Class. The money in this fund after the reduction for excluded merchants will also be used to pay:
  - The cost of settlement administration and notice, as approved by the Court,
  - Money awards for Class Plaintiffs as approved by the Court, and
  - Attorneys' fees and expenses, as approved by the Court.

  The money in this fund will only be distributed if the Court finally approves the settlement.

- **Interchange Fund:** The money for this fund is estimated to be up to $1.2 billion and will be equivalent to 10 basis points (i.e. one-tenth of 1%) of transaction volume attributable to Cash Settlement Class members that accept Visa or MasterCard credit cards during an eight-month period starting by July 29, 2013. Every merchant in the Cash Settlement Class that does not exclude itself from the class by the deadline described below and that accepted Visa or

MasterCard credit cards during that eight-month period and files a valid claim ("Authorized Interchange Claimant") will get money from the Interchange Fund. The money in this fund will also be used to pay:

- The cost of settlement administration and notice, as approved by the Court, and
- Any attorneys' fees and expenses that may be approved by the Court.

The money in this fund will not be returned to Defendants, even if the settlement is terminated. If this settlement is terminated, the Court will decide how to distribute this fund.

## 8. How do I ask for money from this settlement?

You must file a valid claim to get money from this settlement. If the Court finally approves the settlement, and you do not exclude yourself from the Cash Settlement Class, you will receive a claim form in the mail or by email. You may also get a claim form at: www.PaymentCardSettlement.com, or call: 1-800-625-6440.

**How much money will I get?**

It is anticipated that the amount paid from the Cash Settlement Fund will be based on your actual or estimated interchange fees attributable to Visa and MasterCard transactions from January 1, 2004 through November 28, 2012.

The amount paid from the Interchange Fund will based on one-tenth of 1% of the merchant's Visa and MasterCard credit card transaction volume during the eight-month period to begin by July 29, 2013.

Valid claims will be paid from the Cash Settlement Fund and/or the Interchange Fund. The amount of money each eligible claimant will receive from the Cash Settlement Fund depends on the money available to pay all claims, the total dollar value of all valid claims filed, the deduction described above not to exceed 25% of the Cash Settlement Fund, the cost of class administration and notice, money awards to Class Plaintiffs, and attorneys' fees and expenses approved by the Court. The amount of money each eligible claimant will receive from the Interchange Fund depends on the money available to pay all claims, the total dollar value of all valid claims filed, the cost of class administration and notice, and attorneys' fees and expenses approved by the Court. Each claimant's payment will be paid in proportion to all claimants' payments.

Details about how all claims are calculated will be available at www.PaymentCardSettlement.com starting no later than April 11, 2013.

## 9. What do the members of the Rule Changes Settlement Class get?

If the Court approves the settlement, Visa and MasterCard will make changes to their rules and practices. These changes will benefit the Rule Changes Settlement Class.

The rule changes, which will start no later than January 27, 2013, are summarized below. To see a detailed description of the rule changes, including other rules not listed here, see the Class Settlement Agreement, paragraphs 40–65.

**Brand Surcharge Rules on Credit (not Debit) Cards**

Merchants will be able to charge an extra fee to all customers who pay with Visa or MasterCard branded credit cards. This is called a brand-level surcharge, and it is allowed if the surcharge:

- is the same for all Visa credit cards or all MasterCard credit cards;
- is not more than the merchant's average Visa or MasterCard merchant discount rate (calculated historically or based on the previous month); and

- is not more than the maximum surcharge cap, which will be posted on Visa's and MasterCard's websites (if a cap is set).

For merchants that accept other brands of credit cards, such as American Express, Discover, or PayPal, there are other requirements that depend on the costs of those brands to the merchant and those brands' surcharge restrictions.

- If the merchant accepts a competing brand of credit card that is as or more expensive than Visa or MasterCard, and that limits the merchant's ability to surcharge, the merchant may surcharge Visa or MasterCard cards only in the same way as the merchant would be allowed to surcharge the competing brand's cards or on the terms on which the merchant actually surcharges the competing brand's cards.
- If the merchant accepts a competing brand of credit card that prohibits or effectively prohibits the merchant from surcharging in a particular channel of commerce, the merchant may not surcharge Visa or MasterCard cards unless it also surcharges the competing brand's cards regardless of the cost of that brand to the merchant. The amount of the surcharge must equal whichever is less: the cost to accept the competing brand or the surcharge imposed on Visa or MasterCard cards.

*Exception:* A merchant may individually negotiate an agreement with the competing brand to waive or limit its ability to surcharge that brand, if that agreement fulfills the terms of the Class Settlement Agreement.

**Product Surcharge Rules on Credit (not Debit) Cards**

A merchant may impose a surcharge on a particular Visa or MasterCard credit card product, such as Visa Signature. The amount of the surcharge must not be more than the merchant's cost to accept the particular Visa or MasterCard credit card product, minus the Durbin Amendment's cap on debit-card interchange fees. The surcharge must be the same for all transactions on the particular Visa or MasterCard credit card product, regardless of the card's issuer.

For merchants that accept credit cards issued by competing brands (e.g., American Express, Discover, or PayPal), there are requirements similar to the brand level surcharge rules summarized above.

Nothing in the settlement affects a merchant's obligations to comply with all applicable state or federal laws, including state laws regarding surcharging of credit or debit card transactions and federal and state laws regarding deceptive or misleading disclosures. However, the fact that a merchant's ability to surcharge may be restricted under the laws of one or more states is not intended to limit that merchant's ability under the settlement to surcharge Visa or MasterCard credit cards where permitted by state law.

**Discount Rule:** Merchants may offer discounts or other financial incentives at the point of sale to customers who do not pay with Visa or MasterCard cards.

**All-Outlets:** Merchants may accept Visa or MasterCard at fewer than all of the merchant's "trade names" or "banners" if the merchant operates multiple businesses under different trade names or banners. For stores operating under the same "trade name" or "banner," however, merchants must accept or decline a network's cards at all of its stores operating under the same "trade name" or "banner."

**Buying Groups:** Merchants that form buying groups that meet certain criteria may make proposals to Visa and MasterCard about card acceptance on behalf of the group's members. If Visa or MasterCard believe that the group's proposal "provides reasonable commercial benefits to the parties," it must negotiate with the buying group and decide, in "good faith," whether or not to make an agreement with the group.

**<u>$10 Minimum Rule</u>:** This rule, which allows merchants to set a $10 minimum purchase for Visa and MasterCard credit cards, will not change even if the requirements of the Dodd-Frank Wall Street Reform Act end.

All these rule changes are set forth in full in the Settlement Agreement, which appears on the website: www.PaymentCardSettlement.com.

## HOW TO FILE A CLAIM FORM

### 10. How do I file a claim?

If the Court approves the settlement (see "The Court's Fairness Hearing" below), the Court will approve a Claim Form and set a deadline for Cash Settlement Class members to submit claims. In order to receive a payment, you must submit a Claim Form.

If you received this Notice in the mail, a Claim Form will be mailed or emailed to you automatically. The Claim Form will also be posted on the website and available by calling the toll free number shown below. Class members will be able to submit claims electronically using this website or by returning a paper Claim Form.

**Who decides the value of my claim?**

The Class Administrator is obtaining data from Visa, MasterCard, certain Bank Defendants, and other entities which it expects will permit it to estimate the total value of interchange fees attributable to each Authorized Cash Claimant on its Visa and MasterCard card transactions during the period from January 1, 2004 to November 28, 2012 with no netting or reductions based on rebates, market support, or promotional payments, or otherwise ("Interchange Fees Paid"). It is the current intention to utilize this data to the extent possible, to estimate the interchange fees attributable to class members. For any calendar year, or part thereof, in which an Authorized Cash Claimant had an agreement with Visa or MasterCard under which the merchant received customized interchange rates, such Claimant may elect to have its Visa or MasterCard Interchange Fees Paid estimated, in lieu of the Interchange Fees Paid amounts shown in the data utilized by the Class Administrator, by multiplying its relevant Visa or MasterCard credit, signature debit, and PIN debit transaction volume by the respective average effective credit, signature debit, and PIN debit interchange rates across the merchant's applicable merchant category (or merchant categories) for that time period. In order for a Claimant to qualify for such an election, the Class Administrator must confirm with Visa or MasterCard that the Claimant had an agreement with Visa or MasterCard in which it received customized interchange rates, for such time period.

Where the necessary data is not reasonably available or if the Interchange Fees Paid claim value established by the Class Administrator is disputed by the class member, class members will be required to submit information in support of its claim. This information will include, to the extent known, Interchange Fees Paid attributable to the class member, merchant discount fees paid, the class member's merchant category code and/or a description of the class member's business, total Visa and MasterCard transaction volume and/or total sales volume. Based on these data, the Interchange Fees Paid attributable to the class member will be estimated for each known Cash Settlement Class member.

The Class Administrator will calculate the value of claims to the Interchange Fund as a percentage of sales volume on Visa- and MasterCard-Branded credit card transactions during the eight-month period. To the extent that available data explicitly specify a particular claimant's sales volume on Visa- and MasterCard-Branded credit card transactions during the eight-month period, these data will be utilized directly in the valuation of that claim.

Claimants whose dollar sales transaction volume is not available from the Defendants and/or third parties will be asked to submit payment card transaction volume for the eight-month period to the Class Administrator or, if payment card transaction volume information is not available to the class member, sales transaction information from which payment card transaction volume may be estimated. The Class Administrator will make what it judges to be the best reasonably accurate estimate of such sales volume based on available data, and will make available to such Authorized Interchange Claimants the estimate of such sales volumes. Such estimates may be provided in a subsequent mailing or email to the Authorized Interchange Claimant and/or may be made accessible over a secure website operated by the Class Administrator.

The Class Administrator also expects to provide class members the ability to access the Claims website with a unique code to permit it to view the manner in which its claim value was calculated and may also provide this information on a pre-populated claim form. Class members may accept or disagree with data on the claim form or the website. The claim form and website will explain how to challenge the data.

More details about how all claims are calculated will be available at www.PaymentCardSettlement.com starting no later than April 11, 2013.

**Claim Preregistration Form**

Class members with more than one location or a franchise that accepts Visa or MasterCard cards may also fill out a pre-registration form at the website. You do not have to pre-register but doing so may be helpful, and does not impact your rights in this case.

**What if the Class Administrator doesn't have my data?**

The claim form also allows class members for whom no financial data is available or who were not identified as class members to file a claim. Those merchants will have to fill out and sign a claim form and return it by the deadline.

**Can anyone else file a claim for me?**

There are specialized companies that may offer to fill out and file your claim in return for a percentage of the value of your claim. Before you sign a contract with one of these companies, you should examine the claim-filing process provided here and decide whether it is worth the cost. You can always seek help from the Class Administrator or Class Counsel.

## 11. Am I giving up anything by filing a claim or not filing a claim?

If the Court finally approves the settlement, members of the Rule Changes Settlement Class (Rule 23(b)(2) Settlement Class) cannot be excluded from the Rule Changes Settlement Class. They will be bound by the terms of that settlement, including releasing all claims that were or could have been alleged in this case against any of the released parties identified in Paragraph 67 of the Class Settlement Agreement.

Members of the Cash Settlement Class (Rule 23(b)(3) Settlement Class) (who do not exclude themselves by the deadline) whether or not they file a claim for payment, will be bound by the terms of that settlement, which include agreeing not to file a claim against any of the released parties identified in Paragraph 32 of the Class Settlement Agreement.

In general, the settlement will resolve and release all claims by persons, businesses and other entities that arise from or relate to their capacity as merchants that accept Visa-Branded Cards and/or MasterCard-Branded Cards in the United States against Visa, MasterCard or banks that were or could have been alleged in the lawsuit, including any claims about interchange or other fees, no-surcharge rules, no-discounting rules, honor-all-cards rules and other rules.

The settlement will also resolve any merchant claims based upon the future effect in the United States of:

- any Visa or MasterCard rules, as of November 27, 2012, that are not to be modified pursuant to the settlement,
- the modified rules provided for in the settlement, or
- any other rules substantially similar to any such rules.

The releases will not bar claims involving new conduct or rules in the future that are not substantially similar to either existing conduct or rules or conduct or rules modified by the settlement (e.g. imposition of a new rule not substantially similar to existing rules or rules modified by the settlement, or reversion to the old rules modified by the settlement). The releases also will not bar claims involving certain specified standard commercial disputes arising in the ordinary course of business.

**The full text of the Releases for both the Cash Settlement Class (Rule 23(b)(3) Settlement Class) and Rule Changes Settlement Class (Rule 23(b)(2) Settlement Class) is set forth at pages 18 to 27 of this Notice. The Releases describe the released claims in legal language. You should carefully read the Releases and if you have questions about them, you may:**

- Call Class Counsel listed in Question 17 at no charge,
- Talk to a lawyer, at your own expense, about the releases and what they mean to you. The complete Settlement Agreement may also be viewed on the website.

**Important!** If you want to keep your right to be part of any other lawsuit that asks for money based on similar claims, you must opt-out (exclude yourself) from the Cash Settlement Class of this settlement. You **cannot** be excluded from the Rule Changes Settlement Class.

## 12. How do I opt-out of the Cash Settlement Class of this settlement?

To opt-out (exclude yourself) from the Cash Settlement Class (Rule 23(b)(3) Settlement Class) of this Settlement, send a letter to:

Payment Card Interchange Fee Settlement
P.O. Box 2530
Portland, OR 97208-2530

Your letter must be postmarked by **May 28, 2013**. You cannot exclude yourself by phone, fax, email or online.

**Should I send my letter by regular mail?**

Yes. Send your letter by first-class mail and pay for the postage. Keep a copy for your records.

**What should my letter say?**

Your letter must be signed by a person authorized to do so and state as follows:

- I want to exclude [name of merchant] from the Cash Settlement Class of the settlement in the case called *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation.*
- My personal information is:

  Name (first, middle, last):
  Position:
  Name of Merchant:

Address:
Phone No.:
Merchant's taxpayer identification number:

- The business names, brand names, and addresses of the stores or sales locations that I want to exclude from the Cash Settlement Class are:

  (list all businesses and addresses of each store or sales location)

- My position at the business that gives me the authority to exclude it from the Cash Settlement Class is as follows:

**Warning!** If your letter is sent after the deadline it will be considered invalid. If this happens, you won't be excluded from the Cash Settlement Class, and you will still be part of the settlement and will be bound by all of its terms.

### 13. If I exclude myself from the Cash Settlement Class, can I still get money from this settlement?

No. If you exclude yourself from the Cash Settlement Class (Rule 23(b)(3) Settlement Class):

- You cannot get money from this settlement, and
- You cannot object to the Cash Settlement (but you can still object to the Rule Changes).

The deadline to exclude yourself is: **May 28, 2013**. To do this, see: www.PaymentCardSettlement.com.
***Important!*** If you exclude yourself, do not file a claim form asking for payment.

**Can I exclude myself from the Rule Changes Settlement Class?**

No. You cannot be excluded from the Rule Changes Settlement Class. But you may object to the Rule Changes Settlement, if you want to.

### 14. If I do not exclude myself from the Cash Settlement Class, can I sue these Defendants for damages for past conduct later?

No. If you do not exclude yourself, you give up your right to sue any of the released parties described in the Class Settlement Agreement for damages for past conduct.

## HOW TO DISAGREE WITH THE SETTLEMENT

### 15. What if I disagree with the settlement?

You may tell the Court you object to (disagree with) the settlement for the Rule Changes Settlement Class. You may also object to the settlement for the Cash Settlement Class if you do not exclude yourself. The Court will consider your objection(s) when it decides whether or not to finally approve the settlement.

**How do I tell the Court I disagree with the settlement?**

You must file a Statement of Objections with the Court at this address:

United States District Court for the Eastern District of New York
Clerk of Court
225 Cadman Plaza
Brooklyn, NY 11201

You must also send a copy of your Statement of Objections to Class Counsel and Counsel for the Defendants at the following addresses:

| DESIGNATED CLASS COUNSEL | DESIGNATED DEFENDANTS' COUNSEL |
|---|---|
| Alexandra S. Bernay<br>Robbins Geller Rudman & Dowd LLP<br>655 West Broadway, Suite 1900<br>San Diego, CA 92101 | Wesley R. Powell<br>Willkie Farr & Gallagher LLP<br>787 Seventh Avenue<br>New York, NY 10019 |

You must send your Statement of Objections postmarked no later than **May 28, 2013**.

**What should my Statement of Objections say?**

Your Statement of Objections must contain the following information:

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

| | | |
|---|---|---|
| In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation | :<br>:<br>: | No. 05-MD-01720 (JG)(JO) |

Statement of Objections

I am a member of the Cash Settlement Class [and/or] the Rule Changes Settlement Class in the case called *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*.

I am a Class member because [*List information that will prove you are a class member, such as your business name and address, and how long you have accepted Visa or MasterCard cards*].

I object to the settlement in this lawsuit. I object to *(list what part(s) of the Settlement you disagree with, e.g. the settlement for the Cash Settlement Class, Rule Changes Settlement Class, Allocation Plan, notice procedures, other features.)* [Note that you may also object to any requests for attorneys' fees and expenses as part of the same objection, or as part of a separate objection described below].

My reasons for objecting are:

The laws and evidence that support each of my objections are:

My personal information is:

Name (first, middle, last):

Address:

Phone No.:

The contact information for my lawyer (if any) is:

**Can I call the Court or the Judge's office about my objections?**

No. If you have questions, you may visit the website for the settlement or call the Class Administrator:

www.PaymentCardSettlement.com
1-800-625-6440

### 16. Is objecting the same as being excluded?

No. **Objecting** means you tell the Court which part(s) of the settlement you disagree with (including the plan for distributing the cash benefits, request for attorneys' fees and expenses or awards for Class Plaintiffs).

Being excluded (also called opting-out) means you tell the Court you do not want to be part of the Cash Settlement Class (Rule 23(b)(3) Settlement Class).

## THE LAWYERS REPRESENTING YOU

### 17. Who are the lawyers that represent the Classes?

The Court has appointed the lawyers listed below to represent you. These lawyers are called Class Counsel. Many other lawyers have also worked with Class Counsel to represent you in this case. Because you are a class member, you do not have to pay any of these lawyers. They will be paid from the settlement funds.

| | | |
|---|---|---|
| **K. Craig Wildfang**<br>Robins, Kaplan, Miller & Ciresi L.L.P.<br>2800 LaSalle Plaza<br>800 LaSalle Avenue<br>Minneapolis, MN 55402 | **H. Laddie Montague, Jr.**<br>Berger & Montague, P.C.<br>1622 Locust Street<br>Philadelphia, PA 19103 | **Bonny E. Sweeney**<br>Robbins Geller Rudman & Dowd LLP<br>655 West Broadway, Suite 1900<br>San Diego, CA 92101 |

**Should I hire my own lawyer?**

You do not have to hire your own lawyer. But you can if you want to, at your own cost.

If you hire your own lawyer to appear in this case, you must tell the Court and send a copy of your notice to Class Counsel at any of the addresses above.

### 18. How much will the lawyers and Class Plaintiffs be paid?

For work done through final approval of the settlement by the district court, the lawyers for the class members (called Class Counsel) will ask the Court for an amount that is a reasonable proportion of the Cash Settlement Fund, not to exceed 11.5% of the Cash Settlement Fund of $6.05 billion and 11.5% of the Interchange Fund estimated to be $1.2 billion to compensate all of the lawyers and their law firms that have worked on the class case. For additional work to administer the settlement, distribute both funds, and through any appeals, Class Counsel may seek reimbursement at their normal hourly rates, not to exceed an additional 1% of the Cash Settlement Fund of $6.05 billion and an additional 1% of the Interchange Fund estimated to be $1.2 billion.

Class Counsel will also request reimbursement of their expenses (not including the administrative costs of settlement or notice), not to exceed $40 million and up to $200,000 per Class Plaintiff in service awards for their efforts on behalf of the classes.

Class Counsel may also seek reimbursement of fees and expenses from class members that opt out of the Cash Settlement Class, to the extent those class members rely on the record compiled in this case. Any monies that Class Counsel successfully recover from opt-outs will be deposited into the Cash Settlement Fund if the Court finally approves the settlement.

The amounts to be awarded as attorneys' fees, reimbursement of expenses, and Class Plaintiffs' Awards **must** be approved by the Court. Class Counsel must file their requests for fees and expenses and other costs to the Court by April 11, 2013. You can object to the requests for attorneys' fees in compliance with the instructions in Question 19 below.

Copies of the lawyers' requests for payment, reimbursement, and other costs will be posted at the settlement website the same day they are filed, which will be no later than April 11, 2013.

## 19. How do I disagree with the requested attorneys' fees, expenses or awards to Class Plaintiffs?

You may tell the Court you object to (disagree with) any request for attorneys' fees and expenses or awards to Class Plaintiffs. You may do so if you do not exclude yourself from the Cash Settlement Class and/or if you are a member of the Rule Changes Settlement Class. The Court will consider your objection(s) when it evaluates any request for attorneys' fees and expenses and/or awards to Class Plaintiffs in connection with its decision on final approval of the settlement.

To file an objection, you must file a Statement of Objections with the Court at this address:

United States District Court for the Eastern District of New York
Clerk of Court
225 Cadman Plaza
Brooklyn, NY 11201

You must also send a copy of your Statement of Objections to Class Counsel and Counsel for the Defendants at the following addresses:

| DESIGNATED CLASS COUNSEL | DESIGNATED DEFENDANTS' COUNSEL |
|---|---|
| Alexandra S. Bernay<br>Robbins Geller Rudman & Dowd LLP<br>655 West Broadway, Suite 1900<br>San Diego, CA 92101 | Wesley R. Powell<br>Willkie Farr & Gallagher LLP<br>787 Seventh Avenue<br>New York, NY 10019 |

The Clerk of Court, the attorneys for the class and defendants must receive your letter by **May 28, 2013**.

**What should my Statement of Objections say?**

Your Statement of Objections must contain the following information:

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

| | | |
|---|---|---|
| In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation | :<br>:<br>: | No. 05-MD-01720 (JG)(JO) |

Statement of Objections

I am a member of the Cash Settlement Class [and/or] the Rules Changes Settlement Class in the case called *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*.

I am a Class member because [*List information that will prove you are a class member, such as your business name and address, and how long you have accepted Visa or MasterCard cards*].

I object to class counsel's request for attorneys' fees and expenses and/or to the request for money awards to Class Plaintiffs.

My reasons for objecting are:

The laws and evidence that support each of my objections are:

My personal information is:

Name (first, middle, last):

Address:

Phone No.:

The contact information for my lawyer (if any) is:

**Can I call the Court or the Judge's office about my objections?**

No. If you have questions, you may visit the website for the settlement or call the Class Administrator:

www.PaymentCardSettlement.com
1-800-625-6440

## THE COURT'S FAIRNESS HEARING

### 20. When and where will the Court decide whether to approve the settlement?

There will be a Fairness Hearing at **10:00 a.m.** on **September 12, 2013**. The hearing will take place at:

United States District Court for the Eastern District of New York
225 Cadman Plaza
Brooklyn, NY 11201

We do not know how long the Court will take to make its decision.

***Important!*** The time and date of this hearing may change without additional mailed or published notice. For updated information on the hearing, visit: www.PaymentCardSettlement.com.

**Why is there a hearing?**

The hearing is about whether or not the settlement is fair, adequate, and reasonable.

The Court will consider any objections and listen to class members who have asked to speak at the hearing.

The Court will also decide whether it should give its final approval of the Plaintiffs' requests for attorneys' fees and expenses, service awards, and other costs.

### 21. Do I have to come to the hearing to get my money?

No. You do not have to go to the hearing, even if you sent the Court an objection. But, you can go to the hearing or hire a lawyer to go the hearing if you want to, at your own expense.

### 22. What if I want to speak at the hearing?

You must file a Notice of Intention to Appear with the Court at this address:

United States District Court for the Eastern District of New York
Clerk of Court
225 Cadman Plaza
Brooklyn, NY 11201

Your Notice of Intention to Appear must be filed by **May 28, 2013**. You must also mail a copy of your letter to Class Counsel and Counsel for the Defendants at the addresses listed in Question 15.

**What should my Notice of Intention to Appear say?**

Your Notice of Intention to Appear must be signed and contain the following information:

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

| | | |
|---|---|---|
| In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation | : : : | No. 05-MD-01720 (JG)(JO) |

- Notice of Intention to Appear
- I want to speak at the Fairness Hearing for the case called *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*.
- My personal information is:
- Name (first, middle, last):
- Address:
- Phone No.:
- Personal information for other people (including lawyers) who want to speak at the hearing:

## IF YOU DO NOTHING

### 23. What happens if I do nothing?

If you do not file a claim, you cannot get money from this settlement.

If you do not exclude yourself from the Cash Settlement Class (Rule 23(b)(3) Settlement Class), you cannot be part of any other lawsuit against Defendants and other released parties listed in the Class Settlement Agreement for damages for past conduct. You will be bound by the Cash Settlement Class (Rule 23(b)(3) Class) Release.

## GETTING MORE INFORMATION

### 24. How do I get more information?

There are several ways to get more information about the settlement.

You will find the following information at: www.PaymentCardSettlement.com:

- The complete Class Settlement Agreement, including all attachments, and
- Other documents related to this lawsuit.

To receive a copy of the Class Settlement Agreement or other documents related to this lawsuit, you may:

| | |
|---|---|
| Visit: | www.PaymentCardSettlement.com |
| Write to: | Payment Card Interchange Fee Settlement<br>P.O. Box 2530<br>Portland OR 97208-2530 |
| Email: | info@PaymentCardSettlement.com |
| Call: | 1-800-625-6440 – *toll-free* |

If you do not get a Claim Form in the mail or by email, you may download one at: www.PaymentCardSettlement.com, or call: 1-800-625-6440.

**Please do not attempt to contact Judge Gleeson or the Clerk of Court with any questions.**

## THE FULL TEXT OF THE RELEASES

### 25. What is the full text of the Release for the Cash Settlement Class?

31. The "Rule 23(b)(3) Settlement Class Releasing Parties" are the Class Plaintiffs, each and every member of the Rule 23(b)(3) Settlement Class that does not become an Opt Out, and any of their respective past, present, or future: officers and directors; stockholders, agents, employees, legal representatives, partners, and associates (in their capacities as stockholders, agents, employees, legal representatives, partners, and associates of a member of the Rule 23(b)(3) Settlement Class only); and trustees, parents, subsidiaries, divisions, affiliates, heirs, executors, administrators, purchasers, predecessors, successors, and assigns — whether or not they object to this Class Settlement Agreement, and whether or not they make a claim for payment from the Class Settlement Cash Escrow Account(s) or the Class Settlement Interchange Escrow Account(s), whether directly, representatively, derivatively, or in any other capacity.

32. The "Rule 23(b)(3) Settlement Class Released Parties" are all of the following:

(a) Visa U.S.A. Inc., Visa International Service Association, Visa Inc., Visa Asia Pacific Region, Visa Canada Association, Visa Central & Eastern Europe, Middle East & Africa Region, Visa Europe, Visa Europe Limited, Visa Latin America & Caribbean Region, and any other entity that now authorizes or licenses, or in the past has authorized or licensed, a financial institution to issue any Visa-Branded Cards or to acquire any Visa-Branded Card transactions.

(b) MasterCard International Incorporated, MasterCard Incorporated, and any other entity that now authorizes or licenses, or in the past has authorized or licensed, a financial institution to issue any MasterCard-Branded Cards or to acquire any MasterCard-Branded Card transactions.

(c) Bank of America, N.A.; BA Merchant Services LLC (formerly known as National Processing, Inc.); Bank of America Corporation; MBNA America Bank, N.A., and FIA Card Services, N.A.

(d) Barclays Bank plc; Barclays Bank Delaware; and Barclays Financial Corp.

(e) Capital One Bank (USA), N.A.; Capital One F.S.B.; and Capital One Financial Corporation.

(f) Chase Bank USA, N.A.; Chase Manhattan Bank USA, N.A.; Chase Paymentech Solutions, LLC; JPMorgan Chase Bank, N.A.; JPMorgan Chase & Co.; Bank One Corporation; and Bank One Delaware, N.A.

(g) Citibank (South Dakota), N.A.; Citibank N.A.; Citigroup Inc.; and Citicorp.

(h) Fifth Third Bancorp.

(i) First National Bank of Omaha.

(j) HSBC Finance Corporation; HSBC Bank USA, N.A.; HSBC North America Holdings Inc.; HSBC Holdings plc; and HSBC Bank plc.

(k) National City Corporation and National City Bank of Kentucky.

(l) SunTrust Banks, Inc. and SunTrust Bank.

(m) Texas Independent Bancshares, Inc.

(n) Wachovia Bank, N.A. and Wachovia Corporation.

(o) Washington Mutual, Inc.; Washington Mutual Bank; Providian National Bank (also known as Washington Mutual Card Services, Inc.); and Providian Financial Corporation.

(p) Wells Fargo & Company and Wells Fargo Bank, N.A.

(q) Each and every entity or person alleged to be a co-conspirator of any Defendant in any of the Operative Class Complaints or any of the Class Actions.

(r) Each of the past, present, or future member or customer financial institutions of Visa U.S.A. Inc., Visa International Service Association, Visa Inc., Visa Europe, Visa Europe Limited, MasterCard International Incorporated, or MasterCard Incorporated.

(s) For each of the entities or persons in Paragraphs 32(a)-(r) above, each of their respective past, present, and future, direct and indirect, parents (including holding companies), subsidiaries, affiliates, and associates (all as defined in SEC Rule 12b-2 promulgated pursuant to the Securities Exchange Act of 1934), or any other entity in which more than 50% of the equity interests are held.

(t) For each of the entities or persons in Paragraphs 32(a)-(s) above, each of their respective past, present, and future predecessors, successors, purchasers, and assigns (including acquirers of all or substantially all of the assets, stock, or other ownership interests of any of the Defendants to the extent a successor's, purchaser's, or acquirer's liability is based on the Rule 23(b)(3) Settlement Class Released Parties as defined in Paragraphs 32(a)-(s) above).

(u) For each of the entities or persons in Paragraphs 32(a)-(t) above, each of their respective past, present, and future principals, trustees, partners, officers, directors, employees, agents, attorneys, legal or other representatives, trustees, heirs, executors, administrators, shareholders, advisors, predecessors, successors, purchasers, and assigns (including acquirers of all or substantially all of the assets, stock, or other ownership interests of each of the foregoing entities to the extent a successor's, purchaser's, or acquirer's liability is based on the Rule 23(b)(3) Settlement Class Released Parties as defined in Paragraphs 32(a)-(t) above).

33. This release applies solely to the Rule 23(b)(3) Settlement Class Releasing Parties. In addition to the effect of the Class Settlement Order and Final Judgment entered in accordance with this Class Settlement Agreement, including but not limited to any *res judicata* effect, the Rule 23(b)(3) Settlement Class Releasing Parties hereby expressly and irrevocably waive, and fully, finally, and forever settle, discharge, and release the Rule 23(b)(3) Settlement Class Released Parties from any and all manner of claims, demands, actions, suits, and causes of action, whether individual, class, representative, *parens patriae*, or otherwise in nature, for damages, interest, costs, expenses, attorneys' fees, fines, civil or other penalties, or other payment of money, or for injunctive, declaratory, or other equitable relief, whenever incurred, whether directly, indirectly, derivatively, or otherwise, regardless of when such claims accrue, whether known or unknown, suspected or unsuspected, in law or in equity that any Rule 23(b)(3) Settlement Class Releasing Party ever had, now has, or hereafter can, shall, or may in the future have, arising out of or relating in any way to any conduct, acts, transactions, events, occurrences, statements, omissions, or failures to act of any Rule 23(b)(3) Settlement Class Released Party that are alleged or which could have been alleged from the beginning of time until the date of the Court's entry of the Class Settlement Preliminary Approval Order in any of the Operative Class Complaints or Class Action complaints, or in any amendments to the Operative Class Complaints or Class Action complaints, including but not limited to any claims based on or relating to:

(a) any interchange rules, interchange fees, or interchange rates, or any other Rule of any Visa Defendant or MasterCard Defendant, or any agreement involving any Visa Defendant or any MasterCard Defendant and any other Rule 23(b)(3) Settlement Class Released Party, and/or any merchant arising out of or relating to interchange rules, interchange fees, or interchange rates, card issuance, or card acceptance with respect to any Visa-Branded Card transactions in the United States or any MasterCard-Branded Card transactions in the United States;

(b) any Merchant Fee of any Rule 23(b)(3) Settlement Released Party relating to any Visa-Branded Card transactions in the United States or any MasterCard-Branded Card transactions in the United States;

(c) any actual or alleged "no surcharge" rules, "honor all cards" rules, "no minimum purchase" rules, "no discounting" rules, "non-discrimination" rules, "anti-steering" rules, Rules that limit merchants in favoring or steering customers to use certain payment systems, "all outlets" rules, "no bypass" rules, or "no multi-issuer" rules, or any other actual or alleged Rule of any Rule 23(b)(3) Settlement Class Released Party relating to any Visa-Branded Cards or any MasterCard-Branded Cards, or a merchant's point of sale practices relating to any Visa-Branded Cards or any MasterCard-Branded Cards;

(d) any actual or alleged agreement (i) between or among any Visa Defendant and any MasterCard Defendant, (ii) between or among any Visa Defendant or MasterCard Defendant and any other Rule 23(b)(3) Settlement Class Released Party or Parties, or (iii) between or among any Visa Defendant, MasterCard Defendant, or any other Rule 23(b)(3) Settlement Class Released Party or Parties relating to conduct or Rules of any Visa Defendant or any MasterCard Defendant;

(e) any reorganization, restructuring, initial or other public offering, or other corporate structuring of any Visa Defendant or MasterCard Defendant;

(f) any service of an employee or agent of any Rule 23(b)(3) Settlement Class Released Party on any board or committee of any Visa Defendant or MasterCard Defendant;

(g) the future effect in the United States of the continued imposition of or adherence to any Rule of any Visa Defendant or MasterCard Defendant in effect in the United States as of the date of the Court's entry of the Class Settlement Preliminary Approval Order, any Rule modified or to be modified pursuant to this Class Settlement Agreement, or any Rule that is substantially similar to any Rule in effect in the United States as of the date of the Court's entry of the Class Settlement Preliminary Approval Order or any Rule modified or to be modified pursuant to this Class Settlement Agreement;

(h) the future effect in the United States of any conduct of any Rule 23(b)(3) Settlement Class Released Party substantially similar to the conduct of any Rule 23(b)(3) Settlement Class Released Party related to or arising out of interchange rules, interchange fees, or interchange rates, any Rule of any Visa Defendant or MasterCard Defendant modified or to be modified pursuant to this Class Settlement Agreement, any other Rule of any Visa Defendant or any MasterCard Defendant in effect as of the date of the Court's entry of the Class Settlement Preliminary Approval Order, or any Rule substantially similar to any of the foregoing Rules;

(i) any conduct of this Action, including without limitation any settlement discussions relating to this Action, the negotiation of and agreement to this Class Settlement Agreement by the Defendants or any member or customer financial institution of the Visa Defendants or the MasterCard Defendants, or any terms or effect of this Class Settlement Agreement (other than claims to enforce this Class Settlement Agreement), including any changes in the Rule 23(b)(3) Settlement Class Released Parties' Rules as a result of this Class Settlement Agreement;

and it is expressly agreed, for purposes of clarity, without expanding or limiting the foregoing, that any claims based on or relating to (a)-(i) above are claims that were or could have been alleged in this Action.

34. Each Rule 23(b)(3) Settlement Class Releasing Party further expressly and irrevocably waives, and fully, finally, and forever settles and releases, any and all defenses, rights, and benefits that the Rule 23(b)(3) Settlement Class Releasing Party may have or that may be derived from the provisions of applicable law which, absent such waiver, may limit the extent or effect of the release contained in the preceding Paragraphs 31-33. Without limiting the generality of the foregoing, each Rule 23(b)(3) Settlement Class Releasing Party expressly and irrevocably waives and releases any and all defenses, rights, and benefits that the Rule 23(b)(3) Settlement Class Releasing Party might otherwise have in relation to the release by virtue of the provisions of California Civil Code Section 1542 or similar laws of any other state or jurisdiction. SECTION 1542 PROVIDES: "CERTAIN CLAIMS NOT AFFECTED BY GENERAL RELEASE. A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS OR HER SETTLEMENT WITH THE DEBTOR." In addition, although each Rule 23(b)(3) Settlement Class Releasing Party may hereafter discover facts other than, different from, or in addition to those that it or he or she knows or believes to be true with respect to any claims released in the preceding Paragraphs 31-33, each Rule 23(b)(3) Settlement Class Releasing Party hereby expressly waives, and fully, finally, and forever settles, discharges, and releases, any known or unknown, suspected or unsuspected, contingent or non-contingent claims within the scope of the preceding Paragraphs 31-33, whether or not concealed or hidden, and without regard to the subsequent discovery or existence of such other, different, or additional facts. Class Plaintiffs acknowledge, and the members of the Rule 23(b)(3) Settlement Class shall be deemed by operation of the Class Settlement Order and Final Judgment to have acknowledged, that the foregoing waiver was separately bargained for and is a key element of this Class Settlement Agreement.

35. Each Rule 23(b)(3) Settlement Class Releasing Party covenants and agrees that it shall not, hereafter, seek to establish, or permit another to act for it in a representative capacity to seek to

establish, liability against any of the Rule 23(b)(3) Settlement Class Released Parties based, in whole or in part, upon any conduct covered by any of the claims released in Paragraphs 31-34 above.

36. For avoidance of doubt, no other provision of this Class Settlement Agreement releases any claim of a Rule 23(b)(3) Settlement Class Releasing Party that is based on:

(a) breach of this Class Settlement Agreement;

(b) standard commercial disputes arising in the ordinary course of business under contracts or commercial relations regarding loans, lines of credit, or other related banking or credit relations, individual chargeback disputes, products liability, breach of warranty, misappropriation of cardholder data or invasion of privacy, compliance with technical specifications for a merchant's acceptance of Credit Cards or Debit Cards, and any other dispute arising out of a breach of any contract between any of the Rule 23(b)(3) Settlement Class Releasing Parties and any of the Rule 23(b)(3) Settlement Class Released Parties; provided, however, that Paragraphs 31-35 [of the Class Settlement Agreement] and not this Paragraph shall control in the event that any such claim challenges the legality of interchange rules, interchange rates, or interchange fees, or any other Rule fee, charge, or other conduct covered by any of the claims released in Paragraphs 31-35 above; or

(c) the claims alleged in the currently operative complaints against the current defendants in (i) NACS, et al. v. Board of Governors of the Federal Reserve System, No. 11-CV-02075-RJL (D.D.C.), and (ii) In re ATM Fee Antitrust Litigation, No. 04-CV-02676-CRB (N.D. Cal) (including claims that have been asserted to have been alleged in the Second Amended and Third Amended Complaints against Bank of America, N.A.).

37. Each Rule 23(b)(3) Settlement Class Releasing Party further releases each of the Visa Defendants, MasterCard Defendants, and Bank Defendants and their counsel and experts in this Action from any claims relating to the defense of this Action, including the negotiation and terms of this Class Settlement Agreement, except for any claims relating to enforcement of this Class Settlement Agreement. Each Visa Defendant, MasterCard Defendant, and Bank Defendant releases the Class Plaintiffs, the other plaintiffs in the Class Actions, Class Counsel, Class Plaintiffs' other counsel who have participated in any settlement conferences before the Court for a Class Plaintiff that executes this Class Settlement Agreement, and their respective experts in the Class Actions, from any claims relating to their institution or prosecution of the Class Actions, including the negotiation and terms of this Class Settlement Agreement, except for any claims relating to enforcement of this Class Settlement Agreement.

38. In the event that this Class Settlement Agreement is terminated pursuant to Paragraphs 96-98 below, or any condition for the Settlement Final Approval Date is not satisfied, the release and covenant not to sue provisions of Paragraphs 31-37 above shall be null and void and unenforceable.

## 26. What is the full text of the Release for the Rule Changes Settlement Class?

66. The "Rule 23(b)(2) Settlement Class Releasing Parties" are the Class Plaintiffs, each and every member of the Rule 23(b)(2) Settlement Class, and any of their respective past, present, or future: officers and directors; stockholders, agents, employees, legal representatives, partners, and associates (in their capacities as stockholders, agents, employees, legal representatives, partners, and associates of a member of the Rule 23(b)(2) Settlement Class only); and trustees, parents, subsidiaries, divisions, affiliates, heirs, executors, administrators, purchasers, predecessors, successors, and assigns — whether or not they object to this Class Settlement Agreement, and whether or not they exercise any

benefit provided under the Class Settlement Agreement, whether directly, representatively, derivatively, or in any other capacity.

67. The "Rule 23(b)(2) Settlement Class Released Parties" are all of the following:

(a) Visa U.S.A. Inc., Visa International Service Association, Visa Inc., Visa Asia Pacific Region, Visa Canada Association, Visa Central & Eastern Europe, Middle East & Africa Region, Visa Europe, Visa Europe Limited, Visa Latin America & Caribbean Region, and any other entity that now authorizes or licenses, or in the past has authorized or licensed, a financial institution to issue any Visa-Branded Cards or to acquire any Visa-Branded Card transactions.

(b) MasterCard International Incorporated, MasterCard Incorporated, and any other entity that now authorizes or licenses, or in the past has authorized or licensed, a financial institution to issue any MasterCard-Branded Cards or to acquire any MasterCard-Branded Card transactions.

(c) Bank of America, N.A.; BA Merchant Services LLC (formerly known as National Processing, Inc.); Bank of America Corporation; MBNA America Bank, N.A., and FIA Card Services, N.A.

(d) Barclays Bank plc; Barclays Bank Delaware; and Barclays Financial Corp.

(e) Capital One Bank (USA), N.A.; Capital One F.S.B.; and Capital One Financial Corporation.

(f) Chase Bank USA, N.A.; Chase Manhattan Bank USA, N.A.; Chase Paymentech Solutions, LLC; JPMorgan Chase Bank, N.A.; JPMorgan Chase & Co.; Bank One Corporation; and Bank One Delaware, N.A.

(g) Citibank (South Dakota), N.A.; Citibank N.A.; Citigroup Inc.; and Citicorp.

(h) Fifth Third Bancorp.

(i) First National Bank of Omaha.

(j) HSBC Finance Corporation; HSBC Bank USA, N.A.; HSBC North America Holdings Inc.; HSBC Holdings plc; and HSBC Bank plc.

(k) National City Corporation and National City Bank of Kentucky.

(l) SunTrust Banks, Inc. and SunTrust Bank.

(m) Texas Independent Bancshares, Inc.

(n) Wachovia Bank, N.A. and Wachovia Corporation.

(o) Washington Mutual, Inc.; Washington Mutual Bank; Providian National Bank (also known as Washington Mutual Card Services, Inc.); and Providian Financial Corporation.

(p) Wells Fargo & Company and Wells Fargo Bank, N.A.

(q) Each and every entity or person alleged to be a co-conspirator of any Defendant in any of the Operative Class Complaints or any of the Class Actions.

(r) Each of the past, present, or future member or customer financial institutions of Visa U.S.A. Inc., Visa International Service Association, Visa Inc., Visa Europe, Visa Europe Limited, MasterCard International Incorporated, or MasterCard Incorporated.

(s) For each of the entities or persons in Paragraphs 67(a)-(r) above, each of their respective past, present, and future, direct and indirect, parents (including holding companies), subsidiaries, affiliates, and associates (all as defined in SEC Rule 12b-2 promulgated pursuant to the Securities Exchange Act of 1934), or any other entity in which more than 50% of the equity interests are held.

(t) For each of the entities or persons in Paragraphs 67(a)-(s) above, each of their respective past, present, and future predecessors, successors, purchasers, and assigns (including acquirers of all or substantially all of the assets, stock, or other ownership interests of any of the Defendants to the extent a successor's, purchaser's, or acquirer's liability is based on the Rule 23(b)(2) Settlement Class Released Parties as defined in Paragraphs 67(a)-(s) above).

(u) For each of the entities or persons in Paragraphs 67(a)-(t) above, each of their respective past, present, and future principals, trustees, partners, officers, directors, employees, agents, attorneys, legal or other representatives, trustees, heirs, executors, administrators, shareholders, advisors, predecessors, successors, purchasers, and assigns (including acquirers of all or substantially all of the assets, stock, or other ownership interests of each of the foregoing entities to the extent a successor's, purchaser's, or acquirer's liability is based on the Rule 23(b)(2) Settlement Class Released Parties as defined in Paragraphs 67(a)-(t) above).

68. This release applies solely to the Rule 23(b)(2) Settlement Class Releasing Parties. In addition to the effect of the Class Settlement Order and Final Judgment entered in accordance with this Class Settlement Agreement, including but not limited to any *res judicata* effect, the Rule 23(b)(2) Settlement Class Releasing Parties hereby expressly and irrevocably waive, and fully, finally, and forever settle, discharge, and release the Rule 23(b)(2) Settlement Class Released Parties from any and all manner of claims, demands, actions, suits, and causes of action, whether individual, class, representative, *parens patriae*, or otherwise in nature, for any form of declaratory, injunctive, or equitable relief, or any damages or other monetary relief relating to the period after the date of the Court's entry of the Class Settlement Preliminary Approval Order, regardless of when such claims accrue, whether known or unknown, suspected or unsuspected, in law or in equity that any Rule 23(b)(2) Settlement Class Releasing Party now has, or hereafter can, shall, or may in the future have, arising out of or relating in any way to any conduct, acts, transactions, events, occurrences, statements, omissions, or failures to act of any Rule 23(b)(2) Settlement Class Released Party that are alleged or which could have been alleged from the beginning of time until the date of the Court's entry of the Class Settlement Preliminary Approval Order in any of the Operative Class Complaints or Class Action complaints, or in any amendments to the Operative Class Complaints or Class Action complaints, including but not limited to any claims based on or relating to:

(a) any interchange rules, interchange fees, or interchange rates, or any other Rule of any Visa Defendant or MasterCard Defendant, or any agreement involving any Visa Defendant or any MasterCard Defendant and any other Rule 23(b)(2) Settlement Class Released Party, and/or any merchant arising out of or relating to interchange rules, interchange fees, or interchange rates, card issuance, or card acceptance with respect to any Visa-Branded Card transactions in the United States or any MasterCard-Branded Card transactions in the United States;

(b) any Merchant Fee of any Rule 23(b)(2) Settlement Released Party relating to any Visa-Branded Card transactions in the United States or any MasterCard-Branded Card transactions in the United States;

(c) any actual or alleged "no surcharge" rules, "honor all cards" rules, "no minimum purchase" rules, "no discounting" rules, "non-discrimination" rules, "anti-steering" rules, Rules that limit merchants in favoring or steering customers to use certain payment systems, "all outlets" rules, "no bypass" rules, or "no multi-issuer" rules, or any other actual or alleged Rule of any Rule 23(b)(2) Settlement Class Released Party relating to any Visa-Branded Cards or any MasterCard-Branded Cards, or a merchant's point of sale practices relating to any Visa-Branded Cards or any MasterCard-Branded Cards;

(d) any actual or alleged agreement (i) between or among any Visa Defendant and any MasterCard Defendant, (ii) between or among any Visa Defendant or MasterCard Defendant and any other Rule 23(b)(2) Settlement Class Released Party or Parties, or (iii) between or among any Visa Defendant, MasterCard Defendant, or any other Rule 23(b)(2) Settlement Class Released Party or Parties relating to conduct or Rules of any Visa Defendant or any MasterCard Defendant;

(e) any reorganization, restructuring, initial or other public offering, or other corporate structuring of any Visa Defendant or MasterCard Defendant;

(f) any service of an employee or agent of any Rule 23(b)(2) Settlement Class Released Party on any board or committee of any Visa Defendant or MasterCard Defendant;

(g) the future effect in the United States of the continued imposition of or adherence to any Rule of any Visa Defendant or MasterCard Defendant in effect in the United States as of the date of the Court's entry of the Class Settlement Preliminary Approval Order, any Rule modified or to be modified pursuant to this Class Settlement Agreement, or any Rule that is substantially similar to any Rule in effect in the United States as of the date of the Court's entry of the Class Settlement Preliminary Approval Order or any Rule modified or to be modified pursuant to this Class Settlement Agreement;

(h) the future effect in the United States of any conduct of any Rule 23(b)(2) Settlement Class Released Party substantially similar to the conduct of any Rule 23(b)(2) Settlement Class Released Party related to or arising out of interchange rules, interchange fees, or interchange rates, any Rule of any Visa Defendant or MasterCard Defendant modified or to be modified pursuant to this Class Settlement Agreement, any other Rule of any Visa Defendant or any MasterCard Defendant in effect as of the date of the Court's entry of the Class Settlement Preliminary Approval Order, or any Rule substantially similar to any of the foregoing Rules;

(i) any conduct of this Action, including without limitation any settlement discussions relating to this Action, the negotiation of and agreement to this Class Settlement Agreement by the Defendants or any member or customer financial institution of the Visa Defendants or the MasterCard Defendants, or any terms or effect of this Class Settlement Agreement (other than claims to enforce this Class Settlement Agreement), including any changes in the Rule 23(b)(2) Settlement Class Released Parties' Rules as a result of this Class Settlement Agreement;

and it is expressly agreed, for purposes of clarity, without expanding or limiting the foregoing, that any claims based on or relating to (a)-(i) above are claims that were or could have been alleged in this Action.

Provided, however, that any Opt Out that is also a member of the Rule 23(b)(2) Settlement Class shall not be deemed to have released any claims for damages based on any Rules or other conduct, acts, transactions, events, occurrences, statements, omissions, or failures to act of any Rule 23(b)(3) Settlement Class Released Party prior to the date of the Court's entry of the Class Settlement Preliminary Approval Order.

69. Each Rule 23(b)(2) Settlement Class Releasing Party further expressly and irrevocably waives, and fully, finally, and forever settles and releases, any and all defenses, rights, and benefits that the Rule 23(b)(2) Settlement Class Releasing Party may have or that may be derived from the provisions of applicable law which, absent such waiver, may limit the extent or effect of the release contained in the preceding Paragraphs 66-68. Without limiting the generality of the foregoing, each Rule 23(b)(2) Settlement Class Releasing Party expressly and irrevocably waives and releases any and all defenses, rights, and benefits that the Rule 23(b)(2) Settlement Class Releasing Party might otherwise have in relation to the release by virtue of the provisions of California Civil Code Section 1542 or similar laws of any other state or jurisdiction. SECTION 1542 PROVIDES: "CERTAIN CLAIMS NOT AFFECTED BY GENERAL RELEASE. A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS OR HER SETTLEMENT WITH THE DEBTOR." In addition, although each Rule 23(b)(2) Settlement Class Releasing Party may hereafter discover facts other than, different from, or in addition to those that it or he or she knows or believes to be true with respect to any claims released in the preceding Paragraphs 66-68, each Rule 23(b)(2) Settlement Class Releasing Party hereby expressly waives, and fully, finally, and forever settles, discharges, and releases, any known or unknown, suspected or unsuspected, contingent or non-contingent claims within the scope of the preceding Paragraphs 66-68, whether or not concealed or hidden, and without regard to the subsequent discovery or existence of such other, different, or additional facts. Class Plaintiffs acknowledge, and the members of the Rule 23(b)(2) Settlement Class shall be deemed by operation of the Class Settlement Order and Final Judgment to have acknowledged, that the foregoing waiver was separately bargained for and is a key element of this Class Settlement Agreement.

70. Each Rule 23(b)(2) Settlement Class Releasing Party covenants and agrees that it shall not, hereafter, seek to establish, or permit another to act for it in a representative capacity to seek to establish, liability against any of the Rule 23(b)(2) Settlement Class Released Parties based, in whole or in part, upon any conduct covered by any of the claims released in Paragraphs 66-69 above.

71. For purposes of clarity, it is specifically intended for the release and covenant not to sue provisions of Paragraphs 66-70 above to preclude all members of the Rule 23(b)(2) Settlement Class from seeking or obtaining any form of declaratory, injunctive, or equitable relief, or damages or other monetary relief relating to the period after the date of the Court's entry of the Class Settlement Preliminary Approval Order with respect to any Rule of any Visa Defendant or any MasterCard Defendant, and the compliance by any Bank Defendant with any such Rule, as it is alleged to exist, now exists, may be modified in the manner provided in Paragraphs 40-45 and 53-57 above, or may in the future exist in the same or substantially similar form thereto.

72. For avoidance of doubt, no other provision of this Class Settlement Agreement releases any claim of a Rule 23(b)(2) Settlement Class Releasing Party that is based on:

(a) breach of this Class Settlement Agreement;

(b) standard commercial disputes arising in the ordinary course of business under contracts or commercial relations regarding loans, lines of credit, or other related banking or credit relations, individual chargeback disputes, products liability, breach of warranty, misappropriation of cardholder data or invasion of privacy, compliance with technical specifications for a merchant's acceptance of Credit Cards or Debit Cards, and any other dispute arising out of a breach of any contract between any of the Rule 23(b)(2) Settlement Class Releasing Parties and any of the Rule 23(b)(2) Settlement Class Released Parties; provided, however, that Paragraphs 66-71 above and not this Paragraph shall control in the event that any such claim challenges the legality of interchange rules, interchange rates, or interchange fees, or any other Rule, fee, charge, or other conduct covered by any of the claims released in Paragraphs 66-71 above;

(c) the claims alleged in the currently operative complaints against the current defendants in (i) *NACS, et al. v. Board of Governors of the Federal Reserve System*, No. 11-CV-02075-RJL (D.D.C.), and (ii) *In re ATM Fee Antitrust Litigation*, No. 04-CV-02676-CRB (N.D. Cal) (including claims that have been asserted to have been alleged in the Second Amended or Third Amended Complaints against Bank of America, N.A.); or

(d) a claim seeking only injunctive relief against only the Visa Defendants regarding the legality of Visa's Fixed Acquirer Network Fee.

73. Each Rule 23(b)(2) Settlement Class Releasing Party further releases each of the Visa Defendants, MasterCard Defendants, and Bank Defendants and their counsel and experts in this Action from any claims relating to the defense of this Action, including the negotiation and terms of this Class Settlement Agreement, except for any claims relating to enforcement of this Class Settlement Agreement. Each Visa Defendant, MasterCard Defendant, and Bank Defendant releases the Class Plaintiffs, other plaintiffs in the Class Actions, Class Counsel, Class Plaintiffs' other counsel who have participated in any settlement conferences before the Court for a Class Plaintiff that executes this Class Settlement Agreement, and their respective experts in the Class Actions, from any claims relating to their institution or prosecution of the Class Actions, including the negotiation and terms of this Class Settlement Agreement, except for any claims relating to enforcement of this Class Settlement Agreement.

74. In the event that this Class Settlement Agreement is terminated pursuant to Paragraphs 96-98 below, or any condition for the Settlement Final Approval Date is not satisfied, the release and covenant not to sue provisions of Paragraphs 66-73 above shall be null and void and unenforceable.

# Exhibit K

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
------------------------------x

EXPRESSIONS HAIR DESIGN,

Plaintiff, New York, N.Y.

v. 13 Civ. 3775(JSR)

ERIC T. SCHNEIDERMAN,

Defendant.

------------------------------x

June 14, 2013
3:20 p.m.

Before:

HON. JED S. RAKOFF,

District Judge

APPEARANCES

GUPTA BECK, PLLC
Attorneys for Plaintiff
BY: DEEPAK GUPTA

FRIEDMAN LAW GROUP, LLP
Attorneys for Plaintiff
BY: TRACEY KITZMAN

ERIC T. SCHNEIDERMAN
Attorney General of the State of New York
BY: CHARLES F. SANDERS
GARRETT COYLE
Assistant Attorneys General

(Case called)

THE DEPUTY CLERK: Will the parties please identify themselves for the record.

MR. GUPTA: Good afternoon, your Honor. Deepak Gupta for the plaintiffs.

MS. KITZMAN: Tracey Kitzman also for the plaintiffs.

MR. SANDERS: Charles F. sanders, from the State Attorney General's office, for defendant.

MR. COYLE: And Garrett Coyle for defendant.

THE COURT: Good afternoon. Please be seated.

So, my understanding is that, first, the plaintiffs want to move for a preliminary injunction, and my understanding is the plaintiffs are prepared to file their moving papers today.

MR. GUPTA: If your Honor could give us until Monday?

THE COURT: Monday, so that's June 17.

Then the next thing that my law clerk said that you suggested was June 28 for *amicus* briefs. I haven't approved any *amicus* briefs and why would I?

MR. GUPTA: Well, if you would prefer that they -- the prospective *amici* make a motion --

THE COURT: That's called what the law requires.

MR. GUPTA: -- they would do that.

THE COURT: And I should tell you that, unlike the Supreme Court which regularly permits all sorts of *amicus* briefs, because they just want to have the great fun of reading all that paper, in the trial court, where we have more than our share of paper from real parties, I frequently do not permit *amicus* briefs. So no one who moves for an *amicus* brief should be spinning their wheels preparing that brief until I grant them permission, and they better make a darn good showing of why an *amicus* brief would add anything to what your own clients are prepared to argue.

MR. GUPTA: Understood, your Honor.

THE COURT: So I'm not going to put any date on that.

I see there also was suggested July 5 *amicus* briefs in opposition from unknown amici. Those are the best kind, of course. If anyone wants to make a motion, if any proposed *amicus* wants to make a motion, they should go ahead and do so. I am going to set a time for that, but I'm not going to take account of that because the chances are at least 50/50 that I will say no.

So, in light of that, why do we need until July 12 for opposition papers from the defendant?

MR. COYLE: Well, your Honor, we only got the complaint last week. We are still reviewing it.

THE COURT: Right. Let's see. It is 22 pages, so you had to read three pages a day. Not too onerous, I think.

MR. COYLE: We have read it, your Honor. We are still having a conversation within our office to determine how we are going to defend this lawsuit, so that's why we put in that much time. We understand if your Honor thinks less time is warranted. We are willing–

THE COURT: Of course, it is your adversary who wants the preliminary injunction. If they don't care, I don't care. Usually one element of a preliminary injunction is a showing of irreparable harm. Maybe they don't think there will be that much irreparable harm between now and July whatever, but is there any opposition to July 12?

MR. GUPTA: There is no opposition from us.

THE COURT: All right. So July 12 is okay, then.

If there were any more problematic -- by the way, then there was also a discussion about whether you were going to file your own motion.

MR. COYLE: Yes, your Honor. We are still deciding how we are going to proceed in this case, but we do think at this stage we are tentatively thinking about moving to dismiss.

THE COURT: On what ground?

MR. COYLE: We have several grounds, but we think --

THE COURT: Tell me. You can favor me with just one or two of them.

MR. COYLE: Sure.

We think that, first, there is a threshold issue of whether they have shown any serious prospect that the statute will be enforced against them, so we don't think that they have standing.

We also think the claims fail on the merits. We don't think they are interpreting the statute correctly, the New York General Business Law Section 518. They contend that the same conduct can be lawful or unlawful depending upon the speech of the merchants. We don't think that's how our office interprets it, and we don't think that's the most reasonable interpretation of the law; rather, the law regulates conduct and, thus, the First Amendment claim fails.

Also, in light of the case law and the legislative history, we think the statute is not void for vagueness. We think it gives the plaintiffs and all other reasonable people adequate notice of what is lawful and what is unlawful.

THE COURT: So the statute allows, according to the complaint, merchants to offer discounts for using cash or a debit card, but makes it a criminal offense to impose surcharges for using a credit card. What's the difference?

MR. COYLE: We don't think there is a difference in terms of the underlying economic value. The way our office interprets the statute is that it doesn't -- we are going after merchants who entice consumers to commence an economic transaction by advertising one price and then, once they arrive at the register, informing them when they pull out their credit card that they are going to be subject to a surcharge above and beyond that. So as long as the two prices -- the credit card price and cash price -- are displayed with equal prominence, our office doesn't think that violates the statute.

THE COURT: So you are interpreting a false advertising statute.

MR. COYLE: Essentially, yes, that's how our office enforces it.

THE COURT: Does the statute say that?

MR. COYLE: We think the statute doesn't give notice of that on its face, but we think with the legislative history and the case law interpreting the statute, we think that's the most reasonable interpretation of it.

THE COURT: Okay. So you want to file your motion on the same day, July 12, right? Okay.

So that forces me to, against all my better instincts, give the plaintiff, as they requested, until July 29 for reply papers on their motion and opposition papers on your motion; and I will give you, as you requested, until August 7 for reply papers on your motion. In the meantime, the merchants of the State of New York will be left in, I am sure, a state of total suspense and wonder.

Now, let's set oral argument, let's look at August 14.

THE DEPUTY CLERK: August 14, Wednesday, any time you would like.

THE COURT: 4 p.m. on August 14.

What size brief does plaintiff want to file in their initial motion?

MR. GUPTA: We are requesting an overlength brief of no more than 50 pages to which the state has consented.

THE COURT: I have an interest in this because I usually fall asleep after page 25. Why do you need more than 25 pages?

MR. GUPTA: It is only going to be 25 pages of legal argument, your Honor. The other 25 pages are to provide a background on how we got to this point of what the statute means, the background, history of how it has been enforced. And the state is going to have two briefs -- they will have an opposition brief and a motion to dismiss -- so --

THE COURT: I understand why you might need more on your responding papers, since there are two, but we are talking about your moving papers. So you are going to have 25 pages of argument and 25 pages of historical background. How far back do you want to go? 1492?

MR. GUPTA: Your Honor, it is a description of the plaintiffs and how they are affected by the law as well as the --

THE COURT: Is this a factual matter?

MR. GUPTA: No, we don't anticipate that there will be any factual disputes. The factual description of the plaintiffs' situation will be supported by declarations by the plaintiffs, and we would also like to include a description of how the statute has been enforced. I think the state has already indicated that the enforcement history of the statute is going to be at play in these motions.

THE COURT: By the way, because I know nothing about this statute, when was it enacted?

MR. GUPTA: In 1984, your Honor. But the reason we are here now, if I may?

THE COURT: Yes.

MR. GUPTA: The reason we are here now is the merchants were under contractual constraints imposed by the credit card companies that had the same effect, and those restraints were only just lifted a few months ago as a result of a national antitrust settlement. Hence, that's why we are here now moving for a preliminary injunction.

THE COURT: So I will give you the 50 pages. I don't guarantee I will read them, but I will give it to you to file.

MR. GUPTA: Thank you.

THE COURT: And then on the combination of -- do you want to file two briefs or one combined brief?

MR. COYLE: If your Honor has a preference, we would follow your Honor's preference, but we think that they can be both covered in a single brief.

THE COURT: That's my preference as well. Okay. You want 50 pages for that?

MR. COYLE: Please, your Honor.

THE COURT: That's fine.

And then on the respective -- well, on plaintiff it will be responding to your motion and also doing a reply on their motion. So how much do you want for that?

MR. GUPTA: We would go with your preference, your Honor.

THE COURT: No, you won't, because my preference would be five pages, on the theory that if it was worth saying, you would have said it in your first 50-page brief; but, under these circumstances, I will give you a combined 25 pages.

MR. GUPTA: Thank you.

THE COURT: And then on the reply, since it is only a reply on the motion to dismiss, I will give you 15 pages. I will tell my law clerk to start weightlifting classes immediately.

Normally I would want you to put in a case management plan, but it sounded to me, from what I heard from your telephone conference with my clerk, that there may not be a need for discovery; or, if there is a need, it will be very limited.

Do I have that right?

MR. GUPTA: That's right, your Honor, with respect to the first two claims. We are moving on the first two claims in the preliminary injunction motion. There is also the antitrust preemption claim that will not be raised in the preliminary injunction motion that could well require discovery or will require discovery.

THE COURT: Let me give you the choice. I will give it to both sides. We could either take up a discovery schedule at the oral argument on August 14 or we could take it up now. Either way, I am going to want to have this case, if it isn't resolved otherwise, ready for trial no later than December. So if you think you need the time for discovery now, we can start now. If you are content to wait until mid August, that's fine. But I just want you to be aware that the bottom line will be a December trial.

MR. GUPTA: I think our preference, and we have consulted with the state, I think we both agree that deferring to oral argument would be fine.

THE COURT: Very good. Then we will take that up on August 14.

I think that's all I have. Anything else that counsel wanted to raise?

MR. COYLE: Nothing from the defense, your Honor.

MR. GUPTA: Nothing from us.

THE COURT: Very good. Thanks very much.

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# Exhibit L

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

EXPRESSIONS HAIR DESIGN, LINDA FIACCO, THE BROOKLYN FARMACY & SODA FOUNTAIN, INC., PETER FREEMAN, BUNDA STARR CORP., DONNA PABST, FIVE POINTS ACADEMY, STEVE MILLES, PATIO.COM LLC, and DAVID ROSS,

Plaintiffs,

– v. –

ERIC T. SCHNEIDERMAN, in his official capacity as Attorney General of the State of New York,

Defendant.

No. 13-cv-3775 (JSR)

**MEMORANDUM OF LAW IN SUPPORT OF**
**ATTORNEY GENERAL SCHNEIDERMAN'S MOTION TO DISMISS**
**AND IN OPPOSITION TO**
**PLAINTIFFS' MOTION FOR A PRELIMINARY INJUNCTION**

ERIC T. SCHNEIDERMAN
Attorney General of the State of New York
Garrett Coyle
Assistant Attorney General
*of Counsel*
120 Broadway, 24th Floor
New York, New York 10271
(212) 416-6696

**Dated: July 12, 2013**

price." *See id.* at 8 ("A 'surcharge' here is understood to mean any means of <u>increasing the regular price</u> to a cardholder which is not imposed on customers paying by cash, check or a similar means.") (emphasis added).

The attorney general's interpretation of § 518 makes eminently more sense than the plaintiffs' interpretation in light of the statute's objectives. *See Lewis v. United States*, 523 U.S. 155, 160 (1998) (rejecting proposed literal interpretation of statutory language "since a literal reading . . . would dramatically separate the statute from its intended purpose"). The State of New York has a paramount interest in protecting consumers against fraud, deception, and excessive complexity in economic transactions. *See, e.g.*, *Ohralik v. Ohio State Bar Ass'n*, 436 U.S. 447, 462 (1978) ("[T]he State has a legitimate and indeed 'compelling' interest in preventing those aspects of solicitation that involve fraud . . . ."). The State also has a strong interest in facilitating dual pricing so as not to insulate credit card companies from competition. *See, e.g.*, *Turner Broad. Sys. v. FCC*, 512 U.S. 622, 664 (1994) ("[T]he Government's interest in eliminating restraints on fair competition is always substantial, even when the individuals or entities subject to particular regulations are engaged in expressive activity protected by the First Amendment."). The plaintiffs' interpretation of § 518 would not serve the State's anti-deception interest, as liability under their interpretation would turn solely on the label that a seller used to describe its dual pricing scheme — not whether that scheme was adequately disclosed to consumers. And the plaintiffs' interpretation would frustrate the State's interest in promoting competition, as a seller could not lawfully implement a dual pricing scheme under their interpretation if (for example) a cashier inadvertently described the scheme as a credit card "surcharge."

By contrast, under the attorney general's interpretation, the statute is well-tailored to both purposes. Sellers are liable under the statute only when they fail to disclose the credit card price with equal prominence as the cash price, thus protecting credit card users from an unpleasant surprise at the point of sale.[9] It is not hard to imagine how a low advertised price could induce a driver with no cash in her wallet to pull off the highway into a gas station, or a shopper with no cash in his wallet to stand in a long line at a retail store — only to learn at the pump or register about a credit card surcharge that, had it been displayed prominently, they would have refused to pay.

And sellers are free to impose dual pricing schemes under the statute, regardless of the label they use to characterize it. Moreover, requiring sellers to prominently disclose the credit card price exposes credit card companies to competition by allowing consumers to make an informed decision whether the higher credit card price is worth paying at an early moment in the transaction when they can feasibly switch to cash — by, for example, stopping at an ATM or choosing a competitor with a lower credit card fee.

In addition, the attorney general's interpretation of § 518 protects credit card users against gouging. If sellers could hide credit card fees until the point of sale, they could more easily impose a credit card fee much higher than the swipe fee that they in turn incur, pocketing the difference. Consumers with no cash on hand would face an unwelcome dilemma between

[9] A cash discount, even if not prominently displayed, does not implicate the State's anti-fraud interest to the same extent as a credit card surcharge. If a seller's most prominently advertised price applies to credit cards, a credit card user who commences a purchase at that price cannot fairly claim that she was defrauded, even if she later learns that she could have saved money by using cash. *See* Compl. ¶ 26 ("In one study, 74% of consumers had a negative or strongly negative reaction to credit surcharges, while fewer than half had a negative or strongly negative reaction to cash discounts."). Thus, it makes sense that § 518 does not prohibit cash discounts.