No. 03-1532

# In the Supreme Court of the United States

MASTERCARD INTERNATIONAL INCORPORATED,
*Petitioner*,

v.

UNITED STATES,
*Respondent*.

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit**

## REPLY BRIEF FOR PETITIONER


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## REPLY BRIEF FOR PETITIONER

Respondent confirms that "[t]here is no dispute that petitioners' joint ventures are legitimate." Br. in Opp. 17. The courts below used even stronger terms. "The members of MasterCard and Visa work together through each of the associations to achieve benefits for themselves they could not provide independently * * *." Pet. App. 36a. "The associations have also fostered rapid innovation in systems, product offerings, and services." *Id.* at 38a. The district court credited petitioners with "significantly facilitat[ing]" "the growth of the payment card industry." *Ibid.* Before the development of the associations, credit cards were only minimally useful. *Ibid.* Since then, card use by consumers has multiplied – driven in part by decreased prices and increased quality of services. *Ibid.*

Against this backdrop, the Government relies heavily on the district court's so-called factual findings that MasterCard's and Visa's "exclusionary rules"[1] had the effect of "reducing overall output" in the market. Br. in Opp. 13-17. The district court itself observed, however, that the "critical factual findings did not require credibility determinations" and that "this is a case involving substantial *legal issues.*" Pet. App. 191a (emphasis added).

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[1] Respondent complains about our phrase "loyalty requirements," preferring the more-nefarious-sounding term "exclusionary rules." Br. in Opp. 17. The choice of terms has no legal significance. Loyalty rules like MasterCard's CPP of course exclude some firms from working with the joint venturers – "that is their very point." Pet. 12. That characterization merely frames the relevant antitrust question – Is the exclusion of a particular competitor from working with the joint venturers harmful to competition? – rather than answering it. The correct answer depends on the degree of foreclosure (see Pet. 15 n.5), but neither the courts below nor the Government has pointed to *any* meaningful foreclosure of Amex or Discover (see Pet. 15-16, 25-27). In light of the phenomenal commercial success of Amex and Discover, it is nothing short of preposterous for the Government to claim that the "exclusionary rules" "keep[] the Amex and Discover networks weak." Br. in Opp. 15 n.7. Supposedly "weak" Amex has a payment card business roughly the same size as MasterCard's 20,000 members *combined*. See Pet. 6.

The Government points to the district court's findings that MasterCard prevented issuance of Amex and Discover cards *by banks*, thus limiting the total number of *Amex and Discover cards* that were issued and the unique combinations of features that banks, working with Amex and Discover, could offer to consumers. But that kind of "output reduction" provides a legally insufficient basis for condemning a restraint. Every business that refuses to sell its product through a particular distributor will limit sales *by that distributor*, and will limit "product variety" by depriving consumers of the option of purchasing its product in combination with the unique capabilities of that distributor. This type of "output restriction" was present in *MountainWest* (Visa cards issued by Discover were excluded by the restraint), in *Rothery* (Atlas services offered by the excluded agents were denied to consumers), and in *Trinko* (Verizon's network services offered in conjunction with AT&T's unique marketing capabilities were adversely affected). What is fatally lacking is any persuasive explanation why such effects should be deemed legally dispositive here, when this Court, as well as other courts of appeals, have deemed such effects to be inconsequential in other cases.[2]

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[2] The Government's dismissal of the relevance of *Trinko* (Br. in Opp. 27-28) is particularly unsettling. In *Trinko* the Second Circuit reasoned simplistically that making a competitor share its property with a competitor would make consumers better off because in the short term "competition" would increase. The court's error was in failing to account for the long-term disincentives to innovation forced sharing would create. See Pet. 21. Here the Second Circuit reasoned simplistically that making MasterCard and Visa release banks from their loyalty obligation would make consumers better off because in the short term "competition" and product variety would increase. The court's error was, again, in failing to account for the long-term disincentives to the formation and strength of procompetitive joint ventures forced sharing would create. In observing that *Trinko* involved unilateral conduct but this case involves agreements among competitors, and that what was shared in the name of antitrust in *Trinko* was property but what would be shared in this case is the competitive strengths of banks, the Government misses the forest of antitrust policy for the trees of antitrust doctrine. The policy reasons that the Second Circuit's decision was pernicious in *Trinko* are **exactly the same** as the reasons that the same court's decision is pernicious here.

The *only* explanation the Second Circuit offered is that the challenged restraints were imposed by joint ventures formed by competitors, and thus are "exemplars of the type of anticompetitive behavior prohibited by the Sherman Act." Pet. App. 21a. Respondent tries to downplay that explanation: "The horizontal character of the exclusionary rules would not, of course, be sufficient in itself to condemn them." Br. in Opp. 22. But, despite respondent's effort to minimize this holding (see Br. in Opp. 20), *amici* have pointed out its potentially broad impact. "This holding casts a long shadow over the lawfulness of the most common, and arguably most important, form of ancillary restraint in joint ventures – the requirement that joint venture partners be loyal to each other." ICBA Br. 3. "Following the Second Circuit's decision," companies cannot "predict with * * * confidence that, where they faced strong competition and their activities did not foreclose competitors from access to consumers, restraints such as the loyalty rules at issue here would be upheld." ChevronTexaco Br. 2-3.

Respondent characterizes the thorniest unsettled legal issues as factual questions. But the important issues in this case – whether MasterCard and Visa "jointly" possessed market power; whether the loyalty provisions are ancillary to the concededly procompetitive joint ventures; whether there was harm to competition – far from being factual inquiries relevant only in this case, are substantial legal issues on which the court of appeals placed itself in conflict with other courts.

1. The judgment below rests on the conclusion that MasterCard and Visa "jointly or separately" have market power in the network services market. Br. in Opp. 12. On the question whether each association "separately" possesses market power, the Government virtually confesses error. It concedes that "the exclusionary rules have significant anticompetitive effects precisely because *both* of the major bank-owned associations adopted them * * *. [E]ither association could have prevented the rules from having those effects." Br. in Opp. 12-13 (emphasis in original). In other words, *neither* association "separately"

had power to restrain competition in the market; concerted action by *both* was required. The Government's belated concession is well taken. As a matter of law, MasterCard's market share of 26% is far too small to support an inference that it separately possesses market power. See Pet. 23 n.9. That being so, MasterCard's "market power" is legally not distinguishable from that of Atlas in *Rothery*. But see Br. in Opp. 26-27.

The government's remaining argument, that MasterCard and Visa "jointly" exercised market power, is also insupportable. There was no allegation that the two associations agreed with one another to adopt their respective policies, and the district court expressly rejected the government's suggestion that MasterCard's adoption of the CPP indirectly resulted from the associations' dual governance policies. Pet. App. 109a-110a. In the absence of any factual finding that the associations acted in concert, it was legal error to infer market power from the *aggregated* market shares of Visa and MasterCard.[3]

Similarly, the lower courts erred by inferring market power from banks' decisions to remain as MasterCard issuers rather than leave in order to issue Amex cards (Pet. App. 16a), and the Government treats that legal error as if it were somehow a factual finding (Br. in Opp. 12).[4] If the banks' decisions

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[3] If the court below did so, it adopted the concept of "shared monopoly" that has roundly been rejected by other circuits. See, *e.g.*, *Rebel Oil Co.* v. *Atlantic Richfield Co.*, 51 F.3d 1421, 1443 (9th Cir. 1995) ("[t]o pose a threat of monopolization, one firm *alone* must have the power to control market output and exclude competition") (emphasis in original); *Indiana Grocery, Inc.* v. *Super Value Stores, Inc.*, 864 F.2d 1409, 1416 (7th Cir. 1989). See generally Anthony Maul, *Are the Major Labels Sandbagging? An Antitrust Analysis of Strategic Licensing Practices*, 7 N.Y.U. J. LEGIS. & PUB. POL'Y 365, 367 (2004) (noting that in the United States "there has been no judicial recognition of a 'shared monopoly' doctrine").

[4] But see, *e.g.*, *United States Steel Corp.* v. *Fortner Enters., Inc.*, 429 U.S. 610 (1977) (overturning "finding" of market power concurred in by two courts below); *Brokerage Concepts, Inc.* v. *U.S. Healthcare, Inc.*, 140 F.3d 494, 516-519 (3d Cir. 1998) (overturning jury "finding" of market power and

demonstrate market power, every joint venture that successfully adopts a loyalty requirement can be found to have market power, no matter how small its market share and no matter how many competitors it faces. See Pet. 23-24. It would be the case in *Rothery* too, where – despite what Judge Bork emphasized was a lack of market power – the agents that continued to contract with the defendant van lines made the decision not to compete with the association in violation of the loyalty requirement.

In a closely analogous case, the Third Circuit rejected the argument that a network's "market power can be inferred from the fact that exclusion from the * * * network would have a major adverse impact * * * to the point of threatening [a network participant's] survival." *Brokerage Concepts, Inc.* v. *U.S. Healthcare, Inc.*, 140 F.3d at 518. By that logic, Judge Becker's opinion for the court recognized, multiple networks in a single market would have market power, and "it would pervert the antitrust notion of market power to find that each of [multiple] organizations, delivering the same product, has sufficient market power" to violate the antitrust laws. *Ibid.*

The Second Circuit correctly observed that market power may be proved directly by showing that a defendant's conduct produced anticompetitive effects. Pet. App. 15a. Its error, in affirming that MasterCard has market power, flows directly from the flawed premise that harm to individual competitors – Amex and Discover – is a cognizable anticompetitive effect, even in the absence of any meaningful foreclosure from the market. That is an error of law – not a factual finding – that threatens procompetitive joint venture activities and conflicts with decisions in other circuits.

2. The question of ancillarity is one of the oldest issues in the antitrust enforcement arena. See *United States* v. *Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898) ("Restrictions * * *

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noting that remand was unnecessary); *Los Angeles Land Co.* v. *Brunswick Corp.*, 6 F.3d 1422, 1425-1429 (9th Cir. 1993) (overturning jury "finding" of market power despite very high market share).

upon the business activity of the members, with a view of securing their entire effort in the common enterprise, were, of course, only ancillary to the main end of the union, and were to be encouraged."). See Pet. 13-16. As a leading Antitrust Division economist has written, "An ancillary restraint is one that is reasonably necessary to the accomplishment of a venture's efficiency-enhancing purposes." Gregory J. Werden, *Antitrust Analysis of Joint Ventures: An Overview*, in *Symposium: Antitrust Scrutiny of Joint Ventures*, 66 ANTITRUST L.J. 701, 706 (1998) (citing *MountainWest*, 36 F.3d at 970, *Rothery*, 792 F.2d at 224, and *Polk Bros., Inc.* v. *Forest City Enters., Inc.*, 776 F.2d 185, 189 (7th Cir. 1985)). "*As a general rule, restraints on competition between the venture and the participants are likely to be ancillary* * * *." *Id.* at 707 (emphasis added).

Precisely such restraints were invalidated in this case, and the Government offers no coherent explanation of what makes these restraints so unusual as to depart from the general rule that loyalty restrictions are ancillary. Instead, the Government argues that "[t]he question whether an agreement is ancillary is * * * an issue of fact." Br. in Opp. 19. In support of that bizarre assertion, the Government cites *Lektro-Vend Corp.* v. *Vendo Co.*, 660 F.3d 255, 266 (7th Cir. 1981), but that case – which *upheld* a noncompetitive covenant – contains no such holding, only a passing remark, and later precedents from the same court, such as *Polk Bros.*, cut against the Government's position.

Respondent's argument seeks to avoid the square conflict between this case and the Tenth Circuit's contrary holding in *MountainWest*, 36 F.3d 958, that a functionally indistinguishable by-law was ancillary to the Visa joint venture. The characteristics of the loyalty requirements that respondent highlights to support the holdings below (Br. in Opp. 19) were before the Tenth Circuit in *MountainWest*. That court nonetheless held that Visa's bylaw, preventing Discover from becoming a Visa member, was ancillary to the Visa joint venture, and valid. *MountainWest*, 36 F.3d at 970. That split confounds other joint venturers, which – like MasterCard and Visa in this case – rely

on loyalty requirements to ensure the cohesiveness of their associations. ICBA Br. 19-20; ChevronTexaco Br. 11-12.

The Government seizes on one slightly unusual feature of the MasterCard and Visa joint ventures – "duality," or the fact that members of one venture are not contractually precluded from issuing cards for the other – to argue that contractual preclusion of dealing with Amex or Discover must not be ancillary either. Br. in Opp. 19 & n.11. The Government's lengthy brief does not even attempt, however, to answer the point made in the petition (at 29-30) that "triality" and "quadrality" present very different competitive considerations than duality, particularly given that Amex and Discover are not – as MasterCard and Visa are – open networks. The Government does try to answer the point that duality came about by unique historical circumstances, but it does so through a misdirection ploy. Br. in Opp. 19 n.11. MasterCard, which as the smaller of the two associations *benefits* from duality, has indeed always maintained that duality is procompetitive, and competition has thrived with duality in place.[5] The Government's role in bringing about duality has significance *not* because it proves that duality is anticompetitive, but because it proves that no valid inference can be drawn about the ancillarity of the loyalty rules from the mere fact that MasterCard and Visa are not exclusive vis-à-vis each other.

3. It also is impossible to treat as nothing more than findings of fact the important question whether competition in some relevant market has been harmed. Although underlying factual issues exist (such as the effects of the loyalty requirements), the question of harm to competition requires the court to decide

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[5] The record reflects that MasterCard had reason to worry that in the absence of duality Visa would reach a "tipping point" and become so large that MasterCard would cease to exist or become competitively marginal. See C.A. ER T-6165 to T-6166. No one contends that Amex or Discover will cease to exist or become marginal if the loyalty rules stay in place. The only supposed "consumer harm" on which this case rests is not the loss of a competitor, but the supposed loss of product variety that is the inevitable effect of *every* loyalty rule. See Pet. 25-27.

what effects *qualify* as a reduction in output and what constitutes harm to competition, cognizable under the antitrust laws. See Pet. 24-28. A district court that left resolution of those questions to a jury would be reversed; a district court that reaches the relevant determinations itself is not immune from probing appellate review.

In its argument, respondent perpetuates the lower courts' error of failing to find any detrimental effect on price or output suffered by consumers. Instead, "[c]ompetition among issuers largely determines the prices that consumers pay and the variety of card features they can obtain." Pet. App. 37a. And "competition * * * is robust at the issuing level (where 20,000 separate issuers compete to provide products to consumers)." *Id.* at 17a. Other facts that the district court found, which remain undisputed, belie any contention that competition has been injured in a manner meaningful to consumers, and therefore to the antitrust laws. Output, price, and quality in credit card issuance have increased measurably during the same period that the loyalty requirements supposedly were harming competition. *Id.* at 38a.

Indeed, it becomes nearly impossible to determine on what facts the courts did rely when determining that output was reduced. The one example of "output reduction" is the unavailability of Amex or Discover cards issued by banks. Pet. App. 18a. The courts believed such a product would be beneficial because it would combine the strength of Amex or Discover with the issuing strength of the associations' members. As demonstrated by the petition (at 26-27), such increased "product variety" is not the kind of "output" with which the antitrust laws are concerned unless it forecloses much more than just a few imaginable combinations of product features in an already-saturated market. For this *exact* reason, the Tenth Circuit in *Mountain-West* expressly rejected the argument that the antitrust laws required that Discover be permitted to issue a Visa card that would capitalize on the strengths of both competitors. 36 F.3d at 967. The conflict cannot be avoided.

As demonstrated by *amici*, if the definition of output reduction adopted by the courts below is indeed the law, it threatens loyalty rules in countless current and future joint ventures. ICBA Br. 19. If – as here –

> loyalty rules * * * can be successfully challenged on a showing that they prevent a rival from teaming with a joint venture partner to compete against the venture itself, existing joint venture partners will have less incentive to invest in their cooperative activities. In *Rothery*, Judge Bork observed that without Atlas' loyalty rule, "the van line's incentive to spend for reputation, equipment, facilities, and services declines as it receives less benefit from them."

ICBA Br. 19-20 (quoting *Rothery*, 792 F.2d at 221).

4. Respondent compares the loyalty rules to a cartel agreement in an effort to explain away the paradox that MasterCard's member banks are both the alleged perpetrators and the victims of the so-called anticompetitive effects. Br. in Opp. 15 n.7. That analysis – like most of the Government's brief – implicitly assumes its supposed conclusion. Cartel participants unequivocally cause harm to parties other than the cartel's participants, *i.e.*, to the cartel's customers, who pay higher prices. But there has been no showing in this case that there are higher "prices" for the network services that MasterCard provides to its member banks or that such effects cause anticompetitive injury to merchants or cardholders. All of the direct "victims" of this so-called restraint and all of the direct beneficiaries – because the joint venture is kept strong – are MasterCard member banks. The effects on merchants and cardholders depend on the total effects of MasterCard's policy, including effects on card issuing, merchant acquisition, and network services. We do not argue, as respondent suggests (Br. in Opp. 15), that competition in upstream or input markets is unimportant. The point is that effects in one input market (network services) are inextricably linked to effects in other markets (card issuing and merchant acquisition), and it is the *total* effect that matters. Neither the

Government nor the courts below have meaningfully addressed that subject.

5. The Government's effort to limit the effect of the decision below to the MasterCard and Visa joint ventures (Br. in Opp. 23) is belied by the inescapable legal implications of the decision below. Respondent states that "[p]etitioners make no showing that these attributes describe a substantial number of joint ventures." *Ibid.* But petitioner did make such a showing, demonstrating that loyalty is "one issue [that] must be addressed in each of a great variety of joint ventures." Pet. 12. *Amici* have echoed petitioner's concerns about the broad implications of the rules announced by the district court and court of appeals when holding MasterCard's and Visa's loyalty provisions illegal. ICBA Br. 18-20; ChevronTexaco Br. 11-12.

Additionally, respondent glosses over the overwhelmingly ominous result here: a joint venture that all concede to be valid, operating in a marketplace characterized by steadily increasing output and improving consumer welfare, with only 26% market share, has been held to violate the antitrust laws by imposing intra-venture restrictions that operate to *preserve* competition among the major competitors in the marketplace. Although future antitrust defendants will of course endeavor to distinguish their joint ventures from MasterCard and Visa, the decisions below raise the specter of increasing numbers of "false positives," whereby efficiency-enhancing joint ventures operating in vigorously competitive markets are nonetheless subjected to liability simply because they are characterized by horizontal agreements among competitors. See ICBA Br. 2 ("This uncertainty, unless resolved by this Court, will deter companies from cooperating to create new ventures, products and services that enhance consumer welfare.").

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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