DALE A. KIMBALL
CLARK WADDOUPS
HEIDI E.C. LEITHEAD
SCOTT R. RYTHER
KIMBALL, PARR, WADDOUPS,
BROWN & GEE
185 South State, #1300
Salt Lake City, Utah 84111
Telephone: (801) 532-7840

M. LAURENCE POPOFSKY
STEPHEN V. BOMSE
MARIE L. FIALA
RENATA M. SOS
ROBERT G. MERRITT
HELLER, EHRMAN, WHITE
& McAULIFFE
333 Bush Street, #3100
San Francisco, California 94104-2878
Telephone: (415) 772-6000

Attorneys for Defendant and
Counterclaimant
VISA U.S.A. INC.

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

SCFC ILC, INC., d/b/a/ MOUNTAINWEST FINANCIAL,

Plaintiff,

v.

VISA U.S.A. INC.,

Defendant.

VISA U.S.A. INC. and VISA INTERNATIONAL SERVICE ASSOCIATION, Delaware corporations,

Counterclaimants,

v.

SEARS, ROEBUCK AND CO., a New York corporation; SEARS CONSUMER FINANCIAL CORPORATION; and SCFC ILC, INC., d/b/a MOUNTAINWEST FINANCIAL,

Counterdefendants.

Civil No. 2:91-CV-0478
Honorable Dee V. Benson

POST-TRIAL MEMORANDUM OF COUNTERCLAIMANT VISA U.S.A. INC. RE CLAYTON ACT SECTION 7, 15 U.S.C. § 18

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes

Other Authorities

INTRODUCTION

This is the post-trial memorandum of counterclaimant VISA U.S.A. Inc. in support of its counterclaim under Section 7 of the Clayton Act, 15 U.S.C. § 18. For the reasons set forth hereafter, VISA submits that permitting Sears to acquire an interest in VISA and operate a VISA credit card program "may" tend "substantially to lessen competition" in the provision of credit card services to cardholders and merchants. 15 U.S.C. § 18. Specifically, VISA submits that the evidence introduced at trial establishes that competition among general purpose charge card systems is likely to be adversely affected by permitting Sears to operate both a VISA program and its own Discover card program. Unlike competition among system members, which is extraordinarily unconcentrated, there are only a handful of credit card systems. Concentration at the system level is, therefore, high, by any standard antitrust measure, and entry into the systems business is not easy. Thus, Sears' intended acquisition of an ownership interest in VISA creates a strong incipient likelihood that competition may be adversely affected in ways that member-level competition cannot readily rectify. An injunction therefore

should be entered precluding Sears (or any successor)[1/] from owning or operating a VISA program so long as it owns Discover.[2/]

SUMMARY OF THE EVIDENCE

Given the Court's thorough familiarity with the evidence in this case and the extensive brief submitted contemporaneously in support of VISA's post-trial motions, we confine this summary to a brief recitation of the categories of evidence that, we believe, are pertinent to the Court's disposition of VISA's counterclaim:

1. VISA is a Delaware non-stock corporation with its principal place of business in San Mateo, California. VISA is owned by its members

---

1/ This memorandum follows the familiar practice in this case of referring to "Sears" as the party in interest. Technically, the acquisition at issue was made by a subsidiary of Dean Witter Financial Services Group, Inc. which also owns Greenwood Trust, the issuer of Discover. For Section 7 purposes, this ownership structure makes no difference. See Dep't of Justice & FTC Horizontal Merger Guidelines §1.31, 57 Fed. Rep. 41,552, 41,556 reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104 (hereafter "Merger Guidelines").

As the Court is aware, Sears has announced plans to reorganize by, inter alia, spinning off the Dean Witter businesses to the public during 1993. That spin-off is intended to include both Greenwood Trust and the plaintiff in this case, MountainWest Financial. This action, therefore, seeks an injunction against Sears and its affiliates, including Dean Witter. Following the proposed reorganization, VISA would not oppose an application by Sears, Roebuck & Co. to modify the injunction if it is not then in the credit card business.

2/ This memorandum proceeds from the premise that the Court will decide to grant relief to VISA under Rule 50 or 59. If it does not, then whatever the force of the arguments made here by VISA, they would be precluded by the jury's finding that the harm to competition caused by By-law 2.06 outweighs any benefits to competition resulting therefrom. See VISA's Mem. in Supp. of Mot. for J. Under Rule 50(b) and for a New Trial or Conditional New Trial Under Rule 59 ("VISA JNOV Mem.") at 58. Of course, in evaluating whether relief from the jury's verdict is appropriate, the Court may consider the arguments made herein. If Sears' ownership of a partial interest in VISA violates the "incipiency" standards of Section 7, such an acquisition necessarily is unlawful, particularly since the standard for evaluation under Section 7 is stricter than that which applies under Section 1. See Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 220 (D.C. Cir. 1986), cert. denied, 479 U.S. 1033 (1987).

who are approximately 6000 financial institutions located throughout the United States. VISA is the exclusive U.S. licensee (from VISA International) of the VISA name and affiliated registered marks and symbols which it, in turn, licenses to its various members. VISA is in the business of providing, among other things, systems and marketing services to its members. VISA engages in substantial systems development activities and promotes the VISA brand through extensive media and other advertising. (Tr. 443-49.)

2. VISA does not set the terms on which cards are issued by its members to cardholders. (Tr. 449, 1460-61, 2281.) VISA also does not set the terms of merchant discount charged by its members to service establishments. VISA does, however, establish a system-wide interchange fee which is the transfer payment between issuing and acquiring members in transactions in which the two are different. (Tr. 550-51.) See also National Bancard Corp. (NaBANCO) v. VISA U.S.A., Inc., 779 F.2d 592, 603-05 (11th Cir.), cert. denied, 479 U.S. 923 (1986). The practical effect of the interchange fee is to set a floor on merchant discount rates charged by VISA members.

3. Most VISA members are also members of MasterCard International. (Tr. 465.)

4. In 1986, Sears, through its Greenwood Trust subsidiary, began to issue a new general purpose credit card known as Discover. Greenwood Trust is the sole owner of Discover. It does not license others to issue Discover cards or sign merchants to accept Discover.

(Tr. 1096-97.) Discover also engages in systems development and related activities to improve its efficiency. Sears actively promotes Discover to consumers through extensive media and other advertising and marketing promotions. (Tr. 1096-97.) Discover also enters into agreements with merchants pursuant to which they are authorized to accept the Discover card as payment for goods and services. Discover typically charges a merchant discount -- which it sets -- for that service.

5. Discover competes with the VISA cards and MasterCards issued by members of the respective systems. In addition, Discover competes with the VISA and MasterCard associations, with American Express and, to a much lesser extent, with Diners Club. This intersystem competition includes advertising, marketing, systems and product development and related activities. (Tr. 447-48, 799-800.)

6. There also is intersystem competition involving merchant discount rates set by the proprietary systems (Discover, American Express and Diners Club) and the interchange fees set by VISA and MasterCard. (Tr. 333:16-22.) Beginning in 1986 and continuing to the present, Discover has priced its merchant discount below the rates at which VISA and MasterCard members are able to profitably price their services to merchants because of the VISA interchange fee. (Tr. 967:15-21.) Discover's merchant discount rate and the VISA and MasterCard interchange fees constrain the higher

merchant discount rates charged by American Express. (Tr. 333:23-334:14; 1448:17-1453:2.)

7. The market for credit card systems is very concentrated. As testified to by Sears' expert, Professor James Kearl, the relevant market share numbers are as follows: VISA 45.6%; MasterCard 26.4%; Discover 5.5%; American Express 20.5%; Diners Club 2.0%. (See Tr. 1595-97; PX 757.) The HHI Index for these companies is 3231.[3/] That is considered highly concentrated under the Department of Justice Merger Guidelines. See Merger Guidelines § 1.51(c).

8. Entry into the general purpose credit card business at the issuer and merchant-signing level is essentially unrestricted because both VISA and MasterCard continue to accept new members. (Tr. 565:11-566:2, 873:23-874:11.) According to Sears' expert, Professor Kearl, between 1980 and 1991 the number of new VISA members grew from under 2000 to over 6000. (Tr. 1607:7-11.) By contrast, entry of new general purpose charge card systems is quite difficult. It not only requires a great deal of capital but there is a "chicken and egg" problem caused by the need simultaneously to establish both a cardholder and a merchant-signing business. (Tr. 1598.) The only new system presently expected to offer a new

---

3/ This number is derived by squaring the market shares for each of the five systems and then adding the results. See Merger Guidelines, § 1.5 n. 17

general purpose charge card system is JCB, which operates a very substantial credit card business in Japan. (Tr. 1453-55.)

9. VISA is governed by a Board of Directors elected by the membership. (Tr. 376-77.) Typically, large issuers of VISA cards are represented on the VISA Board. (Id.) According to Sears' testimony at trial, it plans to devote substantial resources to its VISA business if it is permitted to become a member. (Tr. 1214-15.) It anticipates becoming one of the five largest VISA issuers within the next several years. (Tr. 187:6-8, DX 72 at S1121313.)

10. Both Discover and VISA have substantial amounts of confidential information which they do not willingly disclose to competitors. (Tr. 674:8-676:18, 1429-30.) In this litigation, for example, Sears has insisted upon a protective order precluding any VISA officers or employees (except for in-house counsel) from having access to Discover's confidential information. VISA similarly insisted that information it produced concerning such matters as budgets, marketing and other plans not be disclosed to Sears.

ARGUMENT

A. Sears' Intent to Become a VISA Member-Owner and Operate a VISA Program Is Subject to Section 7 of the Clayton Act.

Section 7 of the Clayton Act, 15 U.S.C. § 18, provides in pertinent part that:

> No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly . . . the whole or any part of the assets of another person engaged also in

> commerce or in any activity affecting commerce, where in any line of commerce in any section of the country, the effect of such acquisition . . . may be substantially to lessen competition, or to tend to create a monopoly.

The purpose of this statute is to prevent any form of acquisition that has the potential of harming competition "in any line of commerce." See United States v. Penn-Olin Chem. Co., 378 U.S. 158, 170-71 (1964); Crown Zellerbach Corp. v. FTC, 296 F.2d 800, 814 (9th Cir. 1961), cert. denied, 370 U.S. 937 (1962). By its terms, it applies to partial acquisitions. 15 U.S.C. § 18 ("the whole or any part . . ."). See also American Crystal Sugar Co. v. Cuban-American Sugar Co., 152 F. Supp. 387, 395 (S.D.N.Y. 1957), aff'd, 259 F.2d 524 (2nd Cir. 1958). The statute applies whether or not the acquisition, itself, creates control, since "[a] company need not acquire control of another company in order to violate the Clayton Act." Denver & R.G.W.R.R. v. United States, 387 U.S. 485, 501 (1967); see also 5 P. Areeda & D. Turner, Antitrust Law ¶ 1203b at 317 (1980) (hereafter "Areeda") (a court should not "hesitate to find that § 7 confers jurisdiction to consider the anticompetitive effects of partial acquisitions, even where control is neither attained nor contemplated"). It is equally clear that Section 7's standards apply to the creation and operation of a joint venture. Penn-Olin, 378 U.S. at 170-71; see also Northern Natural Gas Co. v. Federal Power Comm'n, 399 F.2d 953, 962 (D.C. Cir. 1968); Julius Nasso Concrete Corp. v. Dic Concrete Corp., 467 F. Supp. 1016, 1022 (S.D.N.Y. 1979); Hibner, Antitrust Considerations of Joint Ventures, Teaming Agreements, Co-Productions and Leader-Follower Agreements, 51 Antitrust L.J. 705, 719 (1983) ("While the Merger Guidelines do not specifically address joint ventures, in light of the Penn-Olin case there has been no or little question that merger law analysis is at least the starting point.").

B. Sears Partial Merger of Its Credit Card Operations with VISA May "Substantially . . . Lessen Competition" in the General Purpose Charge Card Business.

Having successfully launched a major new credit card system in 1986, Sears now wishes to become a part owner of VISA, as well. Indeed, its professed plan is to become one of the five largest issuers of VISA cards within the next several years. That plan is not consistent with the maintenance of effective competition among credit card systems and may materially reduce competition in the general purpose charge card business. Therefore, permitting Sears to operate a VISA program would violate Section 7 and should be enjoined.

While most of the attention at trial was paid to Sears' claim that VISA By-law 2.06 somehow harms competition by excluding Sears (and American Express) from VISA, the evidence that was introduced -- much of it by Sears -- actually demonstrates a clear violation of Section 7 by Sears' proposed entry into VISA. In saying that, we note, first, that the standards of evaluation under the Clayton Act are stricter than those which apply under Section 1 of the Sherman Act. See Rothery, 792 F.2d at 220; FTC v. Warner Communications Inc., 742 F.2d 1156, 1160 (9th Cir. 1984). That is true, specifically, because Section 7 is intended to "arrest restraints of trade in their incipiency." American Crystal Sugar, 152 F. Supp. at 395; see also Penn-Olin, 376 U.S. at 170-71 ("The grand design of [Section 7] was to arrest incipient threats to competition which the Sherman Act did not ordinarily reach."); United States v. El Paso Natural Gas Co., 376 U.S. 651, 658-59 (1964); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 367 (1963). Indeed, the precise goal of the law is to prevent the creation of situations in which future competition may be adversely affected, regardless of any existing harm. Penn-Olin, 376 U.S. at 171 ("actual restraints need not be proved. The requirements of

the [statute] are satisfied when a "tendency" toward monopoly or the "reasonable likelihood of a substantial lessening of competition in the relevant market is shown"); Brown Shoe Co. v. United States, 370 U.S. 294, 323 (1962) ("concern was with probabilities, not certainties"). Consistent with that purpose, merger analysis under Section 7 gives substantial weight to market structure because it is predictive of the likelihood of future anticompetitive behavior or effects, whether through the exercise of market power or the implementation of collusive or coordinated competitive strategies. See Merger Guidelines § 1.5; see also United States v. Continental Can Co., 378 U.S. 441, 458-62 (1964); FTC v. University Health, Inc., 938 F.2d 1206, 1218-20 (11th Cir. 1991).

Accordingly, we begin here with the structure of the market. As discussed at length at trial and in VISA's accompanying memorandum under Rules 50 and 59, the market for the issuance of credit cards (which Sears attacks in its complaint) is highly unconcentrated. In the words of Sears' consultant, Lexecon, "it is intensely competitive, approaching the textbook example of an atomistic market." DeMuth, The Case Against Credit Card Interest Rate Regulation, 3 Yale J. on Reg. 201, 222 (1986) (DX 523). That is because issuers are free to set their own prices and output and because entry into VISA (and MasterCard) remains almost entirely open. Using the standard Department of Justice HHI as a measure of concentration, the index in this market is below 500 (Tr. 2300-01), making this one of the most unconcentrated markets in American commerce. For that reason, exclusion of Sears (and American Express) from VISA raises no viable competitive concern. See Rothery, 792 F.2d at 220 (market with HHI of 520 is "low on the range of unconcentrated markets"); Merger Guidelines § 1.51(a) ("Post-Merger HHI Below 1000. The Agency regards markets in this region to be

unconcentrated. Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis."). See also VISA JNOV Mem. at 47-48.

The situation at the system level is very different. There are, at most, five viable system competitors within the general purpose charge card market and entry of a new system is quite difficult. Using figures offered by Sears' economist, the calculated HHI at the system level is 3231 -- putting it well above the Merger Guidelines "highly concentrated" threshold of 1800. See Merger Guidelines at 1.51(c). Further, employing Dr. Kearl's "overlap" analysis, Sears' acquisition of an ownership interest in VISA would raise the relevant HHI to 3732, a very significant increase under Merger Guidelines standards.[4/] See FTC v. PPG Indus., Inc., 798 F.2d 1500, 1502-03 (D.C. Cir. 1986); United States v. Rockford Memorial Corp., 717 F. Supp. 1251, 1280 (N.D. Ill. 1989), aff'd, 898 F.2d 1278 (7th Cir. 1990); Merger Guidelines § 1.51(c) ("Where the post-merger HHI exceeds 1,800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise.").

Nor is such power capable of being dissipated by competition at the member level. A couple of examples may illustrate why. Assume that the effect of Sears' action was to eliminate or reduce system-level competition, whether through express collusion, the sharing of confidential information or a reduction in competitive incentives. No amount of member level competition would eliminate those adverse

---

4/ Indeed, Dr. Kearl's view of the market (under which the market shares of VISA and MasterCard are combined) would yield a pre-"merger" HHI of 5639 and a post-"merger" HHI of 6431.

competitive effects.[5/] Similarly, any effect on merchant discount (and, in the case of VISA, interchange fee) rates operate at the system level and are largely impervious to being competed away by member-level price competition.

This market structure creates, at least, a presumption of incipient harm to competition. See FTC v. University Health, Inc., 938 F.2d at 1218; United States v. United Tote, Inc., 768 F. Supp. 1064, 1068 (D. Del. 1991). That presumption is strengthened, not rebutted, by the other evidence admitted at trial. For example, the evidence indicates that entry at the system level is relatively difficult. (Tr. 1598:15-19.) More important, concerns over potential competitive coordination, and the like, are very real and substantial. One of the principal concerns that animates merger enforcement policy is the potential for diminished competition when competitors work together. While such coordination is tolerated when it is ancillary to an efficiency-creating joint venture, elimination of competition between competitors (here, VISA and Discover) enjoys no such sanction.

Among the ways in which such competition may be threatened is through the presence of a competitor on a rival's board (see, e.g., F & M Schaefer Corp. v. C. Schmidt & Sons, 597 F.2d 814, 818 (2d Cir. 1979); Hamilton Watch Co. v. Benrus Watch Co., 114 F. Supp. 307, 314 (D. Conn.), aff'd, 206 F.2d 738 (2d Cir. 1953)), or through the exchange of confidential information. (Areeda at 319.) Both of those concerns exist

---

5/ VISA's General Counsel, Bennett Katz, explained this point during his trial testimony. He noted that if there were one automobile manufacturer but a thousand dealers, you would expect to have a great deal of price and other competition at the dealer level but there would still only be one brand of car. Hence, incentives for improvement at the manufacturing level would remain largely non-existent. (See Tr. 475-77.)

here. (See Tr. 450-52, 1429-37.)[6/] See, for example, PX 755, showing that each of the Top 10 VISA/MasterCard issuers enjoys Board representation. See also B.J. Martin's Oct. 25, 1988 memo urging Greenwood Trust to apply for VISA membership so that Discover could be "in a position of knowing everything that takes place at VISA . . . ." (DX 74.)

Concern about the incipient lessening of competition between VISA and Discover at the system level is even more substantial. We review this evidence in some detail in our accompanying memorandum under Rules 50 and 59. In brief, there are substantial incentives for Sears to minimize competition against VISA if it becomes a VISA owner-member. See VISA JNOV Mem. at 50-52. For example, Philip Purcell's testimony demonstrates that anticompetitive considerations were very much a part of the motivation for the initial Greenwood Trust application in 1989. Mr. Purcell stated that he was motivated to apply by the possibility of mitigating the vigor of competition by VISA against Discover. (Tr. 267; VISA JNOV Mem. at 49-50 and n. 45.) This evidence is not surprising since, as Professor Kearl aptly noted, no one wants competition that they can avoid. (Tr. 1708:22.) Yet this point simply demonstrates why VISA's counterclaim is well-taken. The history of diminished competition between VISA and MasterCard following duality is similarly instructive. See VISA JNOV Mem. at 48. Perhaps most important are the incentives to reduce merchant discount competition, a

---

6/ In his testimony, Professor Kearl suggested that concerns over confidential information might justify a VISA rule proscribing or prohibiting a Sears representative from sitting on the VISA Board, but would not justify By-law 2.06. Apart from Mr. Russell's testimony that that would not be practicable (see Tr. 1455-56), it is worth noting that such a "hold separate" approach has not deterred courts from enjoining mergers on this ground. See cases cited in text, supra, p. 7.

subject reviewed at length in VISA's JNOV Memorandum (at 51). See also Denver & R.G.W.R.R., 387 U.S. at 503-04.

Similarly, as we have argued elsewhere, there would be an inevitable potential for Sears to evaluate its business and investment decisions differently if it were VISA member-owner as well as the sole owner of Discover. Cf. Areeda ¶ 1203(c) at 320 (in the case of a partial acquisition "the acquiring firm's market decisions might now be affected not only by their impact on its own operations but also by their impact on its investment . . . in its competitor"). Indeed, in extreme circumstances "competition at the borderline of profitability may be abandoned" entirely. Id.[7/] Cf. VISA JNOV Mem. at 49-52.

Sears witnesses, of course, vigorously assert the purity of their intentions. See, e.g., Tr. 288-89, 1235-36. But that is not sufficient to overcome either the evidence drawn from history or the incentives established by economic theory. Were it otherwise, market structure and other similar evidence could be waived away by protestations of a pure heart. But the relevant test under Section 7 is one of incipiency -- whether the particular action "may" tend "substantially to lessen competition" in a line of commerce. The primary tools for making that assessment are those of market structure and industrial organization theory. Moreover, one thing is certain: If an apparently anticompetitive acquisition is prevented, there is no need to worry about the honesty of

---

7/ Professor Areeda notes the pertinence of the concerns discussed above, and others. For example, he observes that partial acquisitions "may form the basis of willing cooperation between two companies" by, among other things, making "tacit understandings more attractive to the parties." Areeda ¶ 1203(c) at 319-20. He notes, in addition, that partial cross-ownership creates the potential for psychological disincentives to vigorous competition (id. at 319-20) as well as obvious economic incentives to "direct . . . competitive energies away from the acquiring firm." Id. at 320.

the acquirer's professed intentions or the possibility that those intentions may -- under the powerful influence of the universal capitalist desire to "score the most points, i.e. maximize profitability" -- change. See DX 323 at S1750326.

CONCLUSION

For the foregoing reasons, the Court should render judgment in VISA's favor on its counterclaim under Section 7 of the Clayton Act and should enter an injunction enjoining Sears and its affiliates from acquiring or holding any ownership interest in VISA so long as it also owns Discover.

Dated: November 24, 1992

Respectfully submitted,

KIMBALL, PARR, WADDOUPS, BROWN & GEE

HELLER, EHRMAN, WHITE & McAULIFFE

By: _____

Attorneys for Defendant and Counterclaimant
VISA USA INC.