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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,	
Plaintiff,	
v.	**98 Civ. 7076 (MP)**
VISA U.S.A. INC., VISA INTERNATIONAL CORP.,AND MASTERCARD INTERNATIONAL INCORPORATED,	**PLAINTIFF'S MEMORANDUM REGARDING DISQUALIFICATION ISSUES**
Defendants.	

INTRODUCTION

The United States submits this memorandum in accordance with the Court's request made during the parties' telephone conference call with the Court on November 6, 1998. The purpose of this memorandum is to set forth relevant factual information, statutory provisions, and case law that may assist the Court in making its determination as to whether or not disqualification may be appropriate.

THE NATURE OF THE GOVERNMENT'S ALLEGATIONS

The United States brought this civil action to prevent defendants Visa U.S.A. Inc. and Visa International Corp. (collectively "Visa") and MasterCard International Incorporated ("MasterCard") from continuing to violate Section 1 of the Sherman Act by their on-going participation in and facilitation of agreements and combinations among the member banks — which own and govern both associations — to ensure their joint dominance of the general purpose card network market. The largest U.S. banks jointly control both Visa and MasterCard, which together have about 75% of the general purpose card market. These banks have used their control of the two associations to limit competition between them. Moreover, these same banks have agreed to place major hurdles in the path of the rivals of Visa and MasterCard, principally American Express and Discover/Novus, by forbidding essentially every financial institution from doing business with any such rival without suffering the clearly unacceptable loss of the right to issue both Visa and MasterCard cards.

While Visa and MasterCard are, in form, separate entities which purportedly compete with each other, they are in fact controlled by the same group of large banks. Because these banks issue large numbers of both Visa and MasterCard cards, they do not allow Visa and MasterCard to engage in meaningful competition — it is simply not in the governing banks' interests to expend resources trying to convince consumers to switch from one brand of card to the other. The result is that consumers lose: innovation and competitive development in network products and services are stifled, product quality suffers and, ultimately, the value received by consumers is diminished. The government, therefore, has, in Count I of its Complaint, sought to

ensure that the same banks do not govern both Visa and MasterCard and that the banks that govern each of the associations be dedicated to that association.

Two of the most significant banks that control both Visa and MasterCard are Citibank (now part of Citigroup) and Chase Manhattan Bank. Based upon information provided by defendants to date, the government estimates that, together, these two banks own about 15% of Visa and about 25% of MasterCard.[1] Although the government has not named Citibank and Chase as defendants in this action, the Complaint does refer to both. See Complaint ¶ 50; see generally Complaint ¶¶ 47-58. Moreover, Citibank and Chase are among the leading "institutions not made defendants in this Complaint" who "participated as co-conspirators in the violations alleged and have performed acts and made statements in furtherance thereof." See Complaint ¶ 6.

Citibank is the largest issuer of Visa and MasterCard cards, with more than 10% of the ownership and voting rights in Visa and about 20% of MasterCard. Approximately 50% of the cards that Citibank has issued are MasterCard cards. Nevertheless, by virtue of its size, Citibank has the right to appoint two directors to Visa's board. Citibank also places a representative on major Visa and MasterCard business committees, to which management looks for direction on important strategic competitive decisions. Chase Manhattan is one of the top five issuers of Visa and MasterCard cards with approximately 5% of the ownership and voting rights of each. Approximately 50% of the cards that Chase issues are Visa cards. Nevertheless, Chase has a

[1]Either in the defendants' filings pursuant to Local Rule 1.9 or otherwise, the defendants presumably will provide the Court with the precise, current ownership interests of these entities.

representative on the MasterCard board of directors, as well as vital business committees of both defendants.

The government has also alleged, in Count II, that the banks that control Visa and MasterCard have enacted rules that provide that any member bank issuing in the United States any card that Visa or MasterCard considers "competitive" will lose its right to issue both Visa and MasterCard cards. Of course, neither Visa nor MasterCard deems the other to be a competitor. Given Visa's and MasterCard's collective overwhelming dominance of the market, it is hardly surprising that no United States bank issues cards, including American Express and Discover, that Visa and MasterCard deem competitive. Acting together, the banks that govern both Visa and MasterCard, including Citibank and Chase, have thus made it impossible for competing card networks to utilize the card distribution services of banks. This barrier is particularly significant in a network industry, where increased usage leads to increased merchant acceptance, which in turn leads to increased usage, in a continuing cycle that economists call "network effects."

One of the two general purpose card networks thereby deprived of this important access to United States banks is American Express. Its (and others') inability to issue cards through banks has hurt consumers, and that harm is also at the core of the government's case.[2] The relevant allegations are made in paragraphs 101 to 154 of the Complaint.

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[2] This suit was filed on October 7, 1998. On that day, American Express stock prices rose while many bank stock prices, including the price of Citicorp and Chase Manhattan stocks, fell. Some press reports attributed at least some of the price movement that day to the filing of this suit.

THE RELEVANT PROCEDURAL HISTORY

In its most recent financial disclosure statement filed last July, the Court listed share ownership interests in Citicorp, Chase Manhattan, and American Express. The Court confirmed orally on November 6 that it continues to hold shares in those companies. In light of the government's claims here, and the potential effect they may have on banks governing Visa and MasterCard, as well as their two principal competitors, the parties jointly called the Court on November 6 to raise the issue of the possible application of 28 U.S.C. § 455(b) and to request a hearing. That hearing is now set for November 12, 1998.

THE APPLICABLE STATUTORY AND CASE LAW

A federal judge is obligated to disqualify himself if he (or his spouse or a minor child) has financial interests in the subject matter in controversy or a party, or he has an interest that could be substantially affected by the outcome of the pending proceeding. The applicable provision of 28 U.S.C. § 455(b)(4) states:

> (b) He shall also disqualify himself in the following circumstances:
>
> (4) He knows that he, individually or as a fiduciary, or his spouse or minor child residing in his household, has a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding. . . .

Section 455(d)(4) defines a financial interest as "ownership of a legal or equitable interest, however small, or a relationship as director, advisor, or other active participant in the affairs of a party. . . ." Subsection (e) of the statute states expressly that the disqualification grounds at issue in subsection (b) may not be waived by the parties.

Thus, there are three grounds for disqualification which need to be considered by the Court in these circumstances: (1) does stock ownership in Citicorp (now Citigroup), Chase, or American Express constitute a financial interest in the "subject matter of the controversy," (2) does stock ownership in Citicorp or Chase, because of their ownership interests and governance positions in Visa and MasterCard, constitute a financial interest in a party, and (3) does an equity interest in Citicorp, Chase, or American Express constitute an "interest that could be substantially affected by the outcome of the proceeding." The applicable precedent regarding these issues will be addressed in turn.

1. Financial Interests in the Subject Matter in Controversy

The "subject matter in controversy," as used in § 455(b), has been defined as "the matter acted upon" or "the matter presented for consideration" or "the topic of dispute in a legal matter." United States v. Nobel, 696 F.2d 231, 234 (3rd Cir. 1982). No case precedent of which we are aware considers the applicability of the phrase "subject matter in controversy" to factual circumstances similar to those at issue here. Moreover, the case precedent that does interpret that phrase is somewhat conflicting.

In several cases where no monetary relief was sought, the judge's financial interest in a non-party was held not to constitute an interest in the subject matter in question, even where the non-party was a central focus of the litigation. See Nobel, 696 F.2d at 234-35 (holding that a judge did not have a financial interest in subject matter where he owned stock in the corporate victim of a crime committed by defendant in case before court); see also United States v. Rogers, 119 F.3d 1377, 1384 (9th Cir. 1997) (holding that a judge is not required under § 455(b)(4) to

disqualify himself from re-sentencing a defendant who was convicted of committing mail fraud against a bank in which judge owned stock as a result of merger that took place after the first sentencing and before re-sentencing); United States v. Lampe, 98 F.3d 1344 (7th Cir. 1996) (unpublished table decision) (holding that a judge was not required to disqualify himself from a case where he owned stock in a bank that the defendant was accused of robbing); cf. Department of Energy v. Brimmer, 673 F.2d 1287, 1295 (Temp. Emer. Ct. App. 1982) (term "subject matter" was most appropriately read to refer to in rem proceedings under this statute).

On the other hand, one court has held that ownership of shares in a non-party that could ultimately face legal liability as a result of the litigation constitutes a financial interest in the subject matter in controversy. Sollenbarger v. Mountain States Tel. and Tel. Co., 706 F. Supp. 776 (D. N.M. 1989) (granting motion to disqualify based on a judge's financial interest in the subject matter in controversy in a case against a Bell operating company where the judge owned stock in non-party Bell operating companies and the case involved conduct prior to AT&T breakup, which could have resulted in liability for all Bell operating companies); see also United States v. Pappert, 1998 WL 596707, at *5 (D. Kan. July 29, 1998) (stating that a judge "arguably" had a financial interest in the subject matter in controversy where she owned shares of a corporate victim's ultimate parent corporation and she ordered monetary relief in the form of restitution).

2. Financial Interest in Parties to the Litigation

Citibank and Chase, because of their substantial ownership and governance rights in the defendants, might be considered as the equivalent of "parties" to this litigation.[3] While disqualification under § 455(b) may be mandated where a judge holds stock in the parent company of a majority-owned subsidiary that is a named party in the litigation,[4] we have found no authority directly considering the issue whether stockholdings in a firm with a minority ownership and governance interest in the named party would also necessitate disqualification.[5]

3. Other Interests That Could be Substantially Affected

This provision of § 455(b)(4) raises two issues in the current circumstances: (a) could the outcome of this proceeding substantially affect the interests of Citibank, Chase or American Express within the meaning of the statute; and (b) if there were such a substantial effect on any of those entities, does the statute require that there also be a substantial effect on the Court's personal interests? The first question raises fact issues specific to the allegations of the Complaint and these companies' interests, which the Court must weigh in light of the allegations and facts described above. The case law and ethics advisory opinions, which of course do not

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[3]The defendants' filing under Local Rule 1.9 may also provide relevant facts on this subject.

[4]See Advisory Committee on Judicial Activities, Advisory Op. 57 (1978); cf. Kidder, Peabody & Co., Inc. v. Maxus Energy, 925 F.2d 556 (2d Cir. 1991).

[5]To the extent substantive antitrust law sheds light on this issue, it should be noted that acquisition of minority interests in a competitor or customer can create anticompetitive effects which have caused courts to enjoin the acquisition or retention of such stock and governance interests. E.g., Hamilton v. Benrus, 114 F. Supp. 307 (D. Conn.), aff'd, 206 F.2d 738 (2d Cir. 1953); United States v. DuPont, 351 U.S. 377 (1957).

deal with these particular facts, provide somewhat conflicting answers. In one case, a court held that a judge's interest in a company not a party to the litigation, but which produced the same product and was subject to regulation that was the subject of the litigation, did not constitute grounds for disqualification.[6] An Advisory Committee Compendium, however, advises judges to disqualify themselves when they own stock in a non-party that produces the same product that is the subject of the litigation if the judge's award could affect the value of that stock.[7] As to the second question, the only relevant commentary we have found is the same Advisory Committee Compendium section, which does not refer to the amount of a judge's stock ownership or its relative size in the judge's financial portfolio as relevant factors.[8]

CONCLUSION

In light of the continued stock ownership of the Court in three publicly-traded corporations, which are referred to in the government's Complaint and whose actions clearly will

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[6] See Brimmer, 673 F.2d at 1295.

[7] Advisory Committee's Compendium of Selected Opinions on the Code of Conduct of United States Judges § 3.1-1(k).

[8] Compare, e.g., In re New Mexico Natural Gas Antitrust Litigation, 620 F.2d 794, 796 (10th Cir. 1980), where the Court of Appeals for the Tenth Circuit apparently found the size of the trial court's interest, among other factors, to be relevant. In that case, the interest arose from the possibility of reduction of the trial court's (and other consumers') gas bills.

be the subject of scrutiny in this case, the government respectfully requests that the Court consider the relevant facts presented by all parties, as well as the applicable precedent, to determine whether disqualification is, or is not, required.

Respectfully submitted,

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