

Class Action Takes Aim At MasterCard IPO

Wednesday, May 24, 2006 --- As MasterCard Inc. debuts on the New York Stock Exchange as a public entity Thursday, the second largest credit card company is already facing a new challenge over its initial public offering from an ongoing lawsuit.

The law firm Robins Kaplan Miller & Ciresi amended its class action complaint against MasterCard and Visa U.S.A. over interchange fees to include an objection to MasterCard's IPO expected to raise \$2.6 billion, claiming the New MasterCard Corp. will form a single entity that will continue to conceal the price setting by its member banks.

"[T]he purported single entity will operate in the same way as the current member banks' cartel: the member banks will control the setting of interchange fees collectively and will maintain artificially high fees by refusing to compete on price, while preventing new entry into the relevant market," the amended complaint stated.

When a consumer pays with a credit card, a payment is processed through the merchant's bank and the consumer's credit card bank. Both banks charge fees, known as interchange fees, for the transaction that are passed along to the merchant.

Fed up with what they consider a "hidden tax" for merchants and consumers by credit card companies and their banks, merchants have decided to fight back with a large-scale antitrust class action against MasterCard and Visa for alleged price-fixing.

The merchants claim that MasterCard and its member banks have participated in continuous violations of the Sherman Antitrust Act, which prohibits contracts and conspiracies in restraint of trade. But the complaint stated the antitrust concerns will not end once MasterCard, which was a joint venture with its member banks, becomes a single entity.

As an IPO, MasterCard will substantially diminish competition because it would eliminate the anticompetitive conduct of MasterCard and its member banks from being subject to Section 1 of the Sherman Act, according to the complaint.

The complaint warned that by seeking immunity from Section 1, the New MasterCard will gain market power and will be able to hike up interchange fees charged to merchants.

The complaint further asserted that the IPO will not only diminish competition

among member banks in setting fees charged to merchants, it will also restrain trade.

“Both violations will harm competition and consumers by fixing, raising or maintaining prices charged to merchants in the market,” the complaint stated.

While U.S. merchants face interchange rates of 1.7%, which have continued to rise over the years and eat into their profits, the parties that set the rates, Visa, MasterCard and their member banks, are making off with a huge return from the fees, amassing a whopping \$27.6 billion in interchange fees in 2004 alone.

In November 2005, the U.S. Judicial Panel on Multidistrict Litigation ruled that the merchants’ consolidated interchange case against Visa, MasterCard and their 32 member banks will be held in the Eastern District of New York before U.S. District Judge John Gleeson.

At the time, 14 lawsuits had been consolidated under the case, but since then, the number has grown to include nearly 50 suits.

The case represents millions of card-accepting merchants in the U.S., including four of the U.S.’s largest merchant associations, National Association of Chain Drug Stores, the National Association of Convenience Stores, the National Community Pharmacists and the Association the National Grocers Association, as well as the American Booksellers Association.

The amended complaint further alleged that the IPO was a “fraudulent conveyance” because the IPO contemplated the elimination of the ability of MasterCard to evaluate its member banks in order to satisfy the debts and liabilities of the company.

“We’re in a quiet period, and it is inappropriate for us to comment on that particular suit at this point,” a MasterCard spokesperson said.

Dealing with its litigation is one of the main reasons why MasterCard undertook an IPO. When the IPO is complete, MasterCard plans to use \$650 million of the proceeds to reinforce its litigation needs.

MasterCard is hoping the IPO will help dispel the lawsuits and prevent its member banks from being targeted in further litigation.

Its IPO involves the underwriters, Goldman Sachs & Co., Citigroup Inc., JPMorgan Chase & Co., HSBC Holdings PLC and Deutsche Bank Securities.

If MasterCard loses its litigation battle, the company said it may be forced to revamp its business practices. MasterCard noted in its IPO prospectus that a litigation loss could reduce its profitability.

Visa, which is also owned by member banks, said it did not intend to go

public.

Separately, MasterCard reported \$500,000 in legal reserves for an antitrust lawsuit over merchant chargebacks, according to a filing with the U.S. Securities and Exchange Commission.

The credit card billing services firm PSW Inc. filed the lawsuit, claiming MasterCard and Visa breached federal and state antitrust regulations. PSW is asking for \$60 million in compensatory damages and \$180 million in punitive damages, according to the filing.

On top of that suit, MasterCard and Visa have also been sued by American Express Co. and Discover Financial Services LLC over anticompetitive practices that kept member banks from issuing credit cards on their competitors' networks.

The interchange case is In Re: Payment Card Interchange Fee and Merchant-Discount Antitrust Litigation, case number 1:05-md-01720-JG-JO, in the U.S. District for the Eastern District of New York.

--By Erin Coe, erin.coe@portfoliomedia.com