

SUPERIOR COURT OF CALIFORNIA
COUNTY OF ALAMEDA

ADAM A. SCHWARTZ,

Plaintiff,

VISA INTERNATIONAL CORP., VISA
INTERNATIONAL SERVICE ASSOCIATION,
INC., VISA U.S.A., INC., and MASTERCARD
INTERNATIONAL INCORPORATED,

Defendants.

Case No.: 822404-4

STATEMENT OF DECISION
[C.C.P § 632, CRC § 232]

REDACTED VERSION

I
INTRODUCTION

It is significant that one of the commonest objections to competition is that it is “blind.” It is not irrelevant to recall that to the ancients, blindness was an attribute of their deity of justice. Although competition and justice may have little else in common, it is as much a commendation of competition as of justice that it is no respecter of persons.

F.A. Hayek, *The Road to Serfdom* (1944)

The objections to competition referred to in *The Road to Serfdom* were those of socialist planners. Their vision for society was complete and absolute equality of all individuals in all matters subject to human control as implemented by means of a collectivist central government. In such a society there is no liberty. Hayek dismantles the collectivist orthodoxy observing that true freedom (economic and political) thrives only in a liberal society of individuals who are left to compete with one another in pursuit of their own

objectives. In short, where there is competition, there is freedom; and where there is freedom, there is inequality.

This case does not concern issues of conspiracy or violations of antitrust laws insofar as the presence of those matters inhibit competition in an otherwise free market. As noted hereafter, those issues are left for another day in another forum. What this case does concern is a fundamental aspect of a free market, namely, access to market relevant information. No authority need be cited or the proposition that in order for a free market to function for the benefit of all, the consumer must not be encumbered by unfair or unlawful business practices that *inhibit* the free flow of market relevant information. In short, where there is no information, there is no competition; and where there is no competition, we are on the road to serfdom.

A.

Procedural Background

The plaintiff, Adam A. Schwartz, brings this action on behalf of the general public against Visa and MasterCard.¹ The initial complaint in this matter was filed in January of 2000.

Plaintiff's First Amended Complaint, dated February 15, 2000 included state and federal antitrust theories. Defendants moved to stay this action pending resolution of a federal Multi-District Litigation class action that was proceeding in the federal court in New York (the "MDL proceeding"). The MDL proceeding concerns Truth in Lending Act (TILA) and antitrust allegations against Visa and MasterCard and a number of their largest member banks regarding, *inter alia*, the failure to disclose currency conversion fees charged to cardholders. Following defendant's motion to stay this action, plaintiff withdrew his antitrust and conspiracy allegations. By order dated July 3, 2001, the Court ordered plaintiff to file a Second Amended Complaint eliminating all antitrust claims and any theory sounding in

¹ Unless otherwise indicated, Visa U.S.A. Inc. is referred to as "Visa U.S.A." Visa International Service Association is referred to as "Visa international". MasterCard International, Inc. is referred to as MasterCard."

antitrust.

Plaintiff's Second Amended Complaint filed August 3, 2001 alleges unfair and unlawful business practices by Visa and MasterCard regarding their provision of currency conversion services in connection with Visa and MasterCard branded credit card transactions made in foreign currencies by U.S. cardholders.

Plaintiff subsequently sought leave to amend the Second Amended Complaint to add allegations that Visa and MasterCard aided and abetted violations of TILA by their member banks and aided and abetted the member banks in imposing unconscionable contracts on consumers. By order dated November 13, 2001, the Court denied the motion to amend, holding that this case concerns the duties and liabilities of Visa and MasterCard and not the duties and liabilities of their member financial institutions.

At no time have Visa or MasterCard asserted that their member banks are necessary parties to this lawsuit and tried to join them as parties. See CCP § 389. At no time has Plaintiff tried to join any member bank as a party to this action.

Plaintiff's claims at trial were founded exclusively on California's Unfair Competition Law as stated in California Business & Professions Code Sections 17200, *et seq.* ("Section 17200" or the "UCL").

Plaintiff alleges Visa and MasterCard engaged in "unfair" and "deceptive" business practices as follows:

1. Unconscionable practices: defendants' charge an excessive currency conversion fee which constitutes gross overpricing (SAC ¶¶40, 41); and

2. Deceptive practices: defendants' failure to adequately disclose the existence of the currency conversion fee. In addition, inserting "vague and misleading language" into cardholder agreements and misleading consumers "by failing to disclose the currency conversion fee in advertising, solicitations, consumer monthly statements or any other periodic statement." (SAC ¶42)

Plaintiff alleges "unlawful" business practices by Visa and MasterCard as follows:

1. Unlawful practices: defendants' impose and collect unconscionable and grossly excessive currency conversion fees in violation of Civil Code §1670.5. Further, by "inserting an unconscionable provision" in a contract, defendants are in violation of Civil Code §1770(a)(19). (SAC ¶¶46, 48); and
2. Unlawful practices: defendants' failure to disclose the currency conversion fee in applications, solicitations, and billing statements is in violation of the federal Truth-in-Lending Act, 15 U.S.C. § 1600 *et seq.* (TILA), and Regulation Z, 12 C.F.R. §226. (SAC ¶47).

Plaintiff bears the burden of proving his claims by a preponderance of the evidence.

Defendants deny each and every allegation of the plaintiff's Second Amended Complaint and assert a number of legal and equitable defenses. Defendants bear the burden of proving their affirmative defenses by a preponderance of the evidence.

All the Court's findings of fact herein are found proven by a preponderance of the evidence.

The request of Defendant MasterCard International Incorporated to seal certain portions of this Statement of Decision is GRANTED IN PART. ¶ 214 at page 71, lines 18-21, and ¶190 at page 61, lines 23-26, and page 62, lines 1-2 are sealed. All other requests for sealing are

DENIED.

The Court issued its Proposed Statement of Decision on February 3, 2003. Thereafter, the parties and their counsel filed and served written objections to the Proposed Statement of Decision. Thereafter on March 4, 2003 a hearing was held in which the Court heard the oral arguments and objections to the Proposed Statement of Decision. The Court having read and considered the pleadings and heard the arguments of counsel and the matter having been submitted, the Court issues the following Statement of Decision.

II

FINDINGS OF FACT

There are very few facts in dispute in this case. The fact issues in this case lie in what inferences and conclusions can be drawn from the fairly consistent body of evidence.

The documentary evidence was extensive and provided an in-depth view of how Visa and MasterCard designed and implemented and now operate their currency conversion systems. The fact witnesses corroborated and added detail to the documentary evidence. Several witnesses testified as to what he or she meant when writing a document, and in those instances the Court generally relied on inferences that could be drawn from the documentary record rather than the after-the-fact justifications offered by the witnesses. There were no occasions where the Court had to weigh the credibility of competing fact witnesses.

A.

General Findings as to Visa and MasterCard²

(a)

Structure and Operation of Credit Card Networks

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² Except as otherwise noted in the text, all general findings are found as to both Visa (including Visa International Corp., Visa International Service Assoc., Inc., Visa U.S.A.) and MasterCard International, Inc.

1. Adam Schwartz is a California resident and has lived and worked in California continuously since 1995. TX 6011 at 14:2-17:21, Schwartz. He brings this action on behalf of the general public under Business and Professions Code § 17200.
2. The Court has read and considered the decision in *United States v. Visa U.S.A. Inc.*, 163 F. Supp. 2d 322 (S.D.N.Y. 2001). Judge Jones description of the operation of the Visa and MasterCard network systems is entirely consistent with the testimony of a number of witnesses at trial in this matter. Thus, as part of this Court's findings of fact the Court will quote the following language from *United States v. Visa*, supra, in describing the general operation of Visa and MasterCard. Beginning at page 332 of *United States v. Visa*: "MasterCard and Visa are structured as open, joint venture associations with members (primarily banks) that issue payment cards, acquire merchants who accept payment cards, or both. They do not have stock or shareholders; just members and membership interests. MasterCard is open to any eligible financial institution. Similarly, any financial institution that is eligible for Federal Deposit Insurance Corporation deposit insurance can join Visa. Visa members have the right to issue Visa cards and to acquire Visa transactions from merchants that accept Visa cards. In exchange, they must follow Visa's by-laws and operating regulations. The same is true of MasterCard. MasterCard has approximately 20,000 global members. Visa U.S.A. has approximately 14,000 members in the United States, including approximately 6000 Visa card issuers. The remaining 8000 members are acquiring banks." "MasterCard and Visa are operated as not-for-profit associations and are supported primarily by service and transaction fees paid by their members. They set their fees to 'cover the costs involved in providing the basic infrastructure to the members,' but do not charge license fees or royalties. While the associations make a 'profit' from these, fees, they do not try to maximize retained earnings. The profit they earn is used to maintain a capital surplus account to pay merchants in the event of a member failure."

3. Visa and MasterCard branded cards comprise about 93% of the credit cards issued in the United States that can be used for foreign charges. TX 6015 at ¶11. TI 3337: 24-26, Frankel.
4. The clearing process and settlement process employed by Visa and MasterCard can be summarized as follows: MasterCard and Visa operate systems for the clearing and settlement of credit card transactions. Merchants submit transactional data to their banks (“acquirers”) or agents of their banks. Acquirers then collect all such transaction data from each of their merchant clients and submit them to MasterCard and Visa. The associations act as clearinghouses, sorting these transactions according to the financial institution that issued each card (the “issuer”), and sending each issuer (or its agent) a data file listing each transaction made by the issuer’s cardholder customers. Each data file includes the identity of the merchant and the amount of the transaction. Issuers (or their data processing agents) receive these transaction records from Visa and MasterCard in a format that can be transferred directly to the monthly billing statements of their individual cardholders. TX 6003 at ¶9, Frankel; TX 2257; TX 3205 (MasterCard Operations Manual). The core credit card processing system at MasterCard during the relevant period was called the NET System that, *inter alia*, performs the currency conversion calculations. TX 6005 at 35:8-36:1, 38:22-39:2, Griffith.

(b)

Effects of Non-Disclosure on the Market, Competition and Consumer Behavior

5. The Court finds that price is always important to consumers. This is common sense and also consistent with the Durkin study by the Federal Trade Commission, relied on by defendants’ expert Professor Stewart. TT 7629: 11-21, Stewart. Thus, the Court concludes it is important for consumers to know about the existence and amount of defendants’ 1% currency conversion fee. The currency conversion fee is a material factor in the market because it directly affects the cost of foreign currency conversion and the overall cost of using a credit card. TX 6004 at 19:17-20:14, Wright; TT

7601:21-7602:1, TT 7629:11-21; TX 2559 at 203, Stewart, (cost items predominated the list of credit terms important to consumers).

6. Professor Stewart acknowledged that small differences, in price matters to consumers because there is a body of research that suggests that most consumers' are price conscious shoppers. Consumers would want to be informed of an annual fee of \$20 and therefore would want to know about currency conversion fees that can exceed \$20 and may be the only cost of using a credit card if the cardholder pays the entire bill in a timely fashion. TT 7602: 22-7603:13, TT 7631:9-22, TT 7632:6-10, TT 763 5:2-9, Stewart.
7. The Court finds that there is no meaningful disclosure to credit card holders of currency conversion fees by Defendants or their member banks. With some recent exceptions, Visa's currency conversion fee is not disclosed in billing statements, solicitations or applications. TX 6004 at 12:18-24, Wright; TX 1045 (Citibank Visa billing statement); TX 1018 (Nations Bank Visa billing statement); TX 1136 (Capital One Visa billing statement); TX 5382 (First USA Visa and MasterCard billing statements).
8. Visa has the authority to require disclosure of Visa's currency conversion fee. Visa's operating regulations could, but do not, require that the 1% fee be disclosed in solicitations and billing statements. TT 1070:15-25, TT 1072:17-20, Allen.
9. MasterCard's currency conversion fee is not disclosed in billing statements, solicitations or applications. TX 6004 at 12:18-24; TX 3238 (Capital One solicitation); TX 3239 (Direct Merchant solicitation); TX 3240 (MBNA solicitation); TX 3241 (Household MasterCard solicitation); TX 3281 (Chase MasterCard solicitation); TX 1313 (Chase billing statement); TX 1045 (Citibank Visa. billing statement); TX 1018 (Nations Bank Visa billing statement); TT 1136 (Capital One Visa billing statement); TX 5380 (Direct Merchants MasterCard billing statement); TX 5382 (First USA Visa and MasterCard billing statements); TX 3286 (MBNA MasterCard billing statement).

10. The Court finds Visa and MasterCard's 1% fee is hidden in the transaction amount on billing statements and omitted from most, if not all, solicitations. In the context of credit cards, consumers expect that if fees are to be charged for the use of the card, those fees will be disclosed. With expectations conditioned by domestic purchases, consumers, in general, do not expect to be charged an undisclosed fee for use of the credit card. TX 6004 at 12:18-13:5, Wright; TT 4007:15-4008:6, Wright.
11. The Court finds the business practice of embedding or hiding the fee in the transaction amount on billing statements is likely to mislead consumers as to the existence and amount of any currency conversion fee because the fee is concealed. Consumers are very likely to notice, attend to, comprehend and retain information on billing statements which are mailed regularly to cardholders and contain information that consumers know is important to their economic interests. If the currency conversion fee were separately identified on billing statements consumers would likely become informed rather than misled about the existence and amount of the fee. TX 6004 at 13:7-14:11, Wright. IT 4004: 10-21, IT 4011:16A.012:13, Wright; TX 6000 at ¶39, McCornack.
12. The Court concludes cardholders are more likely to carefully review their billing statements than solicitations, advertising, and cardholder agreements because the billing statement is the most relevant document to cardholders. Professor Stewart acknowledges there is no way to discern from a billing statement that Visa adds a 1% fee. TT 7579:15-7580:1, fl 7581:4-10, fl 7578:23-27, TT 7585:24-7586:20, Stewart.
13. The testimony of Esta Brand, Victor Dahir, Heinz Riehl, Professor Wright, Professor Stewart and Dr. McFadden establish that the cardholder monthly billing statement is the communication most likely to be read and reviewed by cardholders. Ms. Brand did not review her cardholder agreement, but she routinely carefully reviews her billing statement using a pen to "x" off charges as she reviewed them. Visa understands that cardholders pay particular attention to the monthly billing statements. TT 1575:12-21, Dahir; TT 5402:26-5403:28, Riehl; TT 5192:26-5193:17, Brand; TT 7580:2-5, Stewart; TT 5823:2-20, TT 5830:12-20, McFadden; TX 6004 at 13:8-14:18,

Wright.

14. Professors Wright and Stewart agree that it would be feasible for Visa and MasterCard to require disclosure of the 1% currency conversion fee in cardholder billing statements. This feasibility is further evidenced by Chase's disclosure on billing statements of its own 2% optional issuer fee, which it describes as a foreign transaction fee. TX 6004 at 14:3-18, Wright; TX 1313; TT 7578:23-27, Stewart; TX 6000 at ¶38-39, McCormack; Professor Stewart further acknowledges that the credit card solicitation is a likely place for consumers to look for a disclosure of a fee such as the currency conversion fee. Consumers reviewing Chase solicitations are likely to become aware that Chase imposes a 2% fee on foreign transactions. TX 6004 at 14:20-15:13, Wright; TX 1258; IT 4012: 20-4013:10, TT 4014:20-28, Wright; TT 7576:19-23, TT 7577:4-7, IT 7577:13-16, Stewart. *See also* TX 1253 (Alaska Airline/Bank of America billing statements discloses the sum total of 2% optional issuer fees, but not Visa's 1% fee), Weiser.
15. Without disclosure on cardholder billing statements, even savvy cardholders will remain ignorant of the 1 % MCCR fee. In fact, Visas foreign exchange expert, Heinz Riehl, who had worked for Citicorp for 35 years and had traveled extensively had never seen or heard of the currency conversion fee. TT 5403:3-28, Riehl. Similarly, neither Dr. Frankel, who has studied the credit card industry *for* 17 years nor Dr. McFadden had heard of the fee. TX 6003 at ¶79 n.56, Frankel; IT 5822: 15-26, McFadden.
16. Credit card solicitations and applications are readily available for a consumer to use when comparing the advantages and costs of credit cards. More than five billion solicitations are mailed each year. Visa pays a share of the cost of mailing these solicitations through its "mail share program". TT 1626:26-1627:20, Dahir. Dr. McFadden agrees that disclosure of the percentage markup or fee in solicitations would be useful to consumers. TX 6004 at 14:20-15:13, Wright; TT 4012:20-4013:10, Wright; TT 5816:23-28,-TT 5810:16-19, TT 5812:4-15, TT 5816:19-22; TT 5818:12-58 19:4, McFadden. Dr. McFadden also cited data in his testimony to the effect that

84% of credit card acquisitions are the result of direct mail solicitations. TT 5816:23-28, McFadden. Consumers reviewing solicitations are likely to focus particular attention on terms relating to costs, charges and fees when comparing credit card plans. Thus, the Court concludes consumers are more likely to become informed of Visa and MasterCard's 1% currency conversion fee if it were disclosed on solicitations and applications. TX 6004 at 14:20-15:13, Wright; TT 4012:20-4013:10, Wright; TT 5816:23-28, TT 5810:16-19, TT 5812:4-15, TI 5816:19-22, 115818:12-5819:4, McFadden. (McFadden agrees that disclosure of the percentage markup applied in currency conversion before the fact and in solicitations is useful).

17. Congress, in an amendment to TILA, requires card issuers to disclose certain costs of credit in solicitations in what is known as a Schumer box. Schumer boxes provide for the disclosure of purchase transaction fees. The most logical place to disclose the 1% MCCR fee is in the Schumer box as a purchase transaction fee. This is because the 1% fee is imposed on each foreign purchase. TX 6002 at 4:23-5:8 (Rubin); TX 2312A; July 10, TT 2949:15-2950:2 (Rubin).
18. The Court finds multiple disclosures of information to consumers is important to ensuring effective communication of a particular message. Thus, disclosure of the 1% currency conversion fee in billing statements, solicitations and cardholder agreements would more likely succeed in informing cardholders about currency conversion fees. TX 6004 at 9:21-10:15, 11:3-23, Wright; TX 6002 at 3:3-5, Rubin.
19. Currently, Visa's 1% fee is disclosed only in cardholder agreements, with minor exceptions noted earlier. (See Finding ¶7). Consumers receive cardholder agreements only after the cardholder has applied for and received a particular credit card. The Court finds cardholders are unlikely to carefully review the dense cardholder agreement. TX 6004 at 15:17-16:3, 16:6-17:7, Wright. MasterCard does not require disclosure of the fee in cardholder agreements, having rescinded the November 1999 Finance Bulletin on disclosure before it became effective.

20. Most consumers do not read the cardholder agreements because they are in fine print and written in legalese. Professors Stewart and Wright testified that most people do not read their cardholder agreements: “most people probably put it aside and don’t spend a lot of time with it ...” (Stewart). The cardholder agreement is a “very complex document.” Both Professor Stewart and McFadden agree that reading a cardholder agreement is a “tedious process.” TT 7575 :24-27, TT 7576:10-18, Stewart; TT 5846:21-27, McFadden, (“it’s a tedious document”). While failing to read a contract will not generally relieve contractual obligations, this reality does bear on consumer awareness. Thus, disclosure of Visa’s and MasterCard’s 1% currency conversion fee only in the small print of dense cardholder agreements is likely to mislead consumers by effectively concealing the 1% fee. TX 6004 at 15:17-18:17, Wright; TT 3811:25-3812:9, Wright. *See, e.g.* TT 5846:21-27, McFadden. *See also* TT 5192:26-5193:17, Brand.
21. Professors Wright and Stewart agree that no survey is necessary to conclude that consumers are likely to pay more attention to billing statements than to cardholder agreements. TT 4006:12-4007:9, Wright; TT 7579:15-7580:1, TT 7581:4-10, TT 7578:23-27, Stewart.
22. The cost imposed on a consumer for using his credit card to make a purchase denominated in another currency is a function of an underlying exchange rate and one or two fees that Visa calls “currency conversion” fees. The networks select the basic exchange rate, which is either a market or government mandated rate and impose the first fee, the 1% currency conversion fee at issue in this case. Currently, many large Visa and MasterCard issuers also charge an additional fee, known as an “optional issuer fee”.
23. The network fees have varied and can vary. Between 1986 and 1989 Visa charged a fee and MasterCard did not. *See Findings*, ¶¶85, 187 and 188. Had MasterCard increased their MCCR in 1999 as they considered doing, (*See Findings*, ¶¶204,205) the network fees would have varied again. Even though both MasterCard’s and Visa’s fees currently stand at 1%, MasterCard and Visa remain free to set this fee in

competition with each other at different levels. Issuer add-on fees vary from 0% to 3%. (See Findings ¶¶47 and 48).

24. Effective competition requires accurate price information. For consumers to play their role in competitive markets they must be able to effectively compare prices between competing products and suppliers and “vote with their wallets.” Disclosure is critical because it allows consumers to make informed choices and to pick lower prices or evaluate quality/price trade-offs more effectively. TX 6003 at ¶¶60-63, Frankel; TT 3422:15-19; TT 3597:21-25, Frankel.
25. The current disclosure practices, *i.e.*, no disclosure in solicitations or on billing statements, and the embedding of Visa’s and MasterCard’s fees in the transaction amount does not provide sufficient information to allow for an informed choice among credit card alternatives or the functioning of the competitive process. Without disclosure of the existence and level of network fees, consumers can neither detect nor respond to those prices. TX 6003 ¶¶80-89, Frankel.
26. Market failure can occur if there is a monopoly or information asymmetry. This occurs when one party, generally the seller, has information that the other cannot readily obtain, or obtain at all. TX 6002 at 2:2-9, Rubin; TT 2936:2-12, Rubin.
27. If network currency conversion fees were disclosed in solicitations, applications and billing statements, they would be easier for consumers to detect and it would be more likely that competition would be generated over the level of the fees and that the fees might be reduced or eliminated. TX 6003 ¶¶23-25, Frankel; TT 3252:15-26, Frankel.
28. Defendants and their experts assert that disclosure of an “all-in effective rate” (*i.e.*, the wholesale exchange rate with fees included) in the billing statement is all that is required. “It is the total price that is important to the consumer, and this total price is conveyed not by any mark-up, but by the total exchange rate including any mark-up.” TX 6402, ¶42, Stewart. Not all issuers disclose this “all-in” rate. TX 1095 Chase MasterCard billing statement; TX 1136 (Capital One Visa billing statement); TX 1045 (Citibank Advantage billing statement); TX 5384 (MBNA billing statements). Nor do Visa or MasterCard require the disclosure of this “all-in rate,” though both have

directed the manner and content of communication with cardholders about currency conversion. TX 5000; TX 3154; TX 2076, 2077, and 2089; see *also* TT 7121:9-11, Fischer (Spoke with FRB on behalf of MasterCard and did not seek permission of banks).

29. The mere disclosure of the “all-in effective rate” is insufficient to provide effective competition between Visa and MasterCard regarding currency conversion fees. Indeed, the Court finds there is no competition between Visa and MasterCard on currency conversion fees that have parallel tracked at exactly one percent for Visa and MasterCard since 1989. In this instance, there is complete equality among the defendants, and thus, no competition. Dr. Frankel makes the point by observing that consumers are better able to comparison shop (and thereby foster competition) by receiving itemized billings that include separately stated fees and charges. He analogizes to the itemized hotel bill that shows the \$2 per minute surcharge for each calling card call, the fax charges, the city taxes and separate hotel specific charges. While consumers may certainly compare the “all-in effective rate” for hotel bills and in using various credit cards for foreign currency transactions, itemized billing facilitates comparison shopping and intensifies competition. TX 6003 ¶1123-25, 73-74, fn. 51, Frankel.
30. Competition is more likely to be effective when prices (here, fees for using a credit card abroad) are known. Clear disclosures, for example, in billing statements, (the communication most attended to by consumers) reduces the “cost” to consumers of obtaining price information making it more likely that consumers will see and react to prices. TT 3280: 17-28, Frankel.
31. Knowing in advance the level of currency conversion fees, including the one percent charged by Defendants together with any optional issuer fees charged by member banks, is a practical and reliable way to determine which card results in lower billed transaction prices because it will almost always be predictive of which credit card offers the lowest transaction cost (currency conversion fees) for a foreign currency denominated transaction. The networks one percent fee is 100% predictive between

Visa and MasterCard issuers because they use the same base rates intra network. As between Visa and MasterCard, which represent 93% of the cards issued in the United States which are usable for foreign transactions, it is predictive roughly 95% of the time and as against American Express, around 90% of the time. TX 6015 at ¶¶2-4, 9-12, Frankel Rebuttal; TT 7811:24-7812:5, Frankel.

32. Attempting to learn price levels after the fact by comparing “all-in” rates calculated from, or shown on, billing statements is inefficient and impractical and insufficient to permit the competitive process to function. The “effective rate” only appears after the fact and, absent disclosure of the embedded transaction fee levels, provides little or no reliable information in advance to guide future decisions. And because the cost of acquiring this information is so high, it is neither efficient nor feasible to expect that effective competition would result by a requirement that a consumer make repeated overseas trips, utilizing multiple cards on the same day so as to compare, after the fact, effective rates. TX 6003 at ¶¶80-89, Frankel; TX 6015 at ¶15, Frankel Rebuttal.
33. The Court’s finding of no meaningful competition between Visa and MasterCard concerning currency conversion fees is due in part to the networks operating as input joint ventures. As observed by Robert Norton, MasterCard’s General Counsel, the decisions of one board are disseminated to its members who are also members of the other network, and therefore both Visa and MasterCard operate in a fishbowl, each knowing what the other is doing. According to Mr. Norton, MasterCard and Visa don’t compete in any conventional business sense. TX 3185, MasterCard Second Supp. Responses To First Special Interrogatories, No. 14(a), (d); TT 4100:8-4101:13. Notwithstanding this anomaly in the marketplace, the Court finds disclosure is likely to bring about competition between Visa and MasterCard (and among their issuers) on the prices they charge for foreign transaction fees to consumers because without disclosure and consequent consumer awareness there is no incentive for Visa or MasterCard to compete over the level of currency conversion fees. TX 6003 at ¶¶102-104, 109-117, Frankel. If consumers are aware of the fees charged by competing brands (Visa and MasterCard), movement to the lower priced network and

the lower priced issuer in the network is facilitated. TT 3259:22-3260:7, Frankel.

34. Funding a portion of the credit card networks (whose members largely overlap) with fees paid by cardholders brought about a competition between Visa and MasterCard, not to charge lower fees, but to compete with each other for the patronage of member banks to charge equal or higher currency conversion fees paid by consumers. As Dr. Frankel testified: “[I]f you can identify a fee that you can charge to consumers directly and they tend not to notice it or they are insensitive to it because of the way in which it’s applied, you get no negative cardholder reaction. But at the same time you can lower membership fees and prices, members will like that because they will be able to attract [sic] more members to issue that brand of cards instead of their rival brand.” TT 3557:4-15, Frankel. Thus, the “competition” between Visa and MasterCard to attract the patronage of member banks with lower assessments, has the perverse effect of increasing fees paid by consumers to these networks. Disclosure to consumers of these fees would lead to competitive pressure to reduce currency conversion fees. TX 6003 at ¶¶105-108, Frankel.
35. By imposing this fee at the network level with the attendant network transparency between MasterCard and Visa, there is in effect a floor or minimum established for currency conversion fees charged by the networks. The issuers understand and treat the fee as a network fee and because these fees are used to reduce the network costs to the issuers, there is no incentive for the issuers to rebate any portion of the fee to the consumer. The Court’s conclusion in this regard is supported by the fact that there is no evidence of any issuer ever rebating any portion of a currency conversion fee. TX 6003 at ¶12, Frankel. TX 5352 at BA000001 (Bank of America – Visa and MasterCard increase the amount by 1% which they keep as a currency conversion fee); TX 5353 at CAPONEOO6 (Capital One – Visa and MasterCard may charge you a conversion fee); TX 5363 at UB39 (Union Bank of California – the Bank Card Associations charge a conversion fee); TX 5359 at Fleet 000014 (“Bank does not control the rate, date or place of exchange.”); TX 5357 at FUWB0026 (“Visa or MasterCard retains this one percent as compensation for performing the currency

conversion service.”). This effectively denies cardholders competitive choice and the ability to shop for a price below the network set 1% price floor. TT 3558:24-3559:8, Frankel.

36. The Court finds the most appropriate way to view the evidence from an economic perspective is that the networks, Visa and MasterCard, are imposing an invisible network level currency conversion fee directly on consumers. The Court finds this to be a deceptive business practice that causes significant injury to consumers by preventing competition between the networks. It also inhibits competition between member banks on currency conversion fees contrary to the general practice of competitive pricing on terms such as interest rates, late fees, annual fees, and frequent flier miles. TT 3558:10-18, Frankel.

(c)

Relevant Market Analysis

(Comparison of Credit Cards and Retail Currency Exchange)

37. As a preliminary matter, the Court notes that the following findings in the area of relevant market analysis are not made in the antitrust context. As noted in the Introduction, this case does not concern claims of antitrust violations. Rather, the findings on relevant market analysis bear on the Court’s determination of “unfair” business practices which are injurious to consumers and which constitute a violation of the UCL.
38. A consumer seeking to use a credit card to transact in another currency has little choice but to incur a currency conversion fee. Visa and MasterCard, which together account for about 93% of the cards issued in the United States that can be used abroad, both impose the fee. American Express also imposes a fee that was 1% until 1999, and is currently at 2%. *E.g.*, TX 3147 at MCS0021677 (Amex raised its currency conversion fee from 1% to 2%); TX 6008 at 80:7-83:2, Sisti, (Amex

currently charges a 2% “conversion charge” on foreign charges).

39. A U.S. issued credit card confers on the holder access to a dollar denominated line of credit from his issuing bank. The cardholder is obligated to repay his issuer only in dollars. Making a purchase denominated in a foreign currency with a U.S. issued credit card does not create any obligation to deliver foreign currency to the merchant or the issuing bank. TX 6033 at ¶¶128-35, Frankel.
40. Because a large percentage of issuers settle in the same currency in which U.S. cardholders are billed, *i.e.*, the U.S. dollar, and because settlement in the MasterCard system (and the Visa system as well) occurs on a net basis, only a small amount of currency relative to the total amount of transactions on which the fee is levied, must actually be bought or sold by MasterCard to balance their system each day. TX6000 at ¶¶77-87 (McCormack); TT6837:1-6, TT6839:4-9 (Griffith). Moreover, this amount is determined by net differences in settlement currencies between acquirers and issuers and has nothing to do with the differences between the transaction currency and billing currency of a given consumer charge, which is what triggers imposition of the 1 % fee. *Id.* The mere fact that MasterCard (and Visa) charges the fee on every transaction incurred by U.S. consumers in Latin America when every bank on both continents settles in U.S. dollars illustrates the lack of nexus between the transaction fee imposed by MasterCard (and Visa) and the “conversion” of any “currency.” TX6000 at ¶¶77-87 (McCormack).
41. The process of using a credit card in a foreign currency denominated transaction thus contrasts with a transaction involving a retail currency exchange outlet such as Travelex or Thomas Cook where one is actually seeking to acquire or exchange hard currencies. In a credit card transaction, foreign currency is not provided to the cardholder. TX6003 at ¶¶128-135 Frankel; TX 6000 at ¶73, McCormack.

42. MasterCard and Visa convert the transaction currency into the billing currency because the network system requires it. TX 6000 at ¶¶73-75, McCormack (“No currency conversion or currency exchange is performed by Visa or MasterCard for the benefit of Cardholders.”). TX 6003 at ¶13, Frankel (The currency conversion service is, from the cardholder’s perspective, nothing but an “arithmetic exercise.”).
43. Foreign currency providers do not view Visa or MasterCard as competitors. TX 6010 at 102:7-14, 167:11-168:3, Montgomery (traditional competitors are retail exchange shops, not credit cards); 201:10-20 (Thomas Cook/Travelex compares other retail exchange providers when pricing, not credit cards); TX 6009 at 122:14-21, Walsh (American Express conversion rates for hard currency are distinct from rates it provides its cardmembers.). The foreign bank note business involves physical bank notes, bundles of cash in armored cars and insurance and travel options as opposed to electronic transactions and point of sale terminals in the credit card industry. TX 6008 at 131:17-132:7, Sisti.
44. To compare using a credit card to make a foreign purchase with converting actual currency to make a purchase is inapt and misleading. Consumers use a credit card precisely because they do not want to spend dollars to buy foreign currency. Visa and MasterCard, because they net settle and settle in only a relative handful of stable non-U.S. dollar currencies, merely act as a clearinghouse performing arithmetical calculations at insignificant cost. Relatively little actual currency gets bought or sold and no currency gets bought or sold at retail. In an open and competitive market, this low cost of net settlement would be available to the general cardholding public. TX 6003 at ¶¶128-135, Frankel.
45. By establishing a network-level fee that funnels directly to cardholder billing statements, the efficiencies of net settlement are not realized at the consumer level where the price to consumers would otherwise approximate the marginal costs (near zero) of Visa and MasterCard in providing this service. TX 6003 at ¶¶128-135; TT 3253:1-14; TT 3339:2-5, TT 3415:21-3416:l, Frankel. In a market in which currency conversion fees were disclosed and set in competition, rather than at the network

level, it is not unreasonable to think they would be reduced to zero because there are no significant variable costs. TT 3253: 1-14, Frankel.

46. Use of a credit card and retail exchange of currency are two different products and retail currency exchange is not the desired product with different features of a consumer who uses his credit card. In determining whether a suggested alternative to a product is sufficiently substitutable so as to be effective at keeping prices at a level that consumers are not overcharged it is appropriate to look at business documents and past price behavior. The evidence in this case is clear that retail currency exchange has not constrained credit card foreign charge transaction fees. TT 3564:26-3566:4, Frankel.
47. The level of transaction (“currency conversion”) fees for foreign charges imposed in the MasterCard and Visa network on cardholders have increased not decreased, notwithstanding the constant “alternative” of retail currency exchange. MasterCard, which had no network “conversion” fee between implementation in 1986 and October of 1989, initiated a 1% fee at that time. *See Findings, ¶¶165, 188, infra.* When examining the possibility of raising the fee in 1999, internal documents indicated the only potential constraint to doing so was whether member issuers would raise their own currency conversion fees first (*see Finding, ¶205*). Whereas issuers used to charge no add-on fees (OIF in the Visa system, ICCR in the MasterCard system (TX 6005 at 162:25-163:23, *Griffith*), in the late 90s most added fees of 1-4%, such that the weighted average total of currency conversion fees charged is now over 2.5%. TX 6003 at Table 2, Frankel; TT 3203:6-11, Frankel; TX 6003 at ¶¶164-172, Frankel. The evidence shows that the presence of a competitive retail currency market has not, to date, constrained the increasing transaction charges on credit card transactions denominated in foreign currencies. TT 3569:11-16, Frankel.
48. Retail currency exchange seller’s prices are driven by competition, not with credit card conversion rates, but by their own cost structures, which are very different from those of a net settling credit card network like Visa and MasterCard, and by competition with other retail currency sellers. Foreign currency providers do not view

Visa or MasterCard as competitors. TX 6010 at 102:7-14, Montgomery; *id.* at 167:11-168:2 (traditional competitors are retail exchange shops, not credit cards); *id.* at 201:10-20 (Thomas Cook/Travelex compares other retail exchange providers when pricing, not credit cards); TX 6009 at 122:14-21, Walsh, (American Express conversion rates for hard currency are distinct from rates it provides its card members.); TX 6003 at ¶¶152-154, Frankel. Likewise, MasterCard dismissed the notion that cash or checks constrained their ability to raise MCCR when they considered doing so in 1999; TX 3147 at MCS0021673, MCS0021690.

49. Retail currency exchange and credit cards have different features and are not the same product. The inferiority of these alternative methods combined with the inability of consumers to detect added fees gives Visa and MasterCard the ability to exploit credit card customers without fear of significant numbers of those transactions defecting to those alternatives. The correct benchmark for assessing consumer welfare relative to foreign credit card purchases is not inferior and different payment products, but rather a more competitive credit card market which would pass the efficiencies of net credit card settlement to consumers. TX 6003 at ¶¶26-28, 120-123, 127, 142-154, 157-158; TT 3322:4-13; TT 3570:7-3571:16, TT 3601:9-22, Frankel.
50. Assessment of the substitutability of alternative products or services for the purpose of evaluating whether they effectively constrain the price of another product or service at competitive levels is frequently undertaken in economics. TT 3564:18-3569:20, Frankel.
51. In such substitutability analysis courts look at the “cross-elasticity of demand” between one product and the other, *i.e.*, the degree to which a consumer will increase his purchase or use of one product as the price of another product changes. This gives a measure of substitutability of products in response to changes in their relative prices. TT 3197:22-3198:5, Frankel, TT 3197:15-17.

52. Consistent with the court’s findings in *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 335 (S.D.N.Y. 2001) (TX 418 1),³ cash and checks are not in the same product market as credit card services, which is to say they are insufficiently substitutable to effectively restrain transaction fee levels on foreign credit card transactions. The conclusion reached in *United States v. Visa* regarding substitutability is even more forceful in this case since obtaining cash is more expensive in foreign countries; travelers checks are likewise expensive and personal checks are largely not an option at all. TT 3582:12-3583:1, Frankel. These other payment methods are irrelevant benchmarks for assessing the “reasonableness” of credit card transaction fees. TX 6003 at ¶¶153-156, Frankel.
53. In sum, retail currency exchange and credit cards have different features and are not the same product. Retail currency exchange is a more expensive and less convenient payment “alternative” that offers little or no competition with credit cards in the currency conversion market. This is particularly true where consumers cannot detect currency conversion fees because they are hidden in the transaction amount. The correct benchmark for assessing consumer welfare relative to foreign credit card purchases is not inferior and different payment products, but rather a more competitive credit card market which would pass the efficiencies of net credit card settlement to consumers. TX 6003 at ¶¶26-28, 120-123, 127, 142-154, 157-158; TT 3322:4-13; TT 3570:7-3571:16, TT 3601:9-22, Frankel.

B.

Findings of fact as to the History and Structure of Visa

54. Visa is headquartered in Foster City, California. TT 405:22-406:6, Nordemann; TT 770:15-28 Fong.

³ In that case, the court found:

[T]he general purpose card ... market [is one of] the relevant markets for antitrust analysis in this case. Although the defendants argue that the relevant market is one which includes all methods of payment including cash, checks, and debit cards, the defendants’ own admissions and evidence of consumer preferences support Prof. Katz’ opinion and demonstrate the existence of a general purpose card market separate from other forms of payment. *Id.*

55. “Visa U.S.A. is a member of Visa International, which administers the Visa system worldwide.” *Nabanco I*, 596 F. Supp. at 1236 n.3. Visa U.S.A. is Visa International’s licensee for the Visa trademarks and brand in this country, and sublicenses the use of the brand to member banks in the United States. *United States v. Visa*, 163 F. Supp. 2d at 406 (citations omitted.) TT 1028:9-1029:4, 1034:18-1035:2, 1033:15-1034:2, Allen. TX 2407 at VSW0081084-86; TX 2451 at VSW0114580-82; TX 2476 at VSW0120020-21.
56. “Visa U.S.A. enters into contractual relationships with member financial institutions, authorizing them to use the Visa payment system and the Visa mark. TT 1029:20-1030:1; TX 2451 at VSW0114580; TX 4002, Art. II; TX 4006. Visa has no contractual relationship with cardholders. TT 1057:25-28, Allen. All Visa members are required to adhere to the By-Laws and Operating Rules and Regulations. A member can be expelled for violations of the By-Laws. TX 4003 at §2.17 (involuntary termination); TT 419:17-420:7, Nordemann; TT 967:27-968:7, Allen; TT 1565:20-26, Weiser; TX2261, at VSW1536 (Visa 1999 By-Laws, §2,02).
57. Visa U.S.A. “is managed by a Board of Directors (elected by its members) and by a management team. This team is responsible for the day-to-day operations and has certain authority delegated by the Board.” *United States v. Visa*, 163 F. Supp. 2d at 333. TT 1064:12-1065:2, 1067:14-22, 1068:21-1069:1, Allen. TX 2407 at VSW0081084-86; TX 4002 Articles IV, V, and VII. The Visa USA Board of Directors, with minor exceptions, is comprised of senior executive officers of its member banks. TT 1064:12-1065:2, Allen.
58. Apart from voting for directors, and on other matters that may be put to a vote in accordance with the by-laws, Visa’s member banks do not have authority to direct Visa U.S.A.’s affairs. TT 1035:3-1038:3, 1042:7-19, 1053:24-27, 1054:8-1055:15, 1069:2-9, Allen. TT 5262:26-5263:11, Theoharis; TX 4002.
59. Visa U.S.A. charges various fees to its members in order to finance its operations, and it balances its expenses and revenues such that it operates on a not-for-profit basis overall. TT 974:28-976:14, 1049:8-19, 1061:16-23, Allen. TT 2804:17-25, Rubin.

Visa collects revenue in excess of its expenses only to the extent necessary to accumulate reserves that are required for regulatory or liquidity reasons; maintenance of these reserves is properly regarded as a cost of doing business. TT 1131:11-21, 1371:6-1372:16, 1380:3-1383:20, 1388:12-21, Cleveland. TT 1532:22-1533:3, 1685:26-1687:3, Dahir. TT 2548:16-2549:14, McFarlane. TX 6401 at ¶¶167-169, McFadden. However, the Court finds that although Visa (and MasterCard) operate on a not-for-profit basis, to the extent that fees are generated from sources outside the Visa network and its member banks, (e.g., from cardholders), such revenues are a form of “profit” in that they may be used to reduce the expenses for operating the Visa network and thereby reduce the fees and assessments chargeable to Visa’s member banks.

60. Visa indemnifies other participants in the system against a member’s failure to honor its settlement obligations but Visa International may and does pursue assets of the failed member, including collateral. TT 976:15-980:12, 1050:12-1052:21, Allen; TT 1538:3-1539:11, Dahir; TT 1129:8-1130:21, 1388:22-1393:10, Cleveland; TT 420:24-421:11, 4514:13-4515:9, Nordemann; TX 4002, Art. IX; TX 2451 at VSW00114585 (Visa USA FY 2000 Financial Statements, Note 8-Restricted Assets and Liabilities);
61. Visa U.S.A. observes corporate formalities. TT 1030:25-1046:8, Allen.
62. There is no evidence of any agreement between Visa U.S.A.’s member banks giving banks an interest in each other’s profits, nor do they share profits in practice. Further, there is no evidence of any agreement between Visa’s member banks giving banks an obligation to bear any part of each other’s losses, nor do they share losses in practice. TT 970:4-11, 972:5-17, 974:16-27, 976:15-28, 1055:22-1056:14, Allen. TT 3537:20-3538:10, Frankel.
63. Visa International is a Delaware membership corporation owned by its members. *United States v. Visa*, 163 F. Supp. 2d at 406. Visa International is organized into six regions (U.S.A., Canada, European Union, CEMEA, Latin America, and Asia Pacific), two of which, (U.S. and Canada) are separately incorporated. TT 1028:11-14, 1033:15- 1034:2, 1035:23-1337:14, Allen; TT 1120:12-1121:12, 1121:25-

1122:10, Cleveland; 1508:25-1510:10, Dahir; 769:18-27, Fong; 4515:10-4516:28, Nordemann; TX 2407 at VSW0081084-86; TX 4004; TX 2476 at VSW0120020-21; TX 4005.

64. Visa International owns the Visa trademarks and brands, and licenses that brand to the various regions, including Visa U.S.A., which in turn sublicense the use of that brand to the member banks for use according to the terms set forth in the by-laws and operating regulations. *United States v. Visa*, 163 F. Supp. 2d at 406 (citations omitted); “Visa International’s ‘role is dominant’ on issues relating to the Visa brand.” *United States v. Visa*, 163 F. Supp. 2d at 406 (citations omitted). Allen, 1034:18-1035:2; TX 2407 at VSW0081084; TX 2451 at VSW0114582; TX 2476 at VSW0120020-21.
65. “Visa International By-law Section 15.02, entitled ‘Fundamental Principles,’ defines the relationship between the Visa International Board of Directors and its Regional Boards, including the Visa U.S.A. Board. The Visa International Board has sole authority to regulate interregional matters.” *United States v. Visa*, 163 F. Supp. 2d at 406-07 (citations omitted). Dahir, 1520:16-1521:20; Nordemann, 4516:7-28; TX 4003 at §15.02.
66. Outside North America, each of Visa International’s regions comprises many countries. The functions served by these four regions largely concern cross-border (i.e., non-domestic) transactions and card use (e.g., processing of international transactions, and advertising associated with international card use). Cleveland, 1358:18-23, 1361:10-21, 1367:28-1368:12, 1402:26-1403:25, 1445:26-1446:21.
67. Although Visa International is incorporated as a for-profit company, it is operated as a not-for-profit association and is supported by fees paid by members. Visa International sets its fees to cover the costs involved in providing the basic infrastructure to the members, but does not charge license fees or royalties. While the corporation makes a “profit” from these fees, it does not try to maximize earnings, and the “profit” earned is used to maintain a capital surplus account to pay merchants in the event of a member bank failure to honor its settlement obligations. *United States*

v. Visa, 163 F. Supp. 2d at 332. Allen, 974:28-976:14, 1049:8-19, 1061:16-23; Cleveland, 1131:11-21, 1371:6-1372:16, 1380:3-1383:20, 1382:20-1383:20, 1388:12-21; McFarlane, 2500:28-2501:5 (Visa operates on a not-for-profit basis), 2548:16-2549:14 (Visa's creation and maintenance of reserves for regulatory or liquidity reasons is properly considered a cost of doing business); Rubin, 2804:11-25 (describing Visa as a "nonprofit organization"); TX 6401 at ¶¶167-168 (McFadden Direct Testimony).

68. Member banks in the United States do not have any direct relationship with Visa International. Instead, they are members of Visa U.S.A., which in turn is a member of Visa International. Allen, 1033:15-1034:2, 1035:3-11; TX 2407 at VSW0081084-86.
69. Visa International's by-laws, operating regulations, nor any other agreement give Visa International any interest in the profits earned by the member banks. Likewise, there is no evidence of an agreement between member banks and Visa International pursuant to which Visa International must bear any part of the losses of the member banks. Allen, 1048:22-1049:2, 1050:5-11; Cleveland, 1389:26-1390:1, 1391:1-18, 1446:22-1447:5; TX 4001; TX 4003.
70. Visa International collects its revenues from members. There is no agreement between Visa International and members pursuant to which the members have a right to receive dividends. Although Visa International has never distributed dividends, if the board of directors of Visa International were, in its discretion, to distribute dividends, such dividends would be calculated as a refund of service fees rather than as a return based on ownership. Allen, 1049:3-5; Cleveland, 1131:11-21; TX 2451 at VSW0114582; TX 2476 at VSW0120020; TX 4003; §11.01.
71. Visa International cannot force its members to bear any losses. Instead, it would have to increase its fees prospectively. Allen, 1048:3-16, 1050:12-1052:21; Cleveland, 1346:8-1347:23; TX 2407 at VSW0081084; TX 2476 at VSW0120020.

72. Visa International does not own any part of its members' card programs. Allen, 1048:17-21.
73. Visa International observes corporate formalities. Allen, 1040:25-1048:16; Cleveland, 1115:22-1116:3, 4810:20-4811:12.
74. The Board of Directors of Visa International and Visa U.S.A. adopt and amend the corporations' bylaws pursuant to Delaware law and the corporations' certificate of incorporation. TT 1030:25-1031:20, 1038:25-1039:1, Allen; TX 2476 at VSW0120029-30.
75. Visa U.S.A. and Visa International have bylaws to establish basic rights and obligations of membership, including, *inter alia*, duties and obligations of directors, duties and obligations of members and responsibilities of directors and officers. TT 1030:25-1031:7, 1038:16-24, Allen.

C.

Findings of Fact as to Visa's Currency Conversion Business Practices

(a)

History and Implementation of Visa's Network Currency Conversion System

76. In the mid-1980's, international use of Visa cards was much more limited than today. During that time a Visa card could be used in about 100 countries, while today it maybe used in over 200 countries. TT 4517:1-13, Partridge. In the mid-1980s there were a number of problems associated with the use of Visa cards in foreign countries, including authorization delays, functionality problems, limited merchant participation, and limited numbers of countries where the cards were in use. TT 7355:2-8, 7355:10-20, Partridge; 426:24-427:4, 4515:10-16, 4517:1-4518:5, 4553:20-4554:19, Nordemann; 1111:23-1112:5, 1305:5015, 1349:12-1350:23, Cleveland.
77. Before 1987, Visa settled and, cleared exclusively in U.S. dollars. Foreign acquiring banks participating in the Visa system had to settle with Visa in U.S. dollars and convert amounts in foreign currencies into U.S. dollars. Issuing banks were free to

mark currency conversion rates up or down, (no evidence was offered at trial to suggest that the rates were ever marked down) and foreign issuers had to convert from U.S. dollars into the billing currency. TT 412:6-11, 414:8-28, 419:20-22, 430:8-431:2, 4519:24-4520:12, 4553:17-19, 4640:4-7, 4663:28-4664:28, Nordemann; 778:28-779:3, Fong; TX 2378.

78. The rate that foreign acquirers used to convert transactions to U.S. dollar was the subject of Visa International operating regulations that gave foreign acquirers latitude in selecting an inter-bank rate not less than the bank's cost of obtaining U.S. dollars, plus 0.25%. Because of routine fluctuations in exchange rates, and opportunistic delays in processing transactions, acquiring banks were able to take advantage of these market fluctuations which resulted in less favorable rates for the cardholder and attendant uncertainty in what consumers could reasonably expect by way of currency exchange rates. Visa did not have an effective way of regulating the rates submitted by acquirers. TT 412:12-18, 548:15-549:7, 580:14-582:4, 4523:14-20, 4529:20-4230:20, 4536:14-4538:9, 4539:2-4540:14, 4643:7-4646:16, 4677:27-4679:3, 582:7-583:15, 4540:15-4542:9, 4653:4-14, Nordemann. Not surprisingly, this generated complaints from members and cardholders about excessive rates from acquirers, unpredictable rates, in addition to objections from foreign members to settling in U.S. dollars. TT 502:1-9, 525:26-526:14, 4521:22-4522:5, 4523:3-20, 4523:13-4527:13, 4528:3-19, 4536:12-4529:1, 4543:14-28, 4679:25-4680-18, Nordemann; TT 1413:26-1418:26, Cleveland; TX 2378.
79. David Nordemann was the Chief Financial Officer of Visa from 1981-1984. In 1985 he authored the report entitled *Alternative Methods of International Clearing and Settlement* ("Nordemann Report"). TX 2003. As part of the Nordemann report, TX 2003, Visa did an audit of the rates submitted by acquirers. The audit revealed that acquirers were taking advantage of the rate fluctuations and charging "margins" of 5% or more. The Nordemann Report recommended that Visa adopt a new multi-currency system to clear and settle cross-border transactions. *Id.* At VSW0027099; TT 417:26-418:4, TT 426:12-21, TT 442:26-443:3, Nordemann.

80. The Nordemann Report recommended a new system in which acquiring banks would enter transactions into the Visa system in local currency and accept settlement in any one of 26 currencies instead of being limited to US dollars. Visa would convert the transaction currency into the billing currency and perform net settlement among members, buying what little currency would be required to balance the system to zero each day. TX 2535, TT 849:3-851:23, 5010:4-5012:24, Fong. Visa would also add a 1% currency conversion fee after converting the transaction amount into the billing amount in the issuers' currency. This fee would be embedded in the transaction amount billed to the cardholder. TX 2003 at VSW0027103; TT 4542:16-22, Nordemann; TT 5115:6-12, Dorsey; TX 2257 at 7-38; TX 2417. The Court finds the Fee Conversion example on page VSW0085351 of TX 2417 instructive. The cardholder would have no convenient means of discerning the imposition of a currency conversion fee assessed by Visa unless it was separately identified in the billing statement. The same is true of any Optional Issuer Markup Fee referred to in TX 2417.
81. Visa's primary purposes in designing, developing, and implementing the multi-currency settlement system were to achieve more consistent conversion rates, prevent excess acquirer markups, and to raise money from cardholders, "[The new system] has the effect of shifting a portion of Visa's operating costs away from the Members to cardholders." TX 3015 at MCS0027338; TT 255:19-22, TT 256:9-10, TT 257:12-15 (Visa Opening); TT 447:6-9, TT 450:19-23, TT 458:12-20; TT 4636:3-5, Nordemann ("...it was a good way to raise money...") TT 1431:8-20, Cleveland (new revenue stream for Visa).
82. Visa's acquiring members were concerned about losing "revenue streams" under the new system prohibiting acquirers from marking up international transactions. Thus, it would have been difficult for Visa to convince its members to approve changes to the settlement system if the costs of developing and operating the system were to be paid by members rather than cardholders. TX 2003 at VSW0027096 ("Members expressed concern over loss of income ... if Visa performed currency conversion."); TT 450:24-

28, TT 452:9-14, TT 454:12-19, TT 4639:5-6, Nordemann (“most members don’t like us to take away revenue streams from them”).

83. The Nordemann report contained five assumptions for the new currency conversion system. TX 2003 at VSW0027096. Two of the five assumptions related to informing or disclosing the conversion fees to the cardholder. It may be reasonably inferred that the reason for informing or disclosing the fee to the cardholder was because Visa expected the cardholder was going to pay the .75%⁴ currency conversion fee.
84. The Court finds that Visa initially contemplated at the time the new system of currency conversion was being developed that cardholders would pay the fee and be informed that international transactions are converted at a wholesale rate plus .75%. In explaining the “cardholders are informed” language in his report, Mr. Nordemann testified that he thought that informing cardholders that transactions are converted at a wholesale rate, plus a .75% fee, to be a “selling point” for members to their cardholders because it was a favorable rate. TT 500:8-18. Notwithstanding this testimony, such an intention is not discernable from reading the Nordemann Report. When considered in light of the Reports reference to concerns expressed by members over the loss of income if Visa performed currency conversion, and the amelioration of those concerns by dividing the .75% fee equally among Visa, acquirers and issuers, it appears clear that informing cardholders about the fee was not a marketing consideration, but rather a revenue consideration which ultimately had implications for cardholders. It also appears that payment of the fee by cardholders was a means of blunting opposition from foreign acquirers to the new system. TT 454:11-28, Nordemann. These findings are buttressed by TX 3015, the November 17, 1986 Staff Letter to the Asia Pacific Region, reciting Visa’s understanding that the new multi-currency conversion system has the effect of “shifting a portion of Visa’s operating costs away from the Members to cardholders.” The Court finds that from the inception of the new currency conversion system Visa intended and expected that its .75% fee would be paid by cardholders.

⁴ As ultimately adopted, the fee was established at 1% and has remained at that level to the present.

85. Based upon the Nordemann Report, the new multi-currency conversion system was approved by the Board of Directors of Visa in October of 1986 and became effective March 31, 1987. The currency conversion fee was fixed at 1%. The fee has remained at 1% since 1987. At the time the new multi-currency conversion system went into effect in 1987, there was no Visa U.S.A. regulation requiring that cardholders be informed that international transactions were converted at a wholesale rate, plus 1%. TT 404:6-405:6, 469:4-23, Nordemann. The Court finds that Visa's multi-currency conversion system implemented in 1987 is a business practice within the meaning of Business and Professions Code § 17200. At the time of the adoption of the new currency conversion system in 1986, the Board of Directors, with minor exceptions, was comprised of senior executive officers of the member banks. TT 1064:12-1065:2, Allen; TX 6000 at ¶66, McCormack.

(b)

Currency Conversion Fees Imposed on Visa branded Cardholders

86. The Court finds the 1% charge imposed by Visa for international credit card transactions has always been a "fee" and not part of the conversion "rate" used to translate foreign transaction amounts into U.S. dollars. Visa's contemporaneous documents refer to the 1% charge for processing international transactions under the new multi-currency settlement system as a "fee". TX 2003 at VSW0027096 ("Visa converts at its trading rate plus a *conversion fee* of 0.75"); TX 2012 at VSW0080912 ("If an issuer wishes Visa to apply a conversion fee in excess of 1%, the excess will accrue to the issuer."); TX 2229 ("*Multi-Currency Conversion Fee – paid by the cardholder*"); TX 3015 at MCS0027338 ("At the same time a portion of the *conversion fee* will accrue to the Asia Pacific Region"; TX 2012 at VSW0080912 ("*International Conversion Fee*: It is recommended that the Visa International Board adopt an International Conversion Fee equal to"); TX 2016 at VSW0027691 ("Resolved, that a *conversion fee* be applied"); TX 2001 at VSW0027505 (one

method of defraying costs is for Visa to apply a small conversion fee) (emphasis in original); TX 2256 at 2-45 (“Reconciliation of conversion fees.”); TX 2257 at 7-38 (“The amount posted to the cardholders account is a combination of the following ... currency conversion fee charged by Visa”).

87. Actual currency trading by Visa and large money center banks, such as Chase and Citi Corp, is carried on at minimal spreads between the bid and offer price. A 1% fee is not a usual or standard markup in foreign currency trading. This further supports the Court’s finding that Visa intended that the 1% fee was to be paid by cardholders and was not part of a wholesale rate to issuers. TT 5422:13-19, TT 5424:18-24, Riehl (0.02% or \$2000 on a \$10,000,000 transaction); TT 4630:9-14; TT 4554:20-4555:1, Nordemann.
88. The Visa Board Of Directors approved Operating Regulations stating that the “Currency Conversion Rate” is defined as a “wholesale market rate ... increased by a one-percent conversion fee.” TX2030 at VSW0063657; May 28, TT 572:26-573:17 Nordemann.
89. Visa International sets and collects this 1% processing fee through its member banks. TT 991:6-992:20, Allen, (1% conversion fee could appropriately be described as a “processing fee”). It has the authority to and must approve regional operating regulations that have inter-regional effect. Therefore Visa International approved both the European Operating Regulations, terming it a processing fee, and the U.S. Operating Regulation 3.6.G which characterizes it as part of the conversion rate. There is no difference between the “processing fee” Visa imposes on European cardholders and the 1% fee at issue here. TT 1520:6-23, Dahir; TX 4003 at §15.02(a) (Visa International has authority to decide interregional matters).
90. The Court finds that Visa designed and implemented its currency conversion business practice with the intention that the 1% currency conversion fee would be imposed on cardholders. While it is true that Visa has no direct contractual relationship with cardholders (Finding ¶56, supra), Visa understood and expected the 1% fee would be passed through the member banks directly to the cardholders for payment. TT

465:28-466:2, 467:18-21, 544:16-20, Nordemann. The imposition of the 1% fee on cardholders by Visa's member banks is also part of Visa's currency conversion business practice.

91. The Nordemann Report states: "A Visa margin of 0.75% compares favorably with the American Express disclosed mark up of 1% and Diners Clubs 2.25%. In fact, for the first time, Visa would be able to compete with these companies in the area of foreign exchange conversion *at the consumer level.*"⁵ TX 2003 at VSW0027097. A preponderance of evidence establishes that *Visa* intended to compete with *other networks* (American Express and Diners Club) that were directly charging cardholders a fee for using their credit cards in foreign countries and that Visa intended the 1% fee to be paid by cardholders.
92. The Nordemann Report provided that the proceeds of the originally proposed .75% fee would be divided 0.25% each to issuing region, acquiring region, and Visa. The regions could, in their discretion, remit some or all of the finds to the issuing and acquiring banks. There is no evidence to explain why a portion of the currency conversion fee that Visa contends is a charge to issuers would be paid back to issuers. TX 2003 at VSW0027097 is clear that "[i]ssuers that apply a conversion fee... are given an alternative revenue source with the ability to add additional fees if they desire." The revenue source refers to the 0.75% fee to be paid by cardholders, 0.25% of which would be paid to issuers. "Additional fees" refers to fees added by issuers to Visa's 1% fees (later known as Optional Issuer Fees). TX2051 is the definition of currency conversion rate adopted at the time the multi-currency settlement system was implemented. TT 471:24-28-472:1-22, Nordemann; 1746:15-18, Theoharis.
93. The Visa Board of Directors approved Operating Rules and Regulations stating that the currency conversion fee was to be 1% plus or minus such additional fees as the issuer may determine. The plus or minus language refers to the additional fees that members could add, not the 1% imposed by Visa. The fact that a bank could charge cardholders another fee or provide a rebate (which was also the case before Visa

⁵ The 0.75% fee was increased to 1% when adopted by the Visa Boards.

implemented the 1% fee) does not change the fact that Visa intended that cardholders pay the 1% fee. TT 569:7-16, TT 573:1-11, TT4570:20-25, Nordemann.

94. Visa stated to its Asia-Pacific members in November 1986 that the new system “has the effect of shifting a portion of Visa’s operating costs away from the Members to cardholders.” TX 3015 at MCS0027338. This Member Letter also stated that the new fee would “permit a reduction of Member processing fees when this service is introduced” (*id.*) and “a method of funding has been developed for the operating costs which solves ... the loss of income problems.” The method of funding was from cardholders. TX 2003 at VSW0027096; TX 3015 at MCS0027338; TT 516:13-20, TT 519:16-17, TT 523:11-22, Nordemann.
95. TX 2229 demonstrates Visa’s recognition that the 1% fee is paid by cardholders. Visa failed to produce a witness to deny the plain meaning of TX 2229. TX 2229 (“*Multi-Currency Conversion Fee – paid by the cardholder*”); TT 4604:3-20, Nordemann; TT 5104:1-6, Dorsey.
96. The Court finds the issuing banks merely act as the conduits through which Visa’s 1% fee is collected from the cardholder. TT4614:19-4615:10, Nordemann (“I would expect that the entire charge including the one-percent fee would go to the cardholder’s account.”); *see also* TX 2096, TX 2064.
97. TX 2257, the VSS User’s Guide, is a systems manual the contents of which is controlled by the technical staff and pursuant to which the currency conversion fee charged by Visa is kept separate and distinct from any Optional Issuer Fee. TT 1749:17-1751:20, Theoharis; TX 2417. Visa asserts as an affirmative defense that the 1% fee is a charge to issuers (Visa Answer to Second Amended Complaint, 10th Affirmative Defense). Visa further contends that issuers have discretion whether to charge the 1% fee. However, the discretion of issuers to charge a negative Optional Issuer Fee is not clearly reflected in the “config” form (TX 2519 at VSW0110503) that appears to only provide for a positive Optional Issuer Fee. *Id.* at VSW1100535 (“what percentage does the issuer add to the conversion charged to the cardholder for inter-regional transactions”). Further, there was no evidence offered at trial of a single

instance of a U.S. bank charging a negative optional issuer fee. This failure of evidence further supports the Court’s conclusion that the currency conversion fee is a charge to the cardholder and not to the issuing bank.

98. The event that triggers the assessment of the one percent fee is a difference between the billing and transaction currencies. With the exception of 1:1 pegged currencies, the 1% currency conversion fee is added to all international transactions. TX 2229; TT 5682:1-5, Isaak; TT 5013:13-16, Fong; TX 2417.
99. The 1% currency conversion fee is computed after the transaction currency has been translated into the billing currency. It is therefore not a component of the rate as Visa claims. TX 2417; TT 4958:1-14, Fong.
100. TX 2417, the Visa Optional Issuer Fee – Service Guide is prepared by technical staff for internal use by Innovant and member banks, and describes how Visa processes international transactions. The clearing information provided by Visa includes, among other things, the “Source Amount” (“purchase amount in the transaction”) and the “Cardholder Billed Amount” (“Destination Amount”). TX 2417; TX 6000 at ¶22, McCormack. *“This destination amount is the cardholder billed amount in the issuer’s billing currency.”* TX 2417 at VSW0085351. The cardholder-billed amount and the destination amount are the same. TT 1754:24-28, Theoharis; TX 2417.
101. Volume I of the VSS User’s Guide (TX 2257), a manual prepared by Visa for use by its members, explains the amount posted to the cardholder’s account is a combination of the following:

- Interchange amount of the transaction;
- Currency conversion fee charged by Visa;
- Optional issuer fee charged by the issuer. If the issuer does not charge an optional issuer fee, this amount is 0 (zero).

TX 2257 at 7-38, 7-39; TT 814:6-816:20, Fong, (Q. “Isn’t the plain meaning of that sentence that the destination amount is the cardholder-billed amount?” A. “That’s the reference in the sentence, yes.”); TT 816:18-21, Fong; (“The destination amount is indistinguishable from the cardholder billed amount.”); TT 848:12-24; TX 2417; TX

2241, Fong; TX 4003; TT 1519:23-1523:2, Dahir.

102. A “config” form is a form completed by Visa regional staff who gather processing parameters from members. It is then provided to Visa/Innovant. There are approximately 25 such config forms. TX 2519 is a Visa Member Information Questionnaire seeking information regarding multi-currency options. It states: “*What percentage does the issuer add to the currency conversion charged to the cardholder for intra -region transactions?*” TX 2519 at VSW0110535. It affords no option for the issuer to decrease the fee imposed by Visa. TT 798:19-801:12 (Fong).
103. It is irrelevant to an analysis of whether the imposition of the 1% fee is Visa’s business practice to claim that issuers pay the 1% fee even if the cardholder does not pay the bill. In the daily settlement process issuers pay the entire transaction amount that includes the 1%. This is an extension of credit to the cardholder by the issuer. Thus, when Visa settles all charges in the system each day, the issuing bank pays both the charge for lunch in London and the embedded 1% Visa fee on behalf of the cardholder. TT 846:16-847:9, Fong.
104. Issuers view the fee as a *network fee* rather than an issuer imposed fee. Shortly after November 6, 1991, Mr. Theoharis received a copy of a letter from Audrey Hendler, Vice-President of Citibank, which had been sued for nondisclosure of the 1% fee, to American Airlines stating: “As for conversion fees, Visa, *not Citibank*, assesses a 1% conversion fee” TX 2096 at VSW0080796 (emphasis in original). Neither Mr. Theoharis nor anyone else at Visa ever responded to or disputed Ms. Hendler’s claim that the conversion fee was Visa’s, not Citi Bank’s. TT 1820:16-1821:15, Theoharis.
105. Not one of Visa’s numerous U.S. issuers has ever decreased or rebated the fee since its inception in 1987. TT 510:20-27, Nordemann; TI 1606:17-24, Dahir. Contemporaneous uncontradicted bank documents establish that it is Visa’s fee over which banks exercise no control. TX 1289; TX 2064 at VSW0081975.09 (“During our conversation ... Visa has committed that it will give members ... notice prior to making any changes to the methodology used in converting foreign currency transactions or changing the 1% fee.”); *id.*, at VSW0081975.11 (“*We [First Chicago]*

do not determine the currency Conversion rate which is used.”); TX 2096 (“As for conversion fees, Visa, *not Citibank*, assesses a 1% conversion fee”) (emphasis in original) TX 1016; (Visa and MasterCard retain the 1% as “currency conversion fee”).

106. Visa presented no evidence that issuers determine what fee should be charged for currency conversion (except for Optional Issuer Fee). Defendants presented no evidence that any U.S. issuer made a decision to charge their cardholders the 1% fee for currency conversion except for adding additional fees. No bank officer or employee appeared to testify that it was the bank’s policy to charge or even pass along a 1% fee. Visa produced no documents or witnesses proving that any of its member banks even considered making a decision to charge the 1% fee. This proof was within the control of Visa and was part of their burden of proof because the tenth affirmative defense states, “Member banks and financial institutions make their own independent decisions about pricing to their cardholders, including how to charge cardholders for currency conversion.” Answer to Second Amended Complaint at 4:10-17. All other evidence was to the contrary. TX 2064 at VSW0081975.09 (“During our conversation ... Visa has committed that it will give members ... notice prior to making any changes to the methodology used in converting foreign currency transactions or changing the 1% fee.”); *id.* at VSW0081975.11 (“We [First Chicago] do not determine the currency conversion rate which is used.”); TX 2096 (“As for conversion fees, Visa, *not Citibank*, assesses 1% conversion fee ...”) (emphasis in original); TX 2064; TT 273:24-28, TT 276:17-18, Visa Opening.
107. Chase and Bank of America disclose their own 2% currency conversion fees in solicitations and billing statements, but do not disclose Visa’s 1% fee. This evidence provides further support for the finding that banks consider the 1% fee to be Visa’s fee to the cardholder.⁶ TX 2096; TX 2064; TX 1253; TX 1258; TX 1313.

⁶ While the language of cardholder agreements is not identical, nearly all provide evidence that the 1% fee on cardholders *is* imposed by the networks, not the banks. For example Bank of America states “Visa and MasterCard increase the dollar amount by 1%, which they keep as a currency conversion fee. TX 1016.

108. The Court finds embedding the fee in the transaction amount has the effect of concealing the fee from cardholders and is likely to deceive consumers. Duane Isaak, a senior systems architect employed by Innovant testified that there is no way a cardholder can determine from a billing statement that a 1% fee has been added and collected by Visa International. TT 5682:20-23, (“From her bill, no.”); TT 5683:1-4, Isaak; *see also* TX 6000 at ¶104, McCormack.
109. No other fee charged by Visa to issuers is embedded into the transaction amount. TT 5117:4-13, Dorsey.
110. Chapter 9 – Fees of the Visa International Operating Rules and Regulations sets forth Base I and Base II transaction fees. The Visa Integrated Billing Manual lists more than 3000 fees that Visa charges to its member banks. The 1% currency conversion fee is not listed in either Chapter 9 nor in the Visa Integrated Billing Manual. This is evidence that Visa does not consider the currency conversion fee a charge to issuers. TX 6000 at ¶38, McCormack; TT 1592:3-1593:26, Dahir.
111. Mr. Dorsey, Visa’s Senior Vice President of finance in financial planning and analysis, could not think of any reason why the 1% currency conversion fee could not be as one of the fees in Chapter 9. TT 5122:18-5123:5, Dorsey. Chapter 9 of the Visa Operating Rules and Regulations “includes most of the transaction processing type charges and miscellaneous services.” TT 5112:10-13, Dorsey.
112. The operating regulations in the European Region, approved by Visa International, termed “Cardholder Transparency” require disclosure of the 1% currency conversion fee as a processing fee. TX 2312A, Chapter 4 Visa Regional Operating Regulations, European Union; TX 2256; TX 6000 at ¶51-65, 129, McCormack. The phrase itself, Cardholder Transparency, suggests that Visa intended that cardholders be informed of the processing fee in Europe, but did not want to disclose the fee, *i.e.*, provide cardholder transparency to U.S. cardholders, because it might trigger TILA disclosure requirements.

(c)

Nondisclosure of the Currency Conversion Fee by Visa

113. At the time the system was implemented Visa legal staff looked at the issue of disclosing the 1% fee, but no documents exist relating to the decision not to require disclosure. TT 1770:5-17, Theoharis.
114. In the late 1980s Mr. Theoharis became aware that nondisclosure of the fee was becoming “an issue.” In 1990, the first cases against issuers were filed. TT 1776:23-1777:1, Theoharis.
115. In correspondence related to the 1990 litigation, banks that communicated with Visa recognized that the 1% fee charged to cardholders was imposed by Visa. TX 1289; TX 2064 at VSW0081975.09 (“During our conversation ... Visa has committed that it will give members ... notice prior to making any changes to the methodology used in converting foreign currency transactions or changing the 1% fee.”); *id.* at VSW0081975.11 (“*We [First Chicago] do not determine the currency conversion rate which is used.*”); TX 2096 (“As for conversion fees, Visa, *not Citibank*, assesses a 1% conversion fee”) (emphasis in original); TX 1016 (Visa and MasterCard retain the 1% as “currency conversion fee”).
116. Mr. Theoharis, director of litigation for Visa U.S.A. received both TX 2096 and TX 2064 as did Mr. Tidd of Visa’s legal staff, both of which state that the 1% is a Visa fee to cardholders. There is no evidence in the record that anyone from Visa advised Citibank or First Chicago that Visa believed the fee to be other than a Visa fee. Further, Mr. Theoharis specifically approved the First Chicago proposed disclosure language that states: “*We [First Chicago] do not determine the currency conversion rate which is used.*” TX 2064; TT 1819:10-18, Theoharis.

117. TX 2065, Mr. Theoharis' letter to Ms. Spiotto, counsel for Visa member First Chicago, confirms the accuracy of the contents of TX 2064, her letter, with attachments; to him wherein she provides the text of a proposed notice to cardholders informing them that Visa rather than First Chicago sets the rates, including the 1% fee, for conversion of foreign charges into the cardholders billing currency. TT 1819:10-18, Theoharis.
118. Mr. Theoharis remembers receiving shortly after November 6, 1991 a copy of the letter from Audrey Hendler, Vice-President of Citibank, to American Airlines stating: "As for conversion fees, Visa, *not Citibank*, assesses a 1% conversion fee ... TX 2096 at VSW0080796 (emphasis in original). Neither he nor anyone else at Visa ever responded to it to say such an assertion was incorrect. TT 1820:16-1821:15, Theoharis. The failure of Visa to respond reflects the appreciation of the delicate balance that Visa has tried to strike on the currency conversion fee issue. If it were an issuer fee charged by the member banks to cardholders, there might be TILA implications for the banks. And if it were a Visa fee charged on cardholder via the member banks, it was in Visa's interest that it not be disclosed so that the fee could be collected from the cardholder unnoticed and without the attendant marketplace impact (i.e., competition between Visa and MasterCard over the fee).
119. In 1990 the Visa U.S.A. Board of Directors passed a resolution amending the operating regulations to require disclosure of the 1% currency conversion fee (3.4.F, now 3.6.G). The regulation specifies that the disclosure be in writing, but does not specify where disclosure is to be effected. TX 4000.
120. In 1990 Visa, by a vote of the Board of Directors, eliminated the word "fee" from the Operating Rules and Regulations because of conceits about litigation. This is probative of Visa's currency conversion business practice being likely to deceive cardholders by eliminating all references in its rules to the fact that the 1% was in fact a fee and had always been considered by Visa to be a fee. TX 2003 at VWW0027906-27097; TX 2059; TX 2063 at VSW0054467 ("In order to protect the Corporation [Visa] ... and individual Members from litigation").

121. The Court finds the change in the definition of currency conversion rate, excising the word “fee,” was not accompanied by or reflective of any change in the way foreign charges were processed. It may be reasonably inferred that the only reason for changing internal documents removing the word “fee” from the definition of currency conversion was cosmetic. TT 1782:5-8, TT 1785:25-1786:6, Theoharis; TX 2059.
122. The Court finds that because the network currency conversion fees are paid by, but are not visible to, consumers, revenue from these fees allow Visa and MasterCard to fund their operations not by assessing members, but by charging cardholders. TX 3015 at MCS0027338.
123. When MasterCard determined to charge a fee to cardholders in 1986, it was originally planning a 25 to 50 basis point fee. As a direct consequence of learning that Visa planned to implement a higher 100 basis point (1%) fee, MasterCard determined to charge the same fee as a “competitive response,” *i.e.*, to assure that it would raise from “cardholders” (and under their then current plans) to share with its members, an amount equal to Visa. *See* TX 3019; TX 3022.
124. Where fees are unambiguously charged to issuers and are not embedded into transaction amounts precisely to “ensure they are paid by cardholders” (TX 3007) issuers have tended *not* to pass those along to cardholders in any kind of way. TT 3357:26-3358:11, Frankel.
125. Further evidence of Visa’s desire not to disclose its currency conversion fee to cardholders is reflected in its policy on pegged currencies. Some currencies are linked or pegged at a fixed ratio to other currencies. TX 6000, ¶¶45, McCormack. Visa charges a currency conversion fee on all international transactions when the transaction currency and billing currency are different, except those involving transaction currencies pegged at a 1:1 ratio to the U.S. dollar. TX 6000, ¶¶43-48, McCormack. The Court finds that neither Visa nor MasterCard offered at trial a satisfactory explanation for excluding pegged currencies from the currency conversion fee. The Court finds that pegged currencies were not assessed the currency conversion fees by Visa and MasterCard because they wanted to reduce cardholder

complaints. On a 1:1 pegged currency the currency conversion fee will be obvious to a cardholder looking at a billing statement. TX 3115 at MCS0024350 (“... many of the initial complaints received by MasterCard were for transactions ... where the currency was pegged to the US dollar. MasterCard has the system flexibility to ‘turn off’ the Adjustment Percentage part of the MCCR in these instances.”); TX 3102; TX 2296 at VSW76030 (Visa Base II Currency Master File Linked Currencies); TX 6000 at 15:9-21, McCormack.

126. The Court finds that Visa’s determination to exclude pegged currencies from assessment of currency conversion fees was intended to help keep the fees concealed from cardholders.

(d)

Visa’s Costs and Revenues from Currency Conversion

127. During trial plaintiff offered considerable evidence regarding the revenues generated and the costs incurred by Visa for foreign currency conversion. The evidence spanned the time period from 1987 to the present. This evidence was offered principally in support of plaintiff’s theory of unconscionability under B&P Code §17200. As will be seen hereinafter, the Court finds as a matter of law no merit to the unconscionability claims of plaintiff because of the lack of privity of contract between Visa and the cardholders.
128. The financial evidence was also offered by plaintiff on the issue of the appropriate amount of restitution to be ordered in the event a finding of liability is made under plaintiff’s unfairness theory of the UCL. However, the amount of restitution to be paid in this matter is not subject to determination of a fixed sum by the Court. Rather, restitution will be effected through a dispersal or claims process as determined by the Court in subsequent proceedings as provided hereafter and prior to entry of judgment. Therefore, the Court’s findings as to the revenues and costs for Visa associated with foreign currency conversion will be limited.

129. Visa International collects a 1% currency conversion fee on most transactions by U.S. cardholders in foreign countries. Visa U.S.A., the issuing region, retains half of this fee. The other half of the fee is paid to the acquiring region. TX 2229.
130. Between 1996 and March 30, 2002 Visa International has collected approximately \$817 million dollars from U.S. cardholder transactions in foreign countries (rounding to nearest million). See TX 2546. This includes debit card transactions that account for approximately 10-15% of all international transactions by U.S. cardholders. TT 1661:5-1662:3, Dahir; TX 2352 at 16-20; TX 2545; TX 2521; TX 2546; TX 2561.
131. Visa USA's total revenue for 2002 fiscal year is \$1.7 billion. TT 1662:12-1663:22, Dahir; TX 2534. Visa USA expects to earn profits or a surplus of more than \$364 million. TT 1664:3-5, Dahir; TX 2534. Visa USA earned \$166 million in currency conversion fees in 2001 and one can expect this figure to increase in 2002. TT 1642:15-1644:1, Dahir; TX 2538.
132. International transactions are less than 2% of Visa's total transaction volume; yet in 2000, the 1% fee comprised 20% of Visa International's revenue and 9% of Visa USA's revenue. TX 4098; TX 2407 at VSW0081082; TX 2497 at VSW0114701, VSW0114716; TX 6000 at ¶110, McCormack.
133. Visa intended to recover the costs of developing and operating the Multicurrency System. TT 459:6-12, Nordemann; TX 2003 at VSW027096.
134. Visa knew from the inception of the Multi-currency Settlement System, that "net settlement" would entail minimal currency conversion costs. Cardholders transact in approximately 200 currencies, but Visa settles in only 15 widely traded settlement currencies, *e.g.*, British Pound, Japanese Yen, etc., chosen by Visa because they account for approximately 95% of transaction volume. Visa aggregates all acquirer and issuer transactions and net settles the differences daily. Thus, Visa settles its systems to "zero" on a daily basis. Visa/Innovant processes four to five billion dollars of transactions daily. Because of this net settlement process, Visa buys and sells only 100-200 million dollars of currency per day. TT 849:3-851:23, Fong; TX 6000 at ¶79, McCormack; TT 780:12-19, Fong; TX 2396, Visa Settlement Funds Transfer

- Guide; TX 6000 at ¶31, McCormack; TT 556:20-26, Nordemann.
135. Visa has no foreign exchange risk in any of the non-settlement currencies because Visa applies, only a translation rate and never has to buy or sell non-settlement currencies. For example, all banks in Latin America and the Caribbean settle in U.S. dollars. Therefore, no matter how many U.S. cardholders engage in transactions in Latin America and vice versa, Visa only moves U.S. dollars among its members during the settlement process, but charges a 1% “currency conversion fee” on each transaction. TT 781:10-784:19, Fong; TT 5013:21-5014:21, Fong; TT 5435:12-5437:10, Riehl.
136. Visa has minimal foreign exchange risk even in its settlement currencies because Visa’s trading banks such as Barclays guarantee spreads to Visa. In addition Visa receives revenue (\$347 million between 1991-2001) from “the Visa Applied Spread.” TT 5430:18-5431:8, Riehl; TX 2197 at VSW112983; TX 6000 at ¶31 n.8, 81, McCormack.
137. Visa/Innovant uses a general ledger accounting system organized into approximately 400 cost centers general ledger accounts, none of which are identified as dealing with international transactions or multi-currency settlement expenses. TT 1578:15-22, Dahir. Between 1985 and 1988, during the development and early operational phase of the system, a cost center was established for multi-currency settlement expenses. TT 1578:5-11, Dahir. The fact that no cost center or account numbers exist presently for multi-currency settlement expenses is evidence that such expenses are minimal. TT 1578:5-1579:11, Dahir; TT 835:15-836:2, Fong.
138. The cost of developing the Multi-currency Settlement System was \$1,800,000. TX 2003 at VSW27094-5; TT 550:3-5, Nordemann. The cost to operate the Multi-currency Settlement System during the first year of operation (including an amortized portion of development costs) was approximately \$2,000,000. TX 2003 at VSW027095; TT 551:6-17, Nordemann.

139. When estimating the cost of development and operation of the new system Visa executives only considered the incremental costs. Fully allocated costs were never discussed or considered. TX 2003 at VSW27095-7. Visa has never analyzed its costs of Multicurrency Conversion on a fully allocated basis. TX 2369 (Interrogatory responses 20, 32 and 33); TT 1444:28-1445:22, Cleveland.
140. From February 1, 1996 through December 31, 2000, Visa incurred \$6.9 million in multicurrency conversion related costs pertaining to U.S. cardholders. During this same period, Visa earned \$630.1 million in currency conversion fee and PIPS revenue from transactions involving U.S. cardholders. TX 6001 at ¶¶5, 27-34, McFarlane.
141. Based on the foregoing findings concerning the costs and revenues incurred and generated by the Visa foreign currency conversion system, the Court finds that the costs of operating the Visa foreign currency conversion system are minimal compared to the revenues generated. While Visa claims there to be specific operational costs for foreign currency conversion, Visa produced little evidence of the same. TT 5134:24-26, TT 5135:1-5136:7, Dorsey.

D.

Findings of Fact as to the History and Structure of MasterCard

142. Defendant MasterCard International Incorporated (“MasterCard”) is a non-stock membership corporation incorporated under the laws of the State of Delaware, with its principal place of business in Purchase, New York. TX 5127 (Certificates of Incorporation); TT 7174:3-7, Heuer; TT 4089:12-15 (publication of TX 3197).⁷
143. MasterCard was established in 1966 when a group of banks with proprietary or regional card systems formed a domestic card program, the InterBank Card Association (“ICA”). TX 5520 at p. 82 (MasterCard Incorporated SEC Form S-4, May 7, 2002). In 1968, ICA began to develop a global network by forming

⁷ Effective June, 2002, MasterCard’s 1500 principal members became shareholders of MasterCard Incorporated, a private share corporation organized in Delaware, and MasterCard International Incorporated became a wholly-owned subsidiary of MasterCard Incorporated, a Delaware corporation. TX 5520 at pp. 10, 35, 81; RT 7175:12-7176:2; 7176:28-7177:5, 7177:11-18 (Heuer).

associations and alliances outside the United States. *Id.* In 1969, ICA acquired exclusive rights to the “Master Charge” name and logo; it subsequently changed its name to MasterCard. *Id.*

144. MasterCard Incorporated is a global company with 1500 principal members, located around the world, who are the shareholders and owners of MasterCard Incorporated, and have equity interests and voting rights in MasterCard. TX 5520 at p. 81; TT 7177:13-18, Heuer. MasterCard is also comprised of approximately 13,500 affiliate members. TX 5520 at p. 81. These members compete with each other. TT 7188:13-19, Heuer (“It is a very competitive market in the U.S.”); TT 5967:12, McFadden (“issuers are in competition with each other”); TT 2812:10-2813:14, Rubin. There are between 6,000 and 8,000 U.S. members issuing MasterCard-branded cards. TT 7187:2-7188:12, Heuer. MasterCard is structured as an open joint venture association, open to any eligible financial institution. TX 3168 at MCS0000366 (Bylaws). It (and Visa) is often referred to as a credit card “network.”
145. MasterCard’s members are licensed to issue payment cards carrying the MasterCard brand. TX 5520 at p. 81; TT 6761:12-15, 19-23, Griffith. These members are commonly referred to as “issuers.” *Id.* MasterCard also licenses members to enroll or contract with merchants pursuant to which the merchants will accept payment cards carrying the MasterCard brand. TX 5520 at p. 81; TT 6761:7-12, 16-18, 21-23, Griffith. These members are commonly referred to as “acquirers.” *Id.*
146. MasterCard adopts operating rules applicable to its members in areas where common procedures and standards are needed to ensure the “smooth, equitable and secure functioning of [the MasterCard] system.” TX 5520 at pp. 82, 89-90.
147. All members of MasterCard are required to “comply in all respects with all bylaws, rules and regulations, and published policies” promulgated by MasterCard including the payment of all fees, dues and assessments. TX 3168 at MCS0000370 (Bylaws & Rules). MasterCard is empowered to enforce their rules by fines, termination and other sanctions. *Id.* at MCS0000434, MCS0000454 (Bylaws). The By-Laws establish member standards, member service provider rules (*Id.* at MCS0000438-454),

rules and procedures for cash disbursements and settlements, as well as standards for dealing with merchants. *Id.* at MCS0000438-454; 485-52-2.

148. No single member can control the operations of MasterCard. TX 5393 at MCS0031085-31086 (4/01 MasterCard Bylaws and Rules) (Art. II, §§1,3); *id.* at MCS0031309-31310 (§20.03(c)) (allowing no MasterCard member to cast more than 15% of votes at annual meetings regardless of business size); TX 5520 at p. 81; TT 7177:13-18, Heuer; *see also* TT 2682:9-11, Rubin (conceding that “[a]ny single member bank [cannot] control MasterCard or Visa”).
149. Each member is responsible to indemnify MasterCard against any loss that it may incur which is attributable to any other member’s failure to perform its obligations. TX 3168 at MCS0000473 (Bylaws); MCS0000485-522.
150. MasterCard does not control the operation of its members’ card businesses. MasterCard “[does] not ... set fees or determine the interest rates that cardholders are charged for use of their cards. Issuers have the responsibility for determining these and most other competitive card features.” TX 5520 at p. 81. Nor does MasterCard solicit merchants or establish the discount rate that merchants are charged for card acceptance; these are the responsibilities of the acquirers. *Id.*
151. MasterCard does not own any part of its various members’ payment card businesses. TT 7209:23-25, Heuer. MasterCard collects no money from members based on member profitability. TT 7210:2-4, Heuer. If a MasterCard issuer earns profits through its payment card business it is not obligated to share those profits with either MasterCard or any other member. TT 7209:26-7210:1; 7210:15-23, Heuer. Likewise, MasterCard does not share in losses sustained by ongoing members’ card businesses. TT 7210:5-8, Heuer. There is no obligation imposed by MasterCard requiring members to share profits or losses with each other. TT 7210:15-23, Heuer.

152. The Court finds MasterCard observes corporate formalities. MasterCard's governance practices are typical of corporations. The Global and U.S. Region Boards of Directors meet periodically. TT 7173:13-26, 7179:4-9, Heuer. These meetings are preceded by notices and agendas of the items scheduled to come before the Board. TT 7179:13-21, 7181:9-20, Heuer. The Board of Directors meetings are conducted according to standard Board procedures: meetings are chaired by the Chairperson; minutes are recorded by the Secretary; and the minutes are reviewed, approved and then distributed. TT 7179:22-7180:25 (regarding Global Board), 7181:9-7182:2 (regarding U.S. Board), Heuer.
153. Issuing banks are licensed by MasterCard to issue cards under the MasterCard brand and, in turn, these issuers establish contractual relationships with cardholders. TT 6761:12-15, Griffith; TT 7208:8-13, Heuer. MasterCard does not have a direct relationship with cardholders – issuing members do. TT 6762:23-28, Griffith; TX 6506 at pp. 204:10-13, Munson; TT 7208:8-13, 7209:2-3, Heuer; *see also* TT 1908:7-12, 2279:8-15, 2280:28-2281:6, McCormack.
154. MasterCard is not a creditor. It does not extend credit to consumers. TT 7208:14-15, Heuer. MasterCard does not issue cards to or contract with consumers. TX 5520 at p. 81; TX 6506 at p. 204:10-13, Munson; TT 6761:26-27, Griffith. MasterCard does not prepare or send card solicitations or applications to prospective cardholders, nor does MasterCard prepare or enter into cardholder agreements. TT 7208:16-23, Heuer; TT 2733:5-7, Rubin. Additionally, MasterCard does not bill cardholders for purchases made with MasterCard-branded cards or collect on payment card bills. TT 6761:24-6762:7, Griffith; TT 7208:14-7209:8, Heuer; *see also* TT 2733:5-13, Rubin.

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E.

Findings of Fact as to MasterCard's Currency Conversion Practices

(a)

History and Implementation of MasterCard's Network Currency Conversion System

155. In the period before 1986, MasterCard utilized an acquirer based currency conversion system, which was in a "state of chaos." TT 615:19-616:19, 632:28-635:5, Dunn; TX 5000 at MCS0022320. Cardholders were being charged exorbitant rates, inconsistent with their expectations and perceptions, resulting in excessive complaints and charge backs within the system. TT 6054:5-6058:11, 6067:21-6068:14, Dunn; TX 3001 at MCS0027889-27890 (1/10/84 Progress Review). The problems were serious enough to have a negative impact on the MasterCard brand resulting in reduced cardholder confidence that MasterCard could provide a good currency conversion rate. TT 6062:21-6063:10, Dunn.
156. Under MasterCard's pre-1986 operating procedures, acquirers converted non-dollar transactions to dollars using vaguely defined "wholesale" rates increased by not more than 1%. TT 631:24-632:27, Dunn. Acquirers, which do not have relationships with cardholders, took advantage of the system and used fluctuations in market rates to select opportunistic wholesale rates. TT 6050:11-27, 6054:7-23; 6056:27-6057:11, Dunn; TX 3001 at MCS0027889; *see also* TT 6566:19-28, 6646:19-6647:1, Pindyck. In addition, acquirers at times increased the rates they selected by more than the specified 1% markup. TT 6050:19-20; 6054:7-23 (compliance was "nonexistent"), Dunn. Thus, in practice, conversion by acquirers at "wholesale plus 1%" led to inconsistently applied rates, varying by as much as 3% or more. TT 631:4-632:16, 637:12-20, 6050:20-25, Dunn; TX 3001 at MCS0027889.
157. In 1983, MasterCard determined to review its procedures for processing transactions denominated in a currency that was different than the billing currency. MasterCard retained a consultant, Edgar Dunn & Company ("EDC"), in connection with that

project in the late fall of 1983. TT 615:13-16; TT 6041:24-28, Dunn. EDC was retained to review MasterCard's then current system for converting cross-border transactions and to make recommendations for improving the system. TT 616:13-617:3, Dunn.

158. On January 10, 1984, EDC described the then current system at MasterCard, problems with the system and potential solutions. TX 3001; TT 628:6-11, Dunn.

159. The 1% charge above the wholesale rate MasterCard permitted acquirers to impose was referred to as the 1% "load," which "load," it was recognized, was borne by cardholders. TX 3001 at MCS27898, MCS0027893; TT 635:11-636:3, Dunn. Most of the MasterCard transactions involving foreign currency were taking place in Europe where MasterCard's partner, Eurocard, was already settling foreign charges using a centralized net settlement system. TT 6044:4-27, Dunn.

160. In January 1984, EDC identified a number of objectives of the new currency conversion system, including objectives that were of concern to issuer members.

Among the concerns were the following:

- a. Get the transaction into the system as soon as possible at an amount as close to the cardholder's perception of the cost as possible.
- b. Bill the cardholder for an amount equal to or greater than the amount reimbursed to the system; but consistent with acceptable total amount.

TX 3001 at MCS0027884.

161. EDC concluded that the costs of the then current system were "an irritant to non-U.S. member MCI [MasterCard International] relations" and that "the majority of [those] cost[s] falls to non-U.S. members." TX 3001 at MCS0027896; TT 637:21-638:17, Dunn. In fact, it was the Eurocard members who were really pushing for MasterCard to change the system because they had recently changed to a central conversion system which net settled. TT 6059:26-6060:17, Dunn. The Eurocard members were incurring a lot of the cost of the old system and were doing most of the complaining. TT 6063:20-6064:14, Dunn.

(b)

Currency Conversion Fee Imposed on MasterCard branded Cardholders

165. During 1985, MasterCard “parallel tested” the new system. TT 660:13-661:9, Dunn. The system was implemented in March 1986 (TX 3010 at MCS0028017: “MasterCard implemented a new currency conversion system about eight months ago.”); TX 3026 at MCS0027464 (new currency conversion system implemented in March 1986). TT 691:20-27; TT 6069:25-27, TT 6070:18-19, Dunn. The only part that was not implemented in 1986 was the imposition of a fee. TT 6113:25-6114:4, Dunn; TX 3021(3/2/87 memo, David Sokal to Andrew Lynch, Executive Vice President, Administration at MasterCard); TX 3185 MasterCard International Incorporated’s Second Supplemental Responses to Plaintiff’s First Set of Special Interrogatories, Response to Interrogatories Nos. 1, 2.
166. The Court finds MasterCard always intended to charge for the currency conversion service it would be providing under the new system. TX 3001 at MCS0027900; As Mr. Dunn explained in December 1986:
- There is no pricing or fee for the service, that MasterCard has now tested the system, it’s working acceptably, there are costs and expenses, investment by both MasterCard and the membership which is being incurred, but at this point there was no revenue item, ... [this was] ‘no longer acceptable’
- TT 6096:3-10 (Dunn) (regarding TX 3019). In TX 3019, under the heading “Observations and Conclusions”, Mr. Dunn stated that now MasterCard “wishes to charge direct and indirect costs for the currency conversion system to users.” TX 3019 at MCS0027994 (12/19/86 letter from Dunn to Hogg).
167. EDC was asked to examine the potential of MasterCard charging a “fee” for its currency conversion services. TT 668:17-669:19, Dunn.

168. On October 13, 1986 EDC concluded that with few exceptions “the system appears to be performing as expected,” and that “[o]ver time, foreign exchange costs should be close to zero....” EDC also stated that they would “include its suggestions relative to a fee in subsequent updates.” TX 3006 at MCS0028016. To that point, no currency conversion fee was being embedded in the detail transaction amount and any costs of the system were being recovered through the normal, *i.e.*, member, assessment process. TT 672:12-673:2, Dunn.
169. The Court finds MasterCard intended from the beginning to collect a fee from cardholders as part of its foreign currency conversion business practice. EDC consulted with MasterCard both as to the amount of the proposed fee and the procedure for collecting it. On October 20, 1986, Peter Dunn wrote to MasterCard’s Andrew Lynch. Dunn stated that he was leaning toward a “fee” in the amount of 25 basis points on issuer volume and went on to state:

“Mechanically, it would be easier to charge this as a fee to the issuer, but to ensure it is collected from cardholders, it should be built into the detail transaction amount.” TX 3007.

Mr. Dunn testified at trial regarding the quoted portion of TX 3007. He explained that charging member banks the currency conversion fee on their weekly billing was not favorable because members would compare the fees between Visa and MasterCard on a per transaction basis. TT 6094:20-6096:1 (Presumably, it was not favorable because it invited member banks to compare Visa and MasterCard on currency conversion fees, resulting in competition over the fees between Visa and MasterCard.) Mr. Dunn further explained that the weekly billing system was a “hard wired” system for which any modification would have created “horrendous” reconciliation problems because members who passed on the currency conversion fees would only be billing cardholders on a monthly basis. TT 6171:17- 6172:6. The Court finds this explanation rings hollow and somewhat revisionist in light of the plain language of TX 3007. Also, Dunn must have been mindful of MasterCard’s sensitivity to increases in fees to members. Dunn was copied with the Sokal report of October 29,

1986 where Sokal at page 3 of the report points out the major drawback of including the currency conversion fee on the weekly billing system report: “it would broadcast this additional FX charge to the membership by adding an FX line item to the weekly member bills.”

170. The “detail transaction amount” means the amount of one sales slip or a discrete charge to the cardholder. It is the amount that is transmitted to the issuer for each particular charge that corresponds with that issuer’s cardholder. May 30, TT 675:24-28, TT 624:18-27, Dunn. There was no question in Dunn’s mind at the time (October, 1986) that mechanically it would have been easier to charge the fee to the issuer. TT 6134:13-16, TT 6138:3-6, Dunn. Posting to the issuer on the weekly bill would, however, impede charging the fee to cardholders. TT 6175:7-19, Dunn.
171. The Court finds MasterCard’s objective was to ensure that the cardholder pay all costs, *i.e.*, “of the merchandise plus any fees.” TT 6159:14-15, TT 6172:7-20, Dunn. When the fee was eventually implemented in 1989, it was, consistent with Dunn’s recommendation, built into the detail transaction amount. Dunn understood the 1% would be a charge to the cardholder “because of the way the system was being designed it would be included in the detail media.” TT 6133:7-12, Dunn.
172. In general, the 1% MCCR fee is applied by MasterCard to all transactions in which the transaction currency differs from the billing currency. TX 3206 at MCS0004001; TX 3205 at MCS003943-44; TX 6000 at ¶43 (McCormack); TX 6005 at 102:22-105:1, 106:20-107:9, Griffith. There have been exceptions to this practice, including where currencies are pegged to the dollar at a 1:1 ratio and in Canada. TX 3102 at MCS0024303, e-mail to Manchisi dated April 29, 1999 (Canada remains at 0% MCCR); TX 6000 at ¶¶44-46, McCormack (currencies pegged at 1:1 ratio to the U.S. dollar are excluded), TX 6005 at 174:7-25, 175:5-19, Griffith; TT 7454:24-27, Griffith (1% MCCR not applied to Canada); TX 3102. Griffith testified that pegging can occur in instances where the ratio is not 1:1 to the U.S. dollar. However, it appears that pegging most often involves a 1:1 ratio to the U.S. dollar. The Court finds that the primary reason for MasterCard’s exclusion of pegged currencies from

assessment of the 1% MCCR fee was to reduce cardholder complaints. TX 5012 at MCS0022391 (“MCCR – May 10, 1999”: “many of the initial complaints received by MasterCard were for transactions acquired in currencies where government mandated rates were in effect or where the currency was pegged to the U.S. dollar”). Therefore, MCCR is applied uniformly to all foreign transactions engaged in by U.S. MasterCard cardholders unless the transaction takes place in one of a relatively few excluded currency pairs. TX 3102 at MCS0024303-04 (summarizes MCCR rates in different MasterCard regions).

173. In settlement, MasterCard retains the 1% MCCR fee, transmitting to the acquirer a settlement amount from which the 1% has been deducted. TX 3224 (“Multiple Currency Conversion Rates (MCCR)) at MCS0022405 (sets forth multi-currency conversion settlement process); TX 3205 at MCS0003943-44; TX 6005 at 112:4-113:2, 114:2-11, Griffith. The 1% MCCR fee applied by MasterCard has the effect of increasing the amount of the transaction amount in the billing currency (in this case U.S. dollars) by 1%. Because the 1% MCCR fee is embedded in the cardholder billing amount of the foreign transaction, cardholders are billed an amount which includes the 1% fee. TX 3147 at MCS0021697 (“MCCR is automatically added to the cardholder’s transaction amount during settlement with the Members.... We know of no Members that currently reduces (sic) the transaction amount for MCCR, and it is highly unlikely that increasing MCCR by 50 basis points would motivate a Member to do this.”); TT 6814:8-18, Griffith (currency conversion factor applicable to U.S. cardholders is 1%).

174. MasterCard aggregates and nets its transactions, including currency positions, at the end of each processing day. *Id.* at ¶79, McCormack; TX 6005 at 161:9-162:4; TT 6837:1-6, Griffith.
175. As of October 21, 1986, EDC had estimated that the total extended cost for the first year of operation of the system (based on costs observed from inception in March 1986 through September 1986) were \$1-1.2 million with ongoing costs estimated at \$750,000-\$1,000,000 per year. TX 3008 at MCS0027975; TT 677:23-679:7 (Dunn). Edgar Dunn recommended that the fee concept which had been “agreed to in May” “cover at least [the] \$750,000 to \$1,000,000 in expected costs.” TX 3008 at MCS0027977. EDC also recommended MasterCard “[i]mplement a fee for the service of either (a) 15 basis points on the sum of acquirer and issuer volume for all international volume, or (b) 25 basis points on issuer only gross volume.” *Id.* at MCS0027978; *see also* TX 3007 (“I am supportive of either fee (a), or (b) ... I find myself leaning to (b),25 basis points on issuer volume.”).
176. On October 23, 1986, Allan of EDC forwarded to Lynch at MasterCard “a more detailed breakdown of cost estimates for the Currency Conversion Program,” annualized for 1986 and forward. TX 3009 at MCS0028134. Allen stated: “It appears that MasterCard’s costs will average about 10 basis points on U.S. and non-U.S. international issuing volume.” *Id.* The enclosed estimate of “total cost,” on an “annual ongoing” basis, including “miscellaneous costs” was \$650,000-\$1.6 million. *Id.* at MCS0028278. Translated into a percentage of issuer volume, at \$5 million per day, this computed to 5-13 basis points; at \$6 million per day, 4-11 basis points.⁸ A 25 basis point fee at these levels easily covered these costs, yielding revenue of \$3.1 to \$3.75 million on that assumed volume. *Id.* at MCS0028279.

⁸ A basis point is one one-hundredth of one percent.

177. No other category of costs were ever reported or estimated by EDC although the concept of “risk cost” was, according to Dunn, “alluded to” but not quantified. TT 686:25-687:25.
178. On November 14, 1986, in direct response to learning of Visa’s plans to charge a 1% fee, MasterCard modified its plans to reflect and incorporate Visa’s new multi-currency clearing and settlement principles. TX 3017; May 30, TT 706:5-25 (Dunn). Dunn recommended, and MasterCard determined, to charge 1% to match or be “competitive with” Visa’s planned 1%. TX 3021 (3/2/87 memo, Sokal to Lynch); TX 3022; TT 6100:21-6101:18, TT 6102:4-9; TT 6161:27-6162:12, Dunn.
179. In an October 29, 1986 memo to Lynch and others at MasterCard and EDC (including Peter Dunn), David Sokal wrote “[d]uring our recent telephone meeting with Peter Dunn, you made it clear that we intend to modify our FX [foreign exchange] settlement process to more than cover all ongoing (and historical) currency conversion expenses and losses.” TX 3010 at MCS0028018 (emphasis added). It again noted Dunn’s recommendation of a 25 basis point fee but the memo also noted awareness that Visa intended to impose a 1% (100 basis point) fee. TX 3010 at MCS0028018. The memo also examined alternatives to charging the fee as a “mark-up on issuer volumes” vs. billing the issuer and noted that the fee would be more effectively “hidden” by marking up the transaction volume than by billing the issuer in a weekly billing report. *Id.* at MCS0028019. The weekly billing report was the weekly bill of charges that MasterCard charged to its members. TT 6090:2-17; TT 6095:3-5, Dunn.
180. On November 7, 1986 Peter Dunn wrote to Andrew Lynch regarding the proposed solution to implement the “fee” for currency conversion. TX 3013 at MCS0028024, 26. Still discussing a 25 basis point fee (*id.*) Dunn described a “simple and effective” alternative for implementing a fee by marking up the exchange rate used. (*id.* at MCS0028026), the “impact” of which “is to charge the cardholder 25 basis points.” *Id.* He concluded:
- The mechanics of this process accomplish the objectives: namely provide MCI with its compensation, provide a means to remit to acquirers, if

desired, and, charge costs to cardholders.

Id. Also on that date, Dunn noted Visa's plans to charge cardholders what he described as "wholesale rates, plus a substantial (1%) markup." *Id.* at MCS0028025. TT 715:13-16, Dunn.

181. On December 19, 1986, Dunn wrote again to MasterCard's president, Russell Hogg, to summarize results and list action steps to be taken related to currency conversion. The letter noted:

- (1) That MasterCard was expected to incur "ongoing expenses to operate the system and from fluctuations in exchange rates of about \$1 million per year." TX 3019 at MCS0027994.
- (2) That Visa's plans to implement a similar currency conversion process and its "plans to charge cardholders at least 1% for the service." *Id.*
- (3) That, at the time, "MasterCard charges no "fee" for the service. *Id.*
- (4) That MasterCard wished to charge "direct and indirect costs for the currency conversion system to users at an amount that "should be competitive with Visa" and fund "MasterCard's direct and indirect exposure as well as provide revenue to issuers and acquirers." *Id.* According to Dunn, "direct" costs meant some of the costs previously referenced and "indirect" costs could include investment costs, overhead costs and most of the other things you might take into account from a pricing point of view. TT 6097:19-6098:6, Dunn.

TX 3019. In this same letter, EDC recommended that MasterCard "implement a procedure to charge cardholders 1% on international transactions." *Id.* at MCS0027995.

182. A presentation document to the Executive Committee of the Board of Directors was prepared in early March of 1987 by EDC. TX 3022; TT 727:15-28, Dunn; TT 6100:4-13; TT 6166:1-9, Dunn. This document describes "estimated annual costs" for the currency conversion system at \$1-\$1.5 million or 8-10 basis points. TX 3022 at MCS0028209-10. It noted the new Visa program included a "1% foreign exchange

fee.” Id. at MCS0028211. Under Proposed Modifications to the MasterCard system, EDC wrote “include a 1% service fee for foreign exchange transactions in currency conversion rate.” Id. at MCS0028214. It described the “Impact” of this as “generat[ing] \$14.4 million revenue from cardholders.” Id. (emphasis added).

183. The Executive Committee and Board (unanimously) approved the proposal on March 26, 1987. TT 6105:19-24, Dunn; TX 3025 at MCS0012045 (4/17/87 Finance Bulletin noting Board approval of the “Second Phase Currency Conversion Enhancements); TX 3185, MasterCard International Incorporated’s Second Supplemental Responses to Plaintiff’s First Set of Special Interrogatories, Response to Interrogatory No. 2. (Board and Committee unanimously approved inclusion of 1% on 3/26/87).
184. The Court finds MasterCard’s implementation of the currency conversion fee is consistent with MasterCard’s intent to impose the fee on cardholders. Subsequent to approval by the Executive Committee and the Board of implementation of the 1% fee, MasterCard issued a Finance Bulletin and an Operations Bulletin to its members regarding the fee. TX 3025 (Finance Bulletin, 4/17/87); TX 3026 (Operations Bulletin, 5/8/87).
185. On April, 17, 1987 MasterCard issued its Finance Bulletin (No. 1) entitled “Second Phase Currency Conversion Enhancements.” TX 3025. It recited that “[t]he system enhancements” (i.e., addition of the 1% charge) “will provide additional income to our acquirers and issuers worldwide and will enable the membership to recoup currency conversion expenses.” (Id. at MCS0012045). Describing this second phase of the currency conversion enhancements, the Bulletin also stated: “MasterCard ... will adjust the rates by one percent prior to settlement [and] ... these expenses will be passed along to the cardholders as part of the conversion calculation on their international transactions.” Id. at MCS0012046 (emphasis added).

186. The Operations Bulletin issued by MasterCard in May 1987, stated that the enhancements “provide funding for our member’s currency conversion expenses from the cardholders” and that the expenses “will be passed along to the cardholders as part of the conversion calculation on their international transactions.” TX 3026 at MCS0027464.
187. At a Board of Directors Meeting on July 23, 1987, the Board opted to delay implementing the currency conversion fee that was originally scheduled to go into effect on September 25, 1987. TX 3029 (Finance Bulletin No. 2 dated 7/1/87).
188. MasterCard implemented the fee in the U.S. in September or October 1989. TX 3102; TX 3147 at MCS0021687; TX 3185.
189. MasterCard’s currency conversion fee, known as MCCR, remains at 1% for U.S. cardholders and has never been reduced. TX 6005 at 114:20-115:9, Griffith; TX 3185 MasterCard International, Inc. Second Supplemental Responses to Plaintiff’s First Set of Special Interrogatories, Response to Interrogatory No. 1. During approximately May through September of 1999, MasterCard considered raising its 1% currency conversion fee. Senior executives, including Jerry McElhatton, the President of the Global Technology Group, and a member of the Executive Management Group (“EMG”), Michael Manchisi, Curt McIntyre, Randall Norris and Dana Lorberg (and others) prepared, reviewed and finalized a report which examined MCCR in general, and the effects of a proposed increase of the fee from 100 bps to 125 or 150 bps. TX 3129; TX 3132; TX 3142; TX 3147; TX 3110; TX 3111; TX 3118; TX 3122; TX 3123; TX 3124; TX 3125; TX 3127; TX 3134; TX 3135.
190. In June 2000, MasterCard implemented buy/sell rates in place of mid-rates. TX 6005 at 131:14-132:7; TT 6829:12-19, Griffith (the change from buy rates to mid-rates occurred in June 2000). [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

(c)

Nondisclosure of the Currency Conversion Fee by MasterCard

191. The Court finds that MasterCard currently neither discloses, nor requires that its issuer member banks disclose, the 1% fee to cardholders. TX 3172; TX 3173 (Finance Bulletin dated Dec. 11, 2000, rescinding before it became effective an earlier bulletin requiring that issuers disclose the fee in cardholder agreements); TX 6005 at 250:24-251:17, Griffith.
192. In the early 1990's, class action litigation was brought against some of the large MasterCard and Visa issuers (including Citibank) over disclosure of the 1% currency conversion fee. TT 5247:10-5248:22, Theoharis. The Court finds these circumstances inspired MasterCard to embark upon a lengthy effort to recast what had always been understood to be a currency conversion fee to what would subsequently be referred to as a "rate". The goal of this effort was to insulate MasterCard and its members from liability for failing to disclose the fee it passed on to cardholders via its member banks.
193. MasterCard's campaign to re-characterize its currency conversion fee began in February of 1990. On February 23, 1990 MasterCard's General Counsel, Robert Norton, received a letter from Richard Fischer, outside counsel, which enclosed a draft member bulletin explaining to member banks how to characterize the conversion rate used by MasterCard. TX 1277. The Court finds the February 23, 1990 letter and draft member bulletin reflect MasterCard's initial concerns about characterization of the currency conversion fee. The timing of this issue following the litigation against member banks for failure to disclose currency conversion fees leads the Court to conclude that in addition to characterization of the fee, MasterCard was concerned with disclosure liability as well.

194. That prior to February 1990 MasterCard considered its 1% currency conversion add on a “fee” as opposed to part of a “rate” is evidenced by the minutes of the Board of Directors meeting prepared by Mr. Norton two months earlier in December 1989. The minutes refer to MasterCard’s “fee” in several instances. TX 3040.
195. There were several draft bulletins developed throughout 1990 addressing the characterization of the “fee” reflecting MasterCard’s early disclosure concerns over the fee. TX 1280; TX 1286 (8/17/90); TX 6007 at 121:3-121:19, Norton; TX 1290 (8/31/90); TX 6007 at 132:2-134:2, Norton.
196. Contemporaneously with the exchange of these drafts, Fisher and Norton were communicating with lawyers for Citibank concerning settlement of a case against Citibank over disclosure of the currency conversion fee. TX 1280 at MCS0041994, MCS0042000 (Norton’s handwriting on proposed disclosure language); TX 6007 at 112:9-113:13, Norton; TX 1282; TX 1283; TX 6007 at 116:13-117:11, Norton; TX 1284; TX 6007 at 117:25-118:11, Norton; TX 1287; TX 1285 (Bergeson of Citibank adopts MasterCard disclosure language).
197. Notwithstanding the determination to adopt the terminology of an “adjustment” to the exchange rate (TX 3264) and to advise its members not to describe the 1% as a “fee” (TX 1290), MasterCard’s continued understanding of the 1% as a transaction fee on foreign purchases is shown in documents eventually disseminated to members about disclosure of the fee.
198. On December 3, 1990, in response to an inquiry from First Chicago Bank, Norton, after consulting outside counsel Fisher, sent First Chicago a memorandum regarding disclosure of MasterCard’s currency conversion fee. Like the draft member bulletins, it advised not to “characterize” the 1% as a fee because of disclosure issues. TX 3045; TX 6007 at 136:13-146:4, Norton. In this communication, MasterCard presented a suggested “form of disclosure.” TX 6007 at 146:5-147:12, Norton. However, the portion of the memorandum that followed the suggested form of disclosure read:

“The statement above [i.e., that MasterCard’s 1% is not a “fee”] assumes

that the member does not impose its own fee, or otherwise share in any fee imposed.” TX 3045 at MCS0027864.

199. Norton testified that the first reference to “fee” referred to a number fee and the second reference to “fee” referred to the MasterCard 1%, directly contradicting the statement earlier in the memorandum that the MasterCard “1% is not a fee.” Id. at MCS0027863 (“the one percent component of the conversion rate is not a separate fee”); TX 6007 at 147:13-148:22 (Norton). This identical passage is found also in the August 19, 1991 Finance Bulletin disseminated to members. TX 5000 at MCS0022321 (“The preceding statement assumes that the issuer does not impose its own fee or otherwise share in any fee imposed”).
200. Roger Griffith testified at trial to the effect that the 1% is an adjustment to foreign exchange rates, but in an October 25, 2000 e-mail from Griffith responding to a question from Caroline Dionisio: “Does MasterCard charge a fee for performing currency conversion services?” He wrote: “For legal reasons, we apply an adjustment to FX rates rather than assessing a direct fee.” TX 3264. He was unable at trial to explain what he meant by “legal reasons.” TT 7405:23-7406:3, Griffith. Additionally, Griffith testified that the similarly named ICCR “rate” (for issuer currency conversion rate) is not an adjustment to an exchange rate, it is an “increase to the transaction amount.” TX 6005 at 171:9-16, Griffith.
201. Correspondence and memoranda prepared by MasterCard and their consultant, EDC, during the design and implementation phase of the multi-currency clearing and settlement system repeatedly state that the fee is intended to be paid by cardholders and is to be embedded in the detail transaction amount precisely for that purpose. TX 3007 (10/20/86 letter from Dunn to Lynch re: implementation of “fee” (“Mechanically, it would be easier to charge this as a fee to the issuer, but to ensure it is collected from cardholders, it should be built into the detail transaction amount.”); TT 6175:7-19, Dunn (Posting to the issuer on weekly bill would have impeded charging fee to cardholder); TT 6172:7-20; TT 6159:14-15 (“[T]he way the system was being designed it would be included in the detail media.” The objective was to

ensure that the cardholder pay all costs, i.e., “of the merchandise plus any fees.”); TT 675:24-28, TT 624:18-27 (Dunn) (“Detail Transaction Amount” refers to the amount transmitted to the issuer for each individual charge that corresponds with that issuer’s cardholder); TX 3013, 11/7/86 letter from Dunn to Lynch of MasterCard discussing process for implementation of currency conversion fee, at MCS0028026. (“The mechanics of this process accomplish the objectives; namely ... charge costs to the cardholders.” “Impact of process” is to “charge the cardholder 25 basis points.”); TX 3019 (12/19/86 letter from Dunn to MasterCard CEO Hogg) at MCS0027994-95:

- describing Visa’s model as a “plan to charge cardholders at least 1%” with a facility for issuers “to further increase the markup to cardholders,”
- recommended MasterCard action steps and “[i]mplement a procedure to charge cardholders 1% on international transactions.”

Id.; TX 3022 at MCS0028214 (3/6/87 Presentation Materials to Executive Committee of MasterCard Board of Directors describes “Impact” of the “Proposed Modifications” of including “a 1% service fee for foreign exchange transactions in currency conversion rate” as “generat[ing] \$14.4 million revenue from cardholders”); TX 3025, 4/17/87 Finance Bulletin, at MCS0012046 (“Second Phase: Currency Conversion Enhancements [i.e., the 1% fee] ... provides funding for our members’ currency conversion expenses from the cardholders” which “expenses will be passed along to the cardholders as part of the conversion calculation.”); TX 3026, 5/8/87 Operations Bulletin at MCS0027464; ([Second Phase of Program, i.e., imposition of the 1% fee] “provides funding for our members’ currency conversion expenses from the cardholders. ... [T]hese expenses will be passed along to the cardholders as part of the conversion calculation These 100 basis points funded by the cardholder”).

202. MasterCard’s counsel, Richard Fisher, recognized that the fee was intended to be and was paid by the cardholder, otherwise there would have been no issue under TILA. TT 7032:28-7033:21, Fischer (The 100 basis points “would be posted to the cardholder account and hopefully paid by the cardholder”; “If, in fact, there’s a fee here, that fee would be paid by the cardholder.”) TT 7068:18-21, Fischer (“Q: [I]f the charge were just on the issuer and the cardholder wasn’t paying anything, that couldn’t conceivably raise a TILA violation? A: That’s absolutely right.”).
203. The 1% currency conversion fee is the only charge in the MasterCard system that is embedded in the reported transaction amount. TX 6000 at ¶126, McCormack; TX 6003 at ¶11, Frankel; TX 3147 at MCS0021697 (“MCCR is automatically added to the cardholder’s transaction amount during settlement with the members); TX 3206 at MCS0003989, MCS0004001; TX 3205 at MCS0003943-44 (MasterCard Operations Manual); TX 3079.
204. TX 3147 is the September 14, 1999 (and final) version of a Discussion Paper prepared by and for the Executive Management Group regarding a proposed increase in the 1% currency conversion fee (known as “MCCR”). This “Multi-Currency Conversion Rate Program (MCCR) Discussion Paper” went through many drafts and was prepared and/or reviewed by senior executives at MasterCard including Jerry McElhatton, President of the Global Technology Group, Michael Marchisi, Senior Vice President, Member Relations, Curt McIntyre, a Senior Vice President, Randall Norris, Senior Vice President, Member Relations, and Dana Lorberg, Senior Vice President, as well as others.⁹ At several points, MasterCard’s understanding that MCCR is paid by cardholders and provides non-member funding for its operations, is explicit. TX 3147 at MCS0021672 (“Since MCCR is paid by cardholders, Members would not be financially impacted by an increase.”); *id.* at MCS0021673 (“Proceeds

⁹ TX3110, 5/28/99 Draft (Manchisi, McIntyre, Lorberg); TX3111, 6/3/99 Draft (Manchisi, McIntyre, Rex Power and Lorberg); TX3122, Revised draft (Manchisi, Lorberg, Randel Norris, Manchisi); TX3125 (Lorberg, Manchisi, Norris, McElhatton, McIntyre); TX3127, 7/8/99 Draft (Lorberg, Manchisi, Norris, McElhatton); TX3129, 7/20/99 Draft (Manchisi, McIntyre, Lorberg, Norris); TX3132, 7/21/99 Draft (McElhatton, Lorberg, Manchisi, Patricia Ward, McIntyre); TX3134, 8/11/99 Draft (McIntyre, McElhatton, Lorberg, Manchisi, Norris); TX3135, 8/18/99 Draft (Manchisi, McIntyre, Norris, McElhatton, Lorberg).

of MCCR increase can be retained (to sustain 1999 impact of the Assessment acceleration initiative), reinvested in Member support, or used to decrease Member Assessments/operations fees.”); *id.* at MCS0021674 (“Consistent with ‘User Pay’ philosophy only Cardholders with transactions requiring foreign exchange, would pay MCCR.”); *id.* at MCS0021675 (“Issuers will benefit from the increased revenue ... This investment would be funded by cardholders through MCCR, rather than through Member assessments or operations fees.”); *id.* at MCS0021684 (“Members are not financially impacted.”); *id.* at MCS0021695 (“Of course, MCCR does not impact a Members P&L, as MCCR is paid by cardholders.”); *id.* at MCS0021696 (“MasterCard should not charge as much [in currency conversion fees] as issuers”); *id.* at MCS0021697 (Question: “[Increase in MCCR] will effectively increase the Members cost of doing business” Response: “Not likely. MCCR is automatically added to the cardholder’s transaction amount during settlement with the Members. Developing a program to reduce the transaction amount would require Member system changes, which would be possible but not very prudent. We know of no Members that currently reduces the transaction amount for MCCR”); *id.* at MCS0021700 (“Rather than do this [raise member assessments, operating fees], which would be harmful to the Membership, MCI believes that it is preferable to increase MCCR which is paid for by the Cardholders”); TX 3185, MasterCard International Incorporated’s Second Supplemental Responses to Plaintiffs First Set of Special Interrogatories, Response to Interrogatory No. 3.

205. That cardholders pay MCCR – and that the 1% MasterCard fee is not a charge on the issuer – is also evidenced by MasterCard’s awareness that it was essentially vying with its own members over whether they or the members would be the first to increase currency conversion fees imposed on cardholders in the late 1990s. TX 3098, 3/29/99 e-mail from Michael Manchisi¹⁰ to Curt McIntyre concerning potential increase to MCCR (“I belief [sic] we’ve got an opportunity here in the 10’s of millions and need to act quickly before the issuers take it from us”); TX 3107, 5/5/99 e-mail from Curt McIntyre to Dana Lorberg and Rex Power concerning potential increase to MCCR (“Our window of opportunity is tight which Mike [Manchisi] is well aware of. Basically, issuers are starting to implement MCCR charges [of their own] of from 1-4%, and we would prefer to take the lead and let the issuers follow, rather than us being the ones accused of ‘piling on.’”).
206. Cardholder agreements often state that MasterCard imposes and retains the 1% fee, not the banks. TX 5352 at BA000001 (Bank of America – Visa and MasterCard increase the amount by 1% which they keep as a currency conversion fee); TX 5353 at CAPONE006 (Capital One – Visa and MasterCard may charge you a conversion fee); TX 5363 at UB39 (Union Bank of California – the Bank Card Associations charge a conversion fee); TX 5359 at Fleet 000014 (“Bank does not control the rate, date or place of exchange.”); TX 5357 at FUWB0026 (“Visa or MasterCard retains this one percent as compensation for performing the currency conversion service.”).
207. In communications directed by MasterCard’s counsel, to the FRB in 1991, which were read and approved by MasterCard’s general counsel, MasterCard unambiguously stated that the 1% was MasterCard’s charge to the cardholder which it controlled; and was not an issuer charge. TX 5519 (5/8/91 draft of MasterCard memo to FRB) at MCS-SA-0128 (MasterCard’s currency conversion “rate,” which it defined as the wholesale or government-mandated rate, plus 1%,” is “beyond the control of the card issuer.”); TX 5518 (5/13/91 MasterCard memo to FRB) at MCS-SA-0085 (The charge

¹⁰ Michael Manchisi, a Senior Vice President, verified MasterCard International Incorporated’s Second Supplemental Responses to Plaintiff’s First Set of Special Interrogatories, Response to Interrogatory No. 3. TX3185.

“is not ‘imposed directly or indirectly by the creditor’ – in this case the card issuer.”); *id.* at MCS-SA-0086 (No part of the currency conversion rate is received or retained by the card issuer.); *id.* at MCS-SA-0086 n. 1 (The “card issuer does not have ... discretion with respect to the conversion rate applied by MasterCard ... and exercises no control with respect to the conversion rate used.”); *id.* (“[E]ven if it is assumed that the MasterCard conversion rate involves a ‘charge’ that ‘charge’ is imposed solely by MasterCard and cannot be characterized as a finance charge indirectly imposed by a card issuer.”); TT 7031:19-7032:7, Fischer (“Yes, if there was a charge that charge was imposed by MasterCard.”); TX 6005 at 223:22-234:12, Griffith.

208. TX 1277, TX 1280, TX 1286, and TX 1290, consist of correspondence and draft bulletins prepared by MasterCard to instruct members on the manner of disclosing its currency conversion fee, in particular, telling members that it should not be described as a “fee” given disclosure obligations under federal and state law. To the same effect are TX 3045 (Correspondence and memorandum directing member First Chicago Bank with respect to manner of disclosure of MasterCard’s currency conversion fee.) and TX 5000 at MCS0022321 (Finance Bulletin dated August 30, 1991, disseminated to members directing that any disclosure of MasterCard’s currency conversion practice “not differ materially” from the form of disclosure provided by MasterCard “unless you discuss the language with appropriate MasterCard attorneys.”).
209. On November 15, 1999 MasterCard issued a Finance Bulletin which effective 12/31/00 “required” “all cardholder agreements to include an updated disclosure statement about multicurrency conversion rates.” TX 3154 at MCS0021577. The new disclosure form was mandatory. The new language was designed to give MasterCard maximum flexibility to more expeditiously increase the fee by eliminating the reference to “1%” and replacing it with “increased by an adjustment factor established from time to time by MCI.” As a “benefit” the bulletin stated “[t]he new disclosure statement is more flexible and will decrease the need for issuers to amend cardholder agreements if MasterCard changes the components of its currency conversion process.” *Id.* at MCS0021579. MasterCard rescinded this Bulletin, but

only after the present litigation was commenced and on the advice of counsel. TX 6007 at 33:20-34:23, Norton.

210. MasterCard executives recognized the competitive dangers if the fee were not embedded and consumers could see the effect of MasterCard's currency conversion fee. In a memo written on December 22, 2000 to several MasterCard executives, including Doug Raymond, Vice President-Financial Analysis, MasterCard's Alan Timblick wrote:

“Another point about MCCR is that MasterCard will not be the card of choice for foreign travel as long as cardholders can see on their statements two currency amounts for the same purchase – one for the original and another including MCCR. I noticed this on my own KEB card personal statement and was shocked – it's a real turn-off!” TX 3174.

211. The Court finds that MasterCard and its consultants conceived, developed and implemented the currency conversion business practice, including the implementation of a one percent fee, which was designed to be embedded in the “detail transaction amount” such that the fee would be passed through member banks undetected by cardholders and be paid by cardholders.

(d)

MasterCard's Costs and Revenues from Currency Conversion

212. The evidence offered against MasterCard in this area is largely in support of plaintiff's theory of unconscionability and restitutionary relief. There is no merit to plaintiff's unconscionability claims and any order of restitution will not specify an amount. Thus, the Court's findings as to MasterCard's costs and revenues in the area of foreign currency conversion will be limited.
213. From February 1996 through December 31, 2000, MasterCard received \$195,563,642 in revenue from U.S. cardholders as a result of its 1% MCCR fee. TX 3180 at 11; TX 3273 at 130.
214. MasterCard charges its members international processing fees and other fees which are designed to cover and do cover the cost of foreign transactions. International processing fees range from 5-20 times higher than domestic processing fees. TX 3166, "MasterCard International Consolidated Billing System Manual" (2000) at MCS00752; TX 6000 at ¶112, McCormack. TX 6001 at 32-33, McFarlane; TT 7452:9-7453:26, Griffith (MasterCard charges its members transaction fees for processing international transactions which have a higher transaction fee);

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

The Court finds the transaction fees MasterCard charges more than cover the costs of these transactions.

215. MasterCard also generates a substantial margin between its MCCR revenues and any reasonable estimate of the costs of operating its multicurrency clearing and settlement function. In 1999 and 2000 each international transaction, on average, generated \$1.06 and \$1.04 in revenue from currency conversion fees charged to U.S. cardholders.

<u>U.S. MCCR Revenue</u>	<u>No. Transactions</u>	<u>Average Revenue per Trans.</u>
1999 \$43,910,580	41,184,332	\$1.06
2000 \$54,504,748	52,325,780	\$1.04

TX 3180 at 11.

216. The Court finds that in the area of foreign currency conversion costs it is reasonable to use Visa as a proxy for MasterCard for the following reasons: Both companies perform the same function in providing currency conversion services, are in the same industry, have similar cost structures, have comparable costs of funds (and the largest incremental cost of performing multi-currency conversion is interest expense (or “float”) on the funds during the currency conversion process) and their contemporaneous estimates of their annual, ongoing costs associated with providing multi-currency conversion are comparable. TX6001 at ¶¶36-37, 41, McFarlane (citing TX 3147 at MCS0027975 (ongoing costs of MCCR from \$750,000 to \$1,000,000; and TX 3063 at MCS0032157 (“The current five countries that settle in local currency presently cost MCI \$1.6 million per year.”)). See also TX 5009 at MCS0033816 (Visa and MasterCard have similar costs).
217. Applying Visa’s costs as a reasonable proxy for MasterCard forms a reasonable basis for concluding that like Visa, MasterCard’s per transaction cost is between \$0.01 and \$0.02. TX 6001 at ¶¶33, 34, 36-42 (McFarlane). These costs are a fraction of the revenue generated on foreign currency transactions.
218. Based on the foregoing findings concerning the costs and revenues incurred and generated by the MasterCard foreign currency conversion system, the Court finds that the costs of operating the MasterCard foreign currency conversion system are minimal compared to the revenues generated.

III

CONCLUSIONS OF LAW

A.

Overview of Business and Professions Code §17200

219. The unfair competition law (Bus. & Prof. Code, §17200 et seq.) was “one of the so-called ‘little FTC Acts’ of the 1930’s, enacted by many states in the wake of amendments to the Federal Trade Commission Act enlarging the commission’s regulatory jurisdiction to include unfair business practices that harmed not merely the interests of business competition, but of the general public as well.” *Rubin v. Green* (1943) 4 Cal. 4th 1187, 1200. The definition of unfair competition in Section 17200 “demonstrates a clear design to protect consumers as well as competitors by its final clause, permitting inter alia, any member of the public to sue on his own behalf or on behalf of the public generally.” *Barquis v. Merchants Collection Assn.* (1972) 7 Cal. 3d 94; *Gregory v. Albertsons, Inc.* 02 C.D.O.S. 12287.
220. In *Barquis v. Merchants Collection Assn.*, supra, 7 Cal. 4th 94, 112, the court observed that the predecessor to section 17200 “was intentionally framed in its broad, sweeping language, precisely to enable judicial tribunals to deal with the innumerable ‘new schemes which the fertility of man’s invention would contrive.’ [Citation.]” “[G]iven the creative nature of the scheming mind, the Legislature evidently concluded that a less inclusive standard would not be adequate.” (*Barquis v. Merchants Collection Assn.*, supra, at p. 112.) The coverage of the statute encompasses “anything that can properly be called a business practice and that at the same time is forbidden by law.” (*Barquis*, supra, at p. 112.) It governs “anti-competitive business practices” as well as injuries to consumers, and has as a major purpose “the preservation of fair business competition.” (*Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal. 4th 163, 180.)

221. §17200 may “borrow” violations of other laws and treats these violations, when committed pursuant to business activity, as unlawful practices independently actionable under §17200 et seq. and subject to the distinct remedies provided thereunder. *Farmers Ins. Exchange v. Superior Court* (1992) 2 Cal. 4th 377.
222. Defendants’ assert that plaintiff, Adam A. Schwartz, is not competent to bring this action, citing *Kraus v. Trinity Management Services* (2000) 23 Cal. 4th 116. Defendants argue Mr. Schwartz is not a “reasonable representative” on behalf of the general public because he has never had a credit card, has no personal knowledge of the issues in this case or its subject matter, and brought this action because he expects some type of financial reward.
223. Mr. Schwartz is not required to prove that he was directly injured by the unfair practice or that the predicate law provides for a private right of action. *Saunders v. Superior Court* (1994) 27 Cal. App. 4th 832, 839. Any person may bring a claim under the UCL for his or her own interests or in the interest of the general public. No transactional nexus is required for claims brought in the interest of the general public. *Stop Youth Addiction, Inc. v. Lucky Stores, Inc.* (1998) 17 Cal. 4th 553, 561-567.
224. Mr. Schwartz is an adequate representative of the general public. In the context of a class action, “Adequacy of representation depends on whether the plaintiff’s attorney is qualified to conduct the proposed litigation and the plaintiff’s interests are not antagonistic to the interests of the class.” *McGhee v. Bank of America* (1976) 60 Cal.App.3d 442, 450. See also *Lazar v. Hertz Corp.* (1983) 143 Cal.App.3d 128, 141-142. Plaintiff has retained counsel who are qualified, experienced and generally able to conduct the proposed litigation. *Miller v. Woods* (1983) 148 Cal.App.3d 862, 874-875. Plaintiff has no interests that are antagonistic to those of the general public. *Richmond v. Dart Industries, Inc.* (1981) 29 Cal.3d 462, 470-471.

225. In construing the unfair competition law, the courts have drawn upon common law precedents in the fields of business torts (e.g. *American Philatelic Soc. v. Claibourne* (1953) 3 Cal 2d. 689, 698) as well as judicial interpretation of the closely parallel provisions of the Federal Trade Commission Act. (See *People ex rel. Mosk v. National Research Co. of Cal.* (1962) 201 Cal App. 2d. 765, 770-774) §17200 is written in the disjunctive. Thus, it establishes three varieties of unfair competition acts or practices: unlawful, unfair or fraudulent.

B.

“Unfair” Business Practices Under B&P §17200

226. Plaintiff alleges Visa and MasterCard engaged in “unfair” business practices under the UCL. The alleged unfair business practices of defendants were perpetrated in two forms: deceptive practices and unconscionable practices. The deceptive business practices of defendants include the failure to adequately disclose the existence of currency conversion fees and inserting vague and misleading language into advertisements, card solicitations, cardholder agreements and cardholder monthly statements. The alleged unconscionable business practices of defendants include charging excessive currency conversion fees that constitute gross overpricing. (SAC ¶¶40, 41, and 42.)
227. The “unfair” standard is intentionally broad, allowing courts maximum discretion to prohibit new schemes to defraud. *Motors, Inc. v. Times Mirror Co.* (1980) 102 CA3rd 735, 740. “The Unfair Business Practices Act defines ‘unfair competition’ as any ‘unlawful, unfair, or fraudulent business practice and unfair, deceptive, untrue or misleading advertising...’ (§17200.) The Legislature intended this ‘sweeping language’ to include ‘anything that can properly be called a business practice and that at the same time is forbidden by law.’ *Bank of the West v. Superior Court* (1992) 2 Cal. 4th 1254, 1266-67.

228. In *Cel Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal 4th 163, 186-187, the Court reviewed earlier attempts to define “unfair” in *State Farm and Casualty Ins. Co. v. Superior Court (Allegro)* (1996) 45 CA 4th 1093, 1104 (courts “must weigh the utility of defendants conduct against the gravity of the harm to the alleged victim”) and *People v. Casa Blanca Convalescent Homes, Inc.* (1984) 159 CA 3rd 509, 530 (“[a]n unfair business practice occurs when it offends an established public policy or when the practice is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers.”). *Cel Tech* rejected these earlier definitions as “too amorphous” and providing “too little guidance to courts and businesses.” The court went on to say that courts may not simply impose their own notions of the day as to what is fair or unfair. 20 Cal 4th at 185.
229. *Cel-Tech* holds that any finding of unfairness under the UCL must be tethered to some legislatively declared policy. Although requiring that claims be tethered to statutes, the Court also stated that UCL claims should not be constrained because “it would be impossible to draft in advance detailed plans and specifications of all acts and conduct to be prohibited, since unfair or fraudulent business practices may run the gamut of human ingenuity and chicanery.” 20 Cal. 4th at 181.
230. The primary source of legislatively declared policy is the statutes enacted by the California Legislature. The clearest application of the unfairness prong of the UCL is to address action that is prohibited by the spirit of a law, but not by the letter of the law. See, e.g. *Schall v. Hertz* (2000) 78 Cal. App. 4th 1144, 1163-1166 (UCL unfairness claim connected to legislatively declared policy of Civil Code §1936, which is predicated on the premise of full disclosure of service charges to automobile renters.)
231. A second source of legislative policy is federal statutes. *Cel-Tech* indicates that courts should consider the UCL’s “parallel” in section 5 of the Federal Trade Commission Act (15 U.S.C. §45). “In view of the similarity of language and obvious identity of purpose of the two statutes, decisions of the federal court on the subject are more than ordinarily persuasive.” *Cel-Tech*, 20 Cal. 4th at 185. See also *Lavie v. Procter &*

Gamble Co. January 17, 2003 No. A093393, slip op at 13 and 19 fn 8.

232. The test set forth in the Federal Trade Commission Act Amendments of 1994 reads as follows: “The FTC shall have no authority to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.” 15 U.S.C. §45(n).
233. To the extent that the Court relies on the Federal Trade Commission Act, 15 U.S.C. §45(n), the Court holds that Plaintiff must establish the following five elements to prove “unfairness” under the UCL in the consumer context:
- a. Defendants must have been engaged in a “business practice.”
 - b. The business practice must cause, or be likely to cause, injury to consumers.
 - c. The injury must be substantial.
 - d. The injury must not be reasonably avoidable by consumers themselves.
 - e. The injury to consumers must outweigh any countervailing benefits to consumers or to competition.
234. A third source of legislative policy is the statutory requirements that every person or entity “is bound, without contract, to abstain from injuring the person or property of another, or infringing on any of his or her rights.” Civil Code §1708. Civil Code §§1708 and 1714 both evidence legislatively declared policy and are the gateway to the body of tort law. A claim under the UCL is akin to, but broader than, a business tort. *Cel-Tech*, 20 Cal. 4th at 181 fn 9. Cases interpreting the UCL have relied on precedent related to business torts. *American Philatelic Soc. v. Clairbourne* (1953) 3 Cal.2d. 689, 698. See also *Motors Inc. v. Times Mirror Co.* (1980) 102 Cal. App. 3rd 735, 740 (analysis for determining whether a business practice is unfair is “quite similar” to the analysis used in the law of nuisance). Finally, a representative UCL claim is in the interest of the general public, whereas a contract claim is for the benefit of a private individual. Prosser, *Law of Torts* (4th ed. 1971) p. 613 (“The distinction between tort and contract is well grounded in common law, and divergent objectives

underlie the remedies created in the two areas. Whereas contract actions are created to enforce the intentions of the parties to the agreement, tort law is primarily designed to vindicate “social policy.”)

235. Reliance on the body of tort law as the basis for finding an unfair business practice risks plunging the Court into the “amorphous” definitions rejected by *Cel-Tech*. A tort analysis does, however, permit the UCL to adapt and address the unfair business practices [that] may run the gamut of human ingenuity and chicanery.” *Cel-Tech*, 20 Cal. 4th at 181. See *Rodriguez v. Bethlehem Steel Corp.* (1974) 12 Cal.3d 382, 394 (“The inherent capacity of the common law for growth and change is its most significant feature. ... It is constantly expanding and developing in keeping with advancing civilization and the new conditions and progress of society, and adapting itself to the gradual change of trade, commerce, arts, inventions, and the needs of the country.”); *American Philatelic Soc. v. Clairbourne* (1953) 3 Cal 2d. 689, 698 (“The fact that the question comes to us in an entirely new guise and that the schemer has concocted a kind of deception heretofore unheard of in legal jurisprudence, is no reason why equity is either unable or unwilling to deal with him. ... When a scheme is evolved which on its face violates the fundamental rules of honesty and fair dealing, a court of equity is not impotent to frustrate its consummation because the scheme is an original one.”)
236. Reliance on the body of tort law is not substantially different from reliance on the FTC test, as both involve weighing of the utility of the defendant’s conduct against the gravity of the harm to the alleged victim. In addition, both permit judicial reliance on a body of established law. *Cel-Tech*, 20 Cal.4th at 187 fn 12 ([The FTC test] is not unduly uncertain. A body of law interpreting section 5 already exists.”)

(a)

Unfair business practices based on deception

237. Plaintiff alleges Visa and MasterCard engaged in “deceptive” business practices under the UCL. The deceptive business practices of defendants include the design and implementation of a system that Defendants intended to result in deception.
238. Plaintiff’s claims of unfairness sounding in a lack of disclosure are tethered to several state and federal statutes, including California’s “Areias Credit Card Full Disclosure Act of 1986,” Civil Code 1748.10 et seq., and the Federal Truth in Lending Act. These statutes evidence a substantial legislative policy that consumers be informed of the costs related to the use of credit cards. The legislative concern is not just that consumers be informed of the costs related to the use of credit. The Legislative concern extends to disclosure of transaction fees that maybe imposed as part of the use of credit cards. Civil Code 1748.11(a)(1)(C); TILA.
239. The Court finds that Visa and MasterCard are engaged in a business practice that is prohibited by the policies evidenced in Civil Code 1748.10 et seq., and TILA. The business practice is the design, development and implementation of multi-currency conversion systems presently operated as part of the Visa and MasterCard credit card networks. The unfairness is that Visa and MasterCard have designed and implemented a system that was intended to, and does, deprive consumers of information concerning the cost of currency conversion contrary to the public policy of providing consumers with that information. Visa and MasterCard’s by-laws and regulations demonstrate that they have control over the contents of cardholder agreements and the disclosures that their members make to cardholders.
240. The Court finds that Visa and MasterCard are engaged in an unfair business practice based on the five elements of the FTC test.
241. The Court finds that Visa and MasterCard are engaged in a “business practice.” Visa and MasterCard are engaged in the business practice of currency conversion, including the design, development and implementation of multi-currency conversion

systems presently operated as part of the Visa and MasterCard credit card networks. *Wilson v. Stearns* (1954) 123 CA2nd 472, 479; *People v. Casa Blanca Convalescent Homes, Inc.* (1984) 159 CA3rd 509, 527. The currency conversion business practices of Visa and MasterCard include the use of a one percent currency conversion fee that was designed, developed, and implemented so that the fee would be concealed from, yet ultimately paid by, cardholders.

242. The Court finds that the business practice causes, or is likely to cause, injury to consumers and to competition. Consumers cannot make informed decisions without adequate information and the practices of Visa and MasterCard are designed to obscure that information from consumers.
243. The Court finds that the multi-currency conversion practices of Visa and MasterCard cause, or are likely to cause, substantial injury to consumers. The Court finds that consumers have suffered and will continue to suffer substantial injury because the business practices of Visa and MasterCard obscure and conceal the fact and amount of the currency conversion fee.
244. The Court finds that the multi-currency conversion practices of Visa and MasterCard cause, or are likely to cause, substantial injury to competition. The fact and amount of the currency conversion fee is market relevant information. In order for consumers to play their role in a competitive market, they must be informed of accurate price information so they may compare prices. Consumers have been denied their rightful role in the marketplace by Defendants' unfair business practices.
245. The Court finds the injury suffered by consumers is not reasonably avoidable by consumers themselves. The practices of Visa and MasterCard of embedding the currency conversion fee in the cardholder billed amount and their failure to require adequate disclosure from their member banks ensure that consumers cannot avoid the fee. If not through disclosure by Visa and MasterCard, or their member banks, how else would consumers be informed of the fee?

246. The Court finds that the injury to consumers from the lack of disclosure outweighs countervailing benefits to consumers or to competition. The Court finds little, if any, benefit to consumers by the business practice of embedding and obscuring the currency conversion fees imposed on them. Perhaps cardholder agreements and billing statements might be a bit shorter and simpler without adequate disclosure of the currency conversion fee. The Court finds that such imaginary benefits do not come close to outweighing the value and import of free, open and competitive markets.
247. The Court finds that Visa and MasterCard are engaged in a business practice that is unfair under principles of tort law.
248. The Court finds that Visa and MasterCard have a duty to consumers to disclose their currency conversion fees imposed on cardholders because Defendants intended that their currency conversion fees would be passed through their member banks and ultimately, and unwittingly, paid by cardholders. The injury suffered by cardholders (concealment of market relevant information, to wit, currency conversion fees) was highly foreseeable in light of the business practice of embedding the fee, without adequate disclosure, as part of the currency conversion rate. *Wright v. City of Los Angeles* (1990) 219 Cal. App. 3d 318, 345 (summarizing law on existence of duties under tort law).
249. The Court finds Visa and MasterCard have breached their duty to consumers of disclosure of their currency conversion fees by failing to require their member banks to make adequate disclosures in solicitations, cardholder agreements and billing statements the fact that Visa and MasterCard charge currency conversion fees which are paid by cardholders.
250. Defendants argue that there is no duty of disclosure of currency conversion fees to cardholders under the UCL absent a contract or similar transactional or fiduciary relationship. Visa and MasterCard argue that they have no duty to consumers because consumers contract with the member banks and any duty of disclosure concerning currency conversion fees rests with the member banks. *LiMandri v. Judkins* (1997)

52 Cal. App. 4th 326, 336-337 (no duty to disclose absent a contract or fiduciary relationship).

251. The Court holds that on the facts of this case a contractual or transactional relationship is not required for a finding of an “unfair” business practice based on deception in violation of Business and Professions Code §17200.
252. The UCL addresses business practices that are “likely” to deceive consumers. Therefore, a UCL claim based on deception can be meritorious even if consumers were never deceived and never entered into contracts. *Prata v. Superior Court* (2001) 91 Cal. App. 4th 1128, 1146.
253. A UCL claim is not reliant on the existence of private contracts. *Acree v. General Motors* (2001) 92 Cal. App. 4th 385, 396 (“[U]nlike [a contract claim], the question whether a particular business practice is ‘unfair’ within the meaning of section 17200 is independent of any contractual relationship between the parties.”) This is in part because the UCL is designed to protect the general public, not just those who may have entered in to certain contracts. *People v. Pacific Land Research Co.* (1977) 20 Cal.3d 10, 17 (a UCL action “is fundamentally a law enforcement action designed to protect the public and not to benefit private parties.”)
254. The UCL is designed to address business practices that run the gamut of human ingenuity. *Cel Tech*, 20 Cal. 4th at 181. Visa and MasterCard are complex entities in that they are owned by their member banks, provide network services to their member banks, and provide currency conversion as part of the network services, but have no contracts with cardholders. This creates a circular flow of responsibility where Visa and MasterCard can legitimately argue that they have no contracts with cardholders and the member banks can legitimately argue that they do not charge for currency conversion. The UCL enables a representative of the general public to address this fact specific situation and affix responsibility to protect the public.
255. The Court holds that the business practices of Visa and MasterCard were designed to deceive reasonable consumers and in fact are likely to and do deceive reasonable consumers. *Lavie v. Procter & Gamble Co.* January 17, 2003 No. A093393.

256. The Court's findings regarding Visa's and MasterCard's business practices permit the Court to conclude with confidence that reasonable consumers will be misled. *In the Matter of Novartis Corp.* (May 13, 1999, No. 9279, 1999 FTC Lexis 63 *14. Visa and MasterCard were collecting a currency conversion fee on every foreign currency transaction, but the billing statements entered into evidence contained no indication to consumers that they were being charged a fee or the amount of that fee. This total absence of information in cardholder billing statements is likely to deceive reasonable consumers. Defendants' argue that information about the fee is available from other sources, such as travel magazines, newspapers and the internet. However, Professor's Wright and Stewart agree that the place where reasonable consumers are most likely to be informed about fees and charges for the use of credit cards is the monthly billing statement. See Findings ¶¶20 and 21.
257. Assuming extrinsic evidence were required to demonstrate that Visa's and MasterCard's business practices would mislead reasonable consumers, the record contains such information. Virtually none of the witnesses (except for those directly involved in conceiving, designing and implementation of the currency conversion fees) could testify that they were aware of the currency conversion fees before it was brought to their attention as part of this lawsuit. These witnesses were sophisticated persons and included a partner at a large law firm, a Nobel Prize winner, and a professor of economics. In addition, expert testimony by Professor Wright on consumer expectations and reactions provided gross evidence that Visa's and MasterCard's business practices would mislead reasonable consumers.
258. The "reasonable consumer" analysis in this case is different from the "reasonable consumer" analysis in *Lavie v. Procter & Gamble Co.* January 17, 2003 No. A093393, *Pizza Hut, Inc. v. Papa John's Int'l, Inc.*, 227 F.3d 489, 503, and other cases cited to the Court. *Lavie* and *Pizza Hut* involved affirmative statements to consumers and surveys could be used to determine how consumers interpreted the statements. This case concerns a lack of disclosure, so surveys would be less useful in determining what consumers thought in the absence of information.

259. For all of the forgoing reasons, the Court finds that Visa and MasterCard have engaged in unfair business practices in violation of the UCL.
260. The Court's finding that the business practices of Visa and MasterCard are unfair is independent of any actions by the member banks. The member banks are not parties to this lawsuit and Visa and MasterCard cannot be held liable for the action or inaction of the member banks. (Order of November 13, 2001, denying motion for leave to file Second Amended Complaint; Order of February 20, 2002, denying motion to stay proceedings.) The Court finds the practices of Visa and MasterCard are likely to result in the deception of reasonable consumers, and contribute to the deception of reasonable consumers. The practices at issue would be unfair even if a substantial number of the member banks undertook to provide full disclosure to consumers.

(b)

Unfair business practices based upon unconscionable pricing

261. In order for the Court to make a finding that defendants Visa and MasterCard engaged in an unfair business practice premised upon unconscionable pricing, the Court must apply the analytical template for unconscionability to the facts of this case. The recent case of *Armendariz v. Foundation Health Physicare Services, Inc.* (2000) 24 Cal. 4th 83 is most helpful in charting the course for unconscionability. However, the Court notes that *Armendariz* is not a UCL case. This Court holds that any finding of unfairness under the UCL based upon "unconscionability" must follow a finding of a contractual relationship between the parties. This Court has found no authority where principles of unconscionability under the UCL have been applied outside of the context of a contract.

262. Following the analysis in *Armendariz*, unconscionability has two components: one is procedural and the other is substantive. In order for a finding of unconscionability to be made, both components must be present. However, the two components operate on a sliding scale; the greater the procedural showing, the less is required from a substantive perspective, and vice versa. *Armendariz v. Foundation Health Physicare Services, Inc.* (2000) 24 Cal. 4th 83, at 114. Procedural unconscionability is found when a contract provision is the result of “surprise” or “oppression”. Surprise is present in a contract when the supposed agreed terms are hidden in a prolix agreement drafted by the party seeking to benefit from the disputed term. “Oppression” is found when there is unequal bargaining power among the parties to the contract resulting in no real negotiation over the terms of the contract and no meaningful choice is available to the weaker party. “Substantive” unconscionability is found when a contract term is objectively excessive or unreasonable as in the case of excessive profits in relation to costs of goods or services. *Armendariz v. Foundation Health Physicare Services, Inc.* (2000) 24 Cal. 4th 83, at 114; *A & M Produce Co. v. FMC Corp.* (1982) 135 Cal. App. 3rd 473, at 489.
263. A finding of an “unfair” business practice in violation of the UCL does not require privity of contract. *Acree v. General Motors* (2001) 92 Cal. App. 4th 385). Indeed, business practices may be found unfair based upon the mere likelihood of public deception, and nothing more. *Bank of the West v. Superior Court*, (1992) 2 Cal. 4th 1254, 1267. While the analysis of “unfair” business practices based upon deception do not require a finding of privity of contract, the Court finds privity is required to support a finding of a violation of the UCL based upon unconscionability. Plaintiff argues that privity is not required as part of the unconscionability analysis under the UCL. Plaintiff points to the fact that the currency conversion fee at issue in this matter is that of Visa and MasterCard, despite not being creditors or card issuers. Plaintiff argues it is defendant’s business practice of embedding the fee in the cardholder billed amount so that the fee may be passed through to the cardholder that constitutes an unconscionable business practice in violation of the UCL. This is

particularly so in light of Visa and MasterCard’s rules and regulations which govern their members on such matters as the contents of cardholder agreements and disclosures to cardholders. TT 8185:9-8186:25. Plaintiff cites the Court to *Armedariz* at page 114 to support the argument that privity is not required under these facts. *Armedariz* does not support plaintiff’s argument on privity. There is no mention of privity, either way. Indeed, the *Armedariz* court’s analysis takes place entirely within the rubric of contract principles and under facts where privity was clearly present. At best, plaintiff seems to be arguing that there exists some sort of de facto privity. No such principle is recognized in California law and absent evidence of traditional contract privity, the Court finds there to be no violation by defendants of the UCL based upon unconscionability.

C

“Unlawful” Business Practices Under B&P §17200

264. Plaintiff alleges Visa and MasterCard engaged in “unlawful” business practices under the UCL. The UCL “borrows” violations of other laws and treats them as unlawful practices independently actionable under §17200. *Cel Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal. 4th 163, 180. Plaintiffs allege violations of three laws: Civil Code §1670.5, Civil Code §1770(a)(19), and the Federal Truth in Lending Act (“TILA”).

(a)

Violation of Civil Code § 1670.5

265. Plaintiff asserts that MasterCard and Visa have violated the UCL by engaging in an unlawful business practice in violation of Civil Code section 1670.5 by charging an exorbitant “fee.” (2AC at ¶¶46, 48)

266. Civil Code section 1670.5(a) states that if a court finds a contract or any clause of a contract “to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.” This section states that a party to a contract may raise unconscionability as a defense to the enforcement of a contract, but does not state clearly that the section can support an affirmative claim for relief. *California Grocers Ass’n v. Bank of America* (1994) 22 Cal. App. 4th 205, 213, 217-218.
267. Civil Code section 1670.5 is premised on the existence of a contract between the plaintiff and the defendant. Therefore, to prevail on his claim alleging an unlawful practice of imposing unconscionable contract terms, Plaintiff must prove the existence of contracts between Defendants and cardholders.
268. The Court finds that Visa and MasterCard are not in contract with cardholders and are therefore, as a matter of law, not in violation of Civil Code §1670.5. Plaintiff’s claim is that cardholder agreements contain unconscionable provisions and that Defendants are liable for either inserting directly or taking actions intended to result in the insertion of clauses in cardholder agreements. Plaintiff cannot prevail on the claim based on Civil Code section 1670.5 because the Court makes a factual finding that Visa and MasterCard do not have contracts with cardholders.

(b)

Violation of Civil Code §1770(a)(19)

269. Plaintiff asserts that MasterCard and Visa have violated the UCL by engaging in an unlawful business practice in violation of Civil Code section 1770(a)(19) by charging an exorbitant “fee.” (2AC at ¶¶46, 48)
270. Civil Code 1770(a)(19) states that a party can be liable if it engages in methods, acts, or practices as part of a transaction that is intended to result in or that results in the insertion of an unconscionable provision in the contract. Because the statute refers to methods, acts, or practices “intended” to have certain results, actual contracts are not

necessary and a plaintiff may sue to prevent actions intended to result in the formation of contracts. *Ting v. AT&T* (N.D.Cal. 2002) 182 F.Supp.2d 902, 922.

271. The statute is limited, however, to methods, acts, or practices undertaken by a defendant in a “transaction.” The “transaction” referenced in 1770(a) must be “the contract” referenced in section 1770(a)(19). The Legislature’s use of “the” instead of “a” in section 1770(a)(19) indicates that a specific, previously referenced, contract is at issue, and the only previously referenced contract is the “transaction.”¹¹ Visa and MasterCard’s dealings with their member banks (as authorized by their organizational by-laws, rules and regulations) are not part of the “transaction” between member banks and cardholders that lead to “the contract” between the banks and cardholders for the extension of credit. Therefore, Plaintiff cannot prevail on his claim based on Civil Code 1770(a)(19).
272. An actual or intended contract between Defendants and cardholders is a requirement for the unlawful business practice claims because contracts are required in the underlying statutes that are “borrowed” to support the UCL claims.

(c)

Violation of TILA

273. Plaintiff asserts that MasterCard and Visa have violated the UCL by allegedly engaging in an unlawful business practice by failing to disclose the currency conversion fee in applications, solicitations, and billing statements in violation of the federal Truth-in-Lending Act, 15 U.S.C. §§ 1600 *et seq.* (“TILA”), and Regulation Z, 12 C.F.R. § 226. (SAC at ¶47.)

¹¹ A contrary reading is possible, as the statute could be read to prohibit any methods, acts, or practices of the Defendants in their transactions with their member banks that are intended to result in the member banks inserting unconscionable provisions in the cardholder’s agreements. The Court finds the alternate reading of the statute is strained and not tenable.

274. The Court finds that Visa and MasterCard have no disclosure duties under TILA because neither is a creditor. TILA’s disclosure obligations applicable to open-end credit (see 12 C.F.R. §226.5 et seq.) and civil liability provision (15 U.S.C. §1640(a)) apply only to creditors, a subset of which is comprised of card issuers that extend credit. 12 C.F.R. §226.5 (requiring the “creditor” to make various disclosures); *id.* at §226.2(a)(17) (“creditor” must extend credit); *id.* at §226.2(a)(14) (credit, in turn, is defined as “the right to defer payment or debt or to incur debt and defer its payment”).
275. The Court finds that Plaintiffs have not demonstrated that Visa and MasterCard are “creditors” as defined by TILA and Regulation Z. Credit is defined as “the right to defer payment of debt or to incur debt and defer its payment.” 12 C.F.R. §226.2(a)(14). MasterCard does not have contractual relationships with cardholders and does not extend consumer credit. TT 6761:12-15, Griffith; TT 7208:8-13, Heuer; Professor Rubin acknowledged that in terms of ordinary language Visa and MasterCard “are not extending credit, it’s the issuing bank that’s extending credit.” TT 2655:8-16. Visa has no express contracts with cardholders. Cleveland, TT 1337:13-23. Allen, TT 960:17-27, 964:11-26, 966:7-19, 1057:25-28; TX 2187 at 7; Theoharis, TT 1760:3-11, 1761:9-15; Heuer, TT 7161:4-27; McCormack, TT 1908:5-13, 2052:16-2053:17, 2069:27-2070:7, 2278:22-2279:15; Rubin, TT 2655:8-16, 2781:8-19, 2812:10-2814:16, 2864:27-2865:2. See also Emery, 95 Cal. App. 4th 952, 956 (“Simply put, VISA has no contractual relationship with consumers or merchants.”)
276. The Court finds that Plaintiffs have not demonstrated that Visa and MasterCard are “card issuers” as defined by TILA and Regulation Z.

(1)

Agency

277. Plaintiff alternatively argues that if Visa and MasterCard are not creditors or card issuers, they nonetheless are the agents of the member banks with respect to credit cards. Neither TILA nor Regulation Z defines “agent.” *See* 15 U.S.C. §1602(n); 12

C.F.R. §226.2(a)(7). The Official Staff Commentary indicates that the issue turns on state or general common-law agency concepts: “An agent of a card issuer is considered a card issuer. Because agency relationships are traditionally defined by contract and by state or other applicable law, the regulation does not define agent.” 12 C.F.R. Pt. 226, Supp. I (§226.2(a)(7)).

278. Plaintiff asserts that Visa and MasterCard are agents of the member banks under theories that (1) Visa and MasterCard are direct agents of the member banks, (2) Visa and MasterCard are a joint venture of the member banks, and (3) Visa and MasterCard are in a joint venture with the member banks. Plaintiff argues that the member banks have delegated to Visa and MasterCard the processing of all international transactions, the setting of conversion rates, and the imposition and collection of the 1% currency conversion fee.
279. Visa and MasterCard argue that they are not agents of the member banks and are not in a joint venture with, or a joint venture of, the member banks. Visa and MasterCard assert they are complex organizations and the carefully designed rights and responsibilities of the Defendants and their member banks should be respected.
280. To establish a principal-agent relationship between Visa or MasterCard and a member bank, plaintiff must show that the defendant is subject to the control of the member and acts on the member’s behalf. *St. Paul Ins. Co. v. Indus. Underwriters Ins. Co.*, 214 Cal. App. 3d 117, 122 (1989). Plaintiff has not made such a showing.
281. Visa and MasterCard are each non-stock membership corporations. The certificates of incorporation and by-laws are the primary evidence of the relationship between defendants and their member banks. These documents show that the member banks own Visa and MasterCard, but do not show that they exercise day-to-day control over Visa and MasterCard’s operations.
282. Assuming the Court could ignore the corporate formalities, the evidence indicates that Visa and MasterCard do not act on behalf of their member banks and are not subject to the control of the member banks. Defendants do not have the authority to act in the place of their member banks for the purpose of affecting their legal relations with

cardholders. *Violette v. Shoup* (1993) 16 Cal. App. 4th 611, 620. The banks are responsible for their own relationships with cardholders. The banks prepare the solicitations, applications, cardholder agreements and billing statements.

283. The Court finds Visa and MasterCard are not subject to the control of their member banks. No individual member has control over what they do. With many directors on MasterCard's and each Visa board, no single director can exercise the sort of authority possessed by a principal. Plaintiff's have not demonstrated that the members have taken over the performance of MasterCard and Visa U.S.A.'s day-to-day operations. Prior decisions have reached the same conclusion. See *United States v. Visa*, 163 F. Supp. 2d at 333 ("Each association is managed by a Board of Directors (elected by its members) and by a management team. This team is responsible for day-to-day operations and has certain authority delegated by the Board."). Similarly, no single member can control MasterCard. See Finding at ¶168.
284. A chief characteristic of a principal-agent relationship "is that of representation, the authority to act for and in the place of the principal for the purpose of bringing him or her into legal relations with third parties." *Violette*, 16 Cal. App. 4th at 620 (quoting *City of Los Angeles v. Sherwood*, 85 Cal. App. 3d 347, 351 (1978)). Plaintiff's have not demonstrated that Visa or MasterCard have been invested with the legal authority to act in the place of their member banks for the purpose of affecting their legal relations with third parties.
285. Here, as in the *Emery* case, "while VISA does contract with member financial institutions, plaintiff points to no provision establishing an agency relationship." 95 Cal. App. 4th at 960. See also *Walsh v. Maryland Bank, N.A.*, 806 F. Supp. 437, 441-42 (S.D.N.Y. 1992) (no agency relationship between MasterCard and member bank).

286. Just as a corporation is not the agent of its shareholders, Visa and MasterCard are not the agents of their member banks. *Sonora Diamond Corp. v. Superior Court*, 83 Cal. App. 4th 523, 542 (2000) (an agency relationship between a parent and its subsidiary can be created only if the parent’s control over the subsidiary is over and above the normal incidents of ownership and must reflect a purposeful disregard of the subsidiary’s independent corporate existence.); Restatement (Second) of Agency §14 M (“A corporation does not become an agent of another corporation merely because a majority of its voting shares is held by the other.”). Plaintiff has not demonstrated that the member banks exercised day-to-day control over Visa’s operations or that the member banks purposefully disregarded Visa’s corporate existence.
287. The Court finds that Visa and MasterCard are not the agents of their member banks or vice versa. Thus, plaintiff may not rely on principles of agency to impose TILA disclosure obligations on Defendants.

(2)

Joint Venture

288. Plaintiff argues that Visa and MasterCard are common-law joint ventures, and suggests that Visa U.S.A. and MasterCard are therefore agents of their member banks. This argument fails for the reasons hereafter set forth.
289. Under Delaware law, to prove that Defendant’s members have formed a legal joint venture, plaintiff must show that they have agreed with each other to share: (1) a proprietary interest, (2) profits, (3) losses, and (4) joint control or a right to joint control. *Warren v. Goldinger Bros., Inc.*, 414 A.2d 507, 509 (Del. 1980).¹² California law on joint venture is not materially different from the law of Delaware in this area.

¹² Delaware law governs the question of whether Visa U.S.A. and MasterCard, Inc., are joint ventures. “In the absence of an explicitly applicable local statute, the local law of the state of incorporation has been applied almost invariably to determine issues involving matters that are peculiar to corporations.” Restatement (Second) of Conflict of Laws § 302 cmt. g (1971). Nothing in the record suggests that this is the “extremely rare situation” where California law might apply. *See id.*; *McDermott v. Bear Film Co.*, 219 Cal. App. 2d 607 (1963) (applying Oregon law); *Thatcher v. City Terrace Cultural Center*, 181 Cal. App. 2d 433 (1960) (applying New York law); *Southern Sierras Power Co. v. Railroad Comm’n*, 205 Cal. 479, 482 (1928) (no legislative power to regulate *intra vires* acts of foreign corporations).

California requires that joint venturers must agree to share (1) a joint proprietary interest, (2) profits, (3) losses, and (4) control over the venture. *Bank of California v. Connolly* (1973) 36 Cal. App. 3d. 350, 364. Plaintiff cannot satisfy the last three criteria under Delaware and California law, as other courts have previously determined with regard to Visa. See *Nabanco I*, 596 F. Supp. at 1253-54, 1263 (“While describing [Visa] as a ‘joint venture’ may be overly ambitious in the strict business organization sense, the term seems fairly applied from the anti-trust standpoint.”); *Nabanco II*, 779 F.2d at 601-02, n.16 (Visa U.S.A: “is not technically a ‘joint venture.’”). The Court finds the same analysis persuasive as to MasterCard as well.

290. The Court finds MasterCard and Visa’s banks share neither revenues nor profits with each other. *Nabanco*, 596 F. Supp. at 1253 (explaining that “profits and losses are not specifically shared among the various Visa members”). Rather, each bank retains its own profits or losses from its card program. Visa’s members compete with each other. *United States v. Visa*, 163 F. Supp. 2d at 332-33;
291. A contractual relationship that works to the mutual benefit of the parties does not necessarily constitute profit sharing; rather, each party must have an interest in the payments received by the other. *Connor v. Great Western Sav. & Loan Ass’n*. 69 Cal. 2d 850, 863 (1968)
292. Plaintiff has not demonstrated that Visa U.S.A. (and MasterCard) have an interest in the payments received by the member banks. For example, Visa charges specified fees to its members, which it collects without regard to whether they earn or lose money in their card operations. Allen, 1048:22-1049:2; Fong, 845:27-846:6, 885:2-7; 4939:16-4940:6. (MasterCard operates in a similar fashion. See TX 5520 at MCS0000370; TX 5520 at page 81; TT 7209:23-25, 7210:2-4, Heuer). This is specifically true with regard to currency conversion, where Visa collects its 1% fee from the issuer regardless of what the issuer bills to, or collects from, the cardholder. This is not profit sharing. *Howard*, 62 Cal. App. 2d at 848 (no profit sharing where one received a “stipulated rental . . . regardless of [the other party’s] profits”); *Sedia*,

201 Cal. App. 2d at 451 (fixed 1% monthly interest charge does not constitute profit sharing). Likewise, the member banks do not have any interest in the payments received by Visa U.S.A.

293. The sharing of losses is an essential characteristic of a joint venture. 9 Witkin, *Summary of California Law*, Partnership § 18 at 417; *Cislaw*, 4 Cal. App. 4th at 1297 (“[T]he essential elements of both a joint venture and [a] partnership [include] a sharing of profits as well as losses . . .”). The Court finds that Visa and MasterCard do not share in the losses of their member banks.
294. Plaintiff argues that the banks mutually benefit from their collective involvement in the Visa and MasterCard networks and would see the value of their ownership interest diminished should the networks incur losses. While this may be true, it is not relevant to the question of whether Visa and MasterCard are joint ventures. The parties to any sort of cooperative contractual arrangement may be said to benefit from it, but only some such arrangements give the parties a legal right or obligation to share in any profits or losses.
295. An “essential element of a partnership or joint venture is the right of joint participation in the management and control of the business. Absent such right, the mere fact that one party is to receive benefits in consideration of services rendered or for capital contribution does not, as a matter of law, make him a partner or joint venturer.” *Bank of Cal.*, 36 Cal. App. 3d at 364. *See also Beck v. Cagle*, 46 Cal. App. 2d 152, 161 (1941); *Stilwell*, 178 Cal. App. 2d at 618, *Howard*, 62 Cal. App. 2d at 848; *Cislaw*, 4 Cal. App. 4th at 1297-98. Visa U.S.A. and its members do not share joint control, but rather retain separate authority in their respective roles. Visa’s product is the “national payment system.” *Nabanco II*, 779 F.2d at 602 n. 17. Its members’ products are, *inter alia*, payment cards. This analysis obtains for MasterCard as well.
296. Visa’s members vote for directors, but do not have any authority to manage Visa U.S.A.’s affairs. TX 4002; *see also* TX 4004; Only thirteen of Visa U.S.A.’s many thousands of members maybe represented on its board, (TX 4002 at §§5.01, 5.02(c)),

and even the directors understand that Visa's management is responsible for day-to-day operations. *United States v. Visa*, 163 F. Supp. 2d at 332-33. Similarly, MasterCard is operated through a board of directors that meets regularly in compliance with all corporate formalities. TT 7173:13-26, 7179:4-9, Heuer. No single member controls the operation of MasterCard nor does MasterCard control the operation of its members' card businesses. TX 5393 at MCS0031085-31086, TX 5520 at page 81.

297. As with MasterCard, Visa U.S.A. has no right to "joint participation in the management and control of the [card-issuing] business" of its members. *Howard*, 62 Cal. App. 2d at 848. Members must comply with the operational standards set in the operating regulations, but these rules are expected to be self-enforcing, and Visa U.S.A. plays no part in the members' business practices. *Theoharis*, 5279:9-5273:22; The setting of these operational standards does not constitute joint control. *See Coca-Cola Bottling Co. v. Coca-Cola Co.*, 696 F. Supp. 57, 74 (D. Del. 1988) ("Although through contractual provisions the Company exercises some control over the bottlers' methods of bottling the product, this control is distinct from control over management of the bottlers' affairs.").

(3)

Alter Ego

298. The two requirements for applying the alter ego doctrine are that (1) there is such a unity of interest and ownership between the corporation and the individual or organization controlling it that their separate personalities no longer exist, and (2) failure to disregard the corporate entity would sanction a fraud or promote injustice. *Communist Party*, 25 Cal. App. At 993; *Wallace*, 752 A.2d at 1183-84.
299. Plaintiff has not satisfied either requirement. *First*, there is no evidence that the separate personalities of the member banks and the Defendants no longer exist. As noted earlier, both Visa and MasterCard observe corporate formalities. *Allen*, 1048:17-19.

300. *Second*, there is no reason to believe that a failure to disregard MasterCard and the Visa defendants' corporate forms would be inequitable. The banks are amenable to suit, and in fact are defending claims in federal court based on many of the allegations present here. To the extent that plaintiff's claims are based on the banks' failure to make additional disclosures to cardholders, plaintiff has not explained why his claims ought not simply be brought against the banks.
301. On the record developed at trial, neither the facts nor the equities justify disregarding the corporate form of the MasterCard and Visa defendants.

(4)

Estoppel

302. Plaintiff points to various instances in which Visa U.S.A. employees and attorneys have described the corporation as a "joint venture," and argues that Visa U.S.A. is estopped from taking a different position in this litigation. However, it is not unusual for a word or phrase to have one meaning as a term of art in one field and a different meaning in another field. *See Heppler v. J.M. Peters Co. Inc.*, 73 Cal. App. 4th 1265, 1284-85 (1999) (holding that the phrase "good faith" is a term of art in the context of C.C.P. §§ 877 and 877.6 and that the meaning of the term in those sections is not applicable in other contexts); *Metric Man, Inc. v. Unemployment Ins. Appeals Bd.*, 59 Cal. App. 4th 1041, 1048 n.4 (1997) (noting that trial judge used the term "illusory" in the commonly used sense of the word and not as a legal term of art); *Balmoral Hotel Tenants Ass'n v. Lee*, 226 Cal. App. 3d 686, 689-91 (1990) (noting different definitions for the phrase "actual damages" as a legal term of art and in lay usage).
303. Estoppel is inappropriate because Visa U.S.A.'s past statements are not inconsistent with its arguments here. The term "joint venture" has a specific, formal meaning under California and Delaware business-organization law and also a different, more colloquial meaning in other contexts, as in antitrust litigation. *See, for example, Nabanco I*, 596 F. Supp. at 1253-54, 1263 ("While describing [Visa] as a 'joint venture' may be overly ambitious in the strict business organization sense, the term

seems fairly applied from the anti-trust standpoint.”); *Nabanco II*, 779 F.2d at 601-02, n.16; *Mountain West*, 36 F.3d at 963 (noting that “virtually any collaborative activity among business firms may be called a joint venture”); *In re Silicone Gel Breast Implants Prod. Liab. Litig.*, 837 F. Supp. 1128, 1138-39 (N.D. Ala. 1993); *Freeman v. San Diego Ass’n of Realtors*, 77 Cal. App. 4th 171, 189, n.20 (1999) (distinguishing between “the corporate formalities” and “the economic realities” and “us[ing] the term ‘joint venture’ in its colloquial rather than legal sense because . . . it is the economic substance, not the legal formalities,” that was at issue in light of the Cartwright Act claims brought by plaintiff). There is no evidence that either Visa defendant or any person speaking on their behalf has ever described Visa as a business-organization joint venture.

D.

Equitable Considerations

304. Visa argues that it acted in good faith because it has in place Operating Regulation 3.6.G, which requires its member banks to make certain disclosures in solicitations and applications.
305. MasterCard argues, inter alia, that it acted in good faith because it recommended to its member banks in 1991 and 2000 that they make disclosures, that it provided the member banks with language that accurately described the currency conversion process (including the 1%), and recommended to the member banks that they consult with their counsel on what their disclosure obligations might be.
306. The Court has weighed these equitable considerations and finds them of little substance. Both Visa and MasterCard designed their currency conversion systems so that the currency conversion fees could be charged to consumers in such a manner that the charge would be invisible to consumers. Both Visa and MasterCard suggested that their member banks make disclosures in solicitations and applications, but the extrinsic evidence and expert testimony at trial demonstrated that those disclosures were not effective. Virtually none of the witnesses (save for those directly involved in

conceiving, designing and implementation of the currency conversion fees) at trial could testify that they were aware of the currency conversion fees before it was brought to their attention as part of this lawsuit. These witnesses were sophisticated persons and included a partner at a large law firm, a Nobel Prize winner, and a professor of economics. The Court notes the general rule that a person who assents to a contract cannot avoid its terms on the ground he failed to read it before signing it. *Randas v. YMCA of Metropolitan Los Angeles* (1993) 17 Cal. App. 4th 158, 163. This general rule does not make disclosures on the applications per se adequate, because the disclosures tended to be buried in fine print in the body of the applications. In addition, the issue in a UCL claim is whether consumers are likely to be deceived, not whether they have been deceived in fact.

307. MasterCard asserts that it relied in good faith on the advice of counsel as well as staff advice from the FRB that TILA does not require disclosure by issuers of MasterCard's currency conversion procedures. TX 6007 at pages 19:24-20:8, 195:6-9,19, 166:20-24, Norton; TX 5000 at MCS0022321 (8/91 Finance Bulletin). MasterCard notes that the advice given by the FRB staff to Mr. Fischer in the early 1990's concerning the applicability of TILA to MasterCard's currency conversion procedures was consistent with an FRB staff interpretation written and signed by Mr. Schmelzer, dated June 25, 1976, which concluded that "nothing in Regulation Z requires a creditor of an open-end credit plan to make any disclosure relative to exchange rates when identifying a purchase made in a foreign country on a periodic statement." TX 5004; TX 6501 at ¶51, Schmelzer. The Court finds this evidence to be of little ameliorative consequence. First, because wrongful intent is not an element of liability under the UCL, good faith reliance is not a valid affirmative defense to a UCL claim. *Kasky v. Nike, Inc.* (2002) 27 Cal. 4th 939. Good faith reliance, however, must be considered in weighing the equities in a UCL action. Second, the 1980 Truth in Lending Simplification Act abolished the FRB's practice of issuing staff letters and abolished the effect of all previously-written staff letters. Thus, the Schmelzer letter of June 25, 1976 is of no legal consequence and may not be relied upon by

MasterCard to show its good faith on the requirements of TILA disclosure. The Simplification Act introduced the Official Staff Commentary to Regulation Z as the only vehicle through which the FRB would interpret TILA. The Act made clear that staff letters would have no prospective legal effect. Since 1980, the FRB has not issued any Official Staff Commentary on TILA's affect on foreign currency conversion disclosure requirements. Third, the communications of MasterCard's counsel with the FRB appear to be self-serving. Mr. Fischer's letters to the FRB setting forth his analysis of these issues (TX5002, TX 5518) were never responded to, nor were they addressed in any Official Staff Commentary. Absent any citable response from the FRB on these issues, MasterCard's construct of the issue can only be considered just that, its construct.

308. Because the cardholder relationship exists between the issuer and the cardholder, MasterCard argues that it does not prescribe how its issuer members should communicate with their cardholders. TX 6506 at page 153:1-20. As the argument goes, it is up to the issuers and their legal counsel to discern whether any disclosure of currency conversion fees is required under state or federal law. While there is evidence of certain issuer banks disclosing the currency conversion fee in solicitations and cardholder agreements (and in one instance, on cardholder billing statements), nowhere in the record is there evidence of any issuing bank embracing this argument and affirmatively assuming full disclosure responsibilities for disclosure of the fees. Indeed, the only position of the issuing banks in the record at trial is that currency conversion fees are network fees of Defendants, not the issuing banks. In fact, the issuing banks position in this regard was argued before the FRB in Mr. Fischer's analysis in 1991. Thus, a vexing circumstance is revealed where neither Defendant's, nor their member banks, acknowledge any obligation to disclose the fee. This is not unlike the two outfielders circling under the same fly ball that ultimately drops between them. Unfortunately, in this game the error is not borne by the team in the field, but rather by the consumers in the stands for whom the game is played.

E.

Affirmative Defenses

(a)

Extraterritoriality and Lack of California Injury

309. The UCL is a California statute and this action is brought in the interest of the general public of the state of California. Therefore, the Court will not construe the UCL as applicable to claims of non-California residents injured by conduct occurring beyond California's borders. *Norwest Mortgage, Inc. v. Superior Court*, 72 Cal. App. 4th 214, 222.
310. Visa's principal place of business is in California, so this Court can apply the UCL to the actions of Visa that emanate from California as well as the actions of Visa that affect California consumers. *Wershba v. Apple Computer, Inc.*, 91 Cal. App. 4th 224, 243 (2001); *Norwest Mortgage, Inc. v. Superior Court*, 72 Cal. App. 4th 214, 222 (1999).
311. MasterCard's principal place of business is in New York, so this Court can apply the UCL to the actions of MasterCard that affect California consumers.
312. The extraterritorial effect of the UCL is determined by the scope of the remedy in this action. The Court is mindful of the need to fashion relief so that it does not have an improper extraterritorial effect.

(b)

Preemption Under the Foreign Coin Clause

313. Visa and MasterCard presented the affirmative defense that Plaintiff's claim asserting that the currency conversion fee is unlawful and unfair because it is unconscionable is barred by the Foreign Coin Clause of the United States Constitution. The Constitution gives Congress the exclusive power to "regulate the Value . . . of foreign Coin." U.S. Const.. Article I, Section 8, clause 5; *Legal Tender Cases*, 79 U.S. 457, 545 (1870).

Visa and MasterCard argue that the Foreign Coin Clause prohibits this Court from applying California law to limit the currency conversion fees charged to consumers. The Court should reach Constitutional issues only as a last resort. See *Arden Carmichael, Inc. v. County of Sacramento* (2000) 79 Cal. App. 4th 1070, 1077, fn 4. The Court does not need to address this Constitutional issue because Plaintiff did not prevail on the merits of his claim that the currency conversion fee is unconscionable.

(c)

Preemption Under the Commerce Clause

314. Visa and MasterCard presented the affirmative defense that all of Plaintiff's claims are barred by the Commerce Clause of the United States Constitution. The Constitution states "the Congress shall have Power . . . to regulate Commerce . . . among the several States." U.S. Const. Article I, §8, cl. 3.
315. The Court finds that Plaintiff's claim that Defendants' design and operation of a practice that is likely to, and does cause deception, is not preempted because the deception concerns a currency conversion fee. The fact that the subject matter of the deception is a fee charged for the use of a credit card out of state does not render the practice foreign commerce.
316. The Court finds that Plaintiff's claim that Defendants' design and operation of a practice that is likely to, and does, cause deception, is not preempted as the "direct regulation" of foreign commerce. "Direct regulation" occurs when a state law or court order directly affects transactions that "take place across state lines" or entirely outside of the state's borders. Such a statute or order is invalid per se, regardless of whether the state intended to inhibit interstate commerce. *Valley Bank of Nevada v. Plus System, Inc.* (9th Cir. 1990) 914 F.2d 1186.
317. Defendants argue that Plaintiff's claims are necessarily a direct regulation of foreign and interstate commerce because Defendants operate global networks and must have consistent rules that all members can follow in all locations. State courts may, however, enter orders that affect interdependent relationships constituting commercial

activity. *Valley Bank*, 914 F.2d at 1190-1191. The non-disclosure of the currency conversion fee and the ability to charge allegedly unconscionable fees is not inherently necessary to the existence of the network. The commerce clause does not prevent states from taking action that may be inconsistent with Defendants' concept of business efficiency. *Valley Bank*, 914 F.2d at 1193.

318. The Court finds that Plaintiff's claim that Defendants' design and operation of a practice that is likely to, and does, cause deception, is not preempted as the "indirect regulation" of foreign commerce. "Indirect regulation" occurs when a state law imposes an excessive burden on interstate commerce in relation to the state's legitimate interests. *BMW v. Gore*, 517 U.S. 559, 570-73 (1996); *Valley Bank*, 914 F.2d at 1193.
319. California has a legitimate state interest in protecting consumers from deceptive or misleading advertisements or contracts. The California Legislature has enacted several statutes relating to the marketing of credit cards and the disclosure of the terms of such cards, indicating a state interest. Civil Code 1747 et seq.; *Diamond Multimedia Systems, Inc. v. Superior Court* (1999) 19 Cal. 4th 1036, 1064 ("California also has a legitimate and compelling interest in preserving a business climate free of fraud and deceptive practices.") *Black v. Financial Freedom Senior Funding Corp.*, 92 Cal. App. 4th 917, 926-928 ("Laws concerning consumer protection, including laws prohibiting false advertising and unfair business practices, are included within the states' police power, and thus subject to this heightened presumption against preemption.").
320. The burden on interstate commerce is determined by the scope of the remedy in this action. The Court is mindful of the need to fashion relief so that it does not have an unconstitutional effect.

(d)

Preemption Under TILA

321. Among Defendants' objections to the Court's Proposed Statement of Decision is the argument that the Court has arrogated to itself the role of the Federal Reserve Board in contravention of long standing federal and state decisional authority. Defendants cite *Ford Motor Credit v. Milhollin* (1980), 444 U.S. 555, and *Drennan v. Security Pacific National Bank* (1981), 28 Cal. 3d 764. *Milhollin* concerned the validity of the FRB's interpretation of TILA as not requiring a statement in a loan contract that the creditor has the right to accelerate payment of the entire debt upon the buyer's default. The high court upheld the FRB's discretion in making the ruling using the following analysis:

"It is commonplace that courts will further legislative goals by filling the interstitial silences within a statute or a regulation. Because legislators cannot foresee all eventualities, judges must decide unanticipated cases by extrapolation from related statutes or administrative provisions. But legislative silence is not always the result of a lack of prescience; it may instead betoken permission or, perhaps, considered abstention from regulation. In that event, judges are not accredited to supersede Congress or the appropriate agency by embellishing upon the regulatory scheme. Accordingly, caution must temper judicial creativity in the face of regulatory silence." *Milhollin* at page 565.

The Supreme Court went on to add that deference is especially appropriate in the process of interpreting TILA noting that unless demonstrably irrational, FRB staff opinions construing TILA should be dispositive because, among other reasons, the FRB played a pivotal role in setting the statutory machinery in motion and has significant regulatory and administrative experience.

Similarly, in *Drennan* the California Supreme Court held that federal law precluded it from requiring conditional sales contracts provide a definition of the term "Rule of 78's". The Supreme Court decided that because federal regulations determined that such an explanation would be too complicated to be informative and would detract from other important disclosures mandated by law (TILA), such federal regulatory decisions preempted any state-imposed requirement that the "Rule of 78's" be defined by way of example or otherwise. Defendants argue that this Court's proposed

decision requiring them to amend their rules and regulations to mandate their member banks disclose Visa and MasterCard's currency conversion fees imposes new consumer credit disclosure requirements on Defendants thereby usurping the regulatory function of the FRB. Such a result, Defendants argue, is in derogation of the holdings in *Milhollin* and *Drennan* that "judges ought to refrain from substituting their own interstitial lawmaking for that of the Federal Reserve." *Drennan*, 28 Cal 3d. 773 n.8.

322. Having studied *Milhollin* and *Drennan*, the Court observes that in both cases the FRB had spoken directly on the issues about which those cases were concerned. By contrast, in the present case the FRB has remained silent on the issue of disclosure of currency conversion fees despite entreaties from MasterCard to address the issue by way of its official commentary. Compare, for example, *Milhollin* at page 568 and 569 where our Supreme Court referred in detail to the FRB staff treatment of the issue of disclosure of acceleration clauses citing, inter alia, 63 Federal Reserve Board, Ann. Rep. 326, 349-350, (1976); Comment, Acceleration Clause Disclosure under TILA, 77 Columbia L. Rev. 649, 662-663 (1977). The court went on to observe that administrative agencies are better suited to strike the appropriate disclosure balance by the use of the empirical process in conjunction with the agencies broad experience with credit practices. Similarly in *Drennan*, plaintiffs sought declaratory relief to require that conditional sales contracts provide a definition for the "Rule of 78's". The California Supreme Court affirmed the trial court's sustaining of defendants' demurrer citing extensively the United States Supreme Court's holding in *Milhollin*. As in *Milhollin*, the court in *Drennan* found significant involvement by the FRB on the issue before the court. The *Drennan* Court cited the FRB's unofficial letter interpretations of Regulation Z concerning the "Rule of 78's" and the FRB's conclusion that the operation of the "Rule of 78's" cannot be explained in a simple manner. The *Drennan* court relied on the FRB's conclusion that attempts to further define the "Rule of 78's" would detract from other important disclosures required by Regulation Z thus demonstrating the FRB's determination that further explanation of

the rule would mislead consumers. This express aeration of the issue by the FRB, the California Supreme Court held, precluded a state court from exercising jurisdiction to require further definition.

It is significant that the issue before the Court concerning disclosure of currency conversion fees under TILA has not been visited in any citable fashion by the FRB since the inception of defendants' currency conversion practices in the mid 1980's. The ongoing silence by the FRB in this subject area is despite direct solicitations from MasterCard's counsel in the early 1990's inviting FRB input on the issue. See TT 7095:21-7096:4; Fischer; TX 5002. The lack of any FRB expression on the topic of foreign currency conversion fees is a significant factual distinction between this case and the holdings in *Milhollin* and *Drennan*. Further, MasterCard may draw no comfort from its verbal discourse and written correspondence with the FRB on this topic. See TX 5002, 5518. This correspondence from MasterCard's counsel to counsel at the FRB summarizing MasterCard's analysis of the currency conversion issue do not shed any light on the FRB's view of currency conversion fees and any possible application of TILA. Since the Simplification Act of 1980, the only citable authority attributable to the FRB is in the Official Commentary. As noted elsewhere, the FRB has not officially addressed this issue since 1980 and any prior communications of the FRB before the adoption of the Simplification Act were rescinded by the Act.

323. In addressing the TILA preemption issue, the Court finds the analysis in *Black v. Financial Freedom Senior Funding Corp.* (2001) 92 Cal. App. 4th 917, particularly helpful. *Black* involved a lawsuit brought by elderly homeowners claiming, inter alia, defendant engaged in unfair business practices in violation of TILA by making inadequate and misleading disclosures about reverse mortgages. The trial court granted summary judgment to defendants based in part on TILA preemption arguments. The Court of Appeal reversed noting there is no express preemption, since TILA, rather than limiting the applicability of state law, emphasizes the

continued role of state law, stating that it does “not annul, alter, or affect the laws of any State relating to the disclosure of information in connection with credit transactions, except to the extent that those laws are inconsistent with the provisions of this subchapter and then only to the extent of the inconsistency.” (15 U.S.C. §1610(a)(1); 15 U.S.C. 1610(e); 12 C.F.R. §226.28(d)). The Court went on to say that implied preemption was not present because TILA only preempts “inconsistent” state laws, thus implicitly negating occupation of the field. Further, absent any direct conflict, conflict preemption is not present either. See *Black* at page 937. The *Black* Court, at pages 937 and 938, goes on to cite *Williams v. First Government Mortgage & Investors* (D.C. Cir. 1999) 176 F.3d 497 wherein the federal court explained that TILA and the District of Columbia Consumer Protection Procedures Act (CPPA) “have quite different purposes and impose quite different requirements. TILA mandates the disclosure of certain documents in lending transactions. The CPPA provides substantive protections for borrowers against unconscionable loan terms and provisions. Nothing in TILA or its legislative history suggests that Congress intended the Act’s disclosure regime to provide the maximum protection to which borrowers are entitled nationwide; states remain free to impose greater protections for borrowers.... We thus hold that TILA does not preempt the CPPA and that TILA compliance does not immunize lenders against CPPA liability.” (Id. at p. 500.) The *Black* Court thus concluded under the facts presented that TILA did not preempt the UCL (17200).

324. In navigating the waters of TILA preemption, *Milhollin* and *Drennan* require state trial courts to steer clear of subject matter where there has been express FRB treatment. However, in the absence of such direct expressions by the agency about specific subject matter, state courts must be guided by larger principles of statutory construction in order to reconcile and harmonize where possible the ambit of TILA and the myriad of state statutes that also provide consumer protection. As noted above, there are no facts in the record before this Court that the FRB has expressly addressed the issue of disclosure of currency conversion fees. And while defendants

argue matters of disclosure of fees such as currency conversion are within the ambit of TILA, the FRB has apparently elected not speak to the issue. As observed in *Black and Williams*, supra, absent direct conflict preemption by TILA, states are free to provide greater protections for consumers than that offered by TILA.

325. The failure of plaintiff to prove that Visa and MasterCard are creditors, card issuers, or agents of card issuers further militates against Defendants' TILA preemption arguments. The Court's findings that the currency conversion fees at issue herein are those of Visa and MasterCard, and not the member banks, make TILA inapplicable in this case. These facts may also speak to the FRB's reluctance in addressing this issue by way of official comment.

(e)

Separation of Powers Doctrine

326. MasterCard presents the affirmative defense that the UCL violates the separation of powers doctrine. The Court holds that the UCL does not violate the separation of powers doctrine. The UCL was enacted by the Legislature and contains a reasonable limitation on the scope of permissible claims.

(f)

Equitable Abstention

327. MasterCard presents the affirmative defense that the Court should refuse to address the business practices at issue under the doctrine of equitable abstention. *Desert Healthcare Dist. v. PacifiCare FHP, Inc.* (2001) 94 Cal. App. 4th 781, 793-796, states "Where a UCL action would drag a court of equity into an area of complex economic policy, equitable abstention is appropriate. In such cases, it is primarily a legislative and not a judicial function to determine the best economic policy." Equitable abstention is not appropriate in this case because it does not involve matters of complex economic policy. This case concerns whether a business may operate a

business practice that is designed to, and has the effect of, obscuring information that would be material to a reasonable consumer. The Court is well suited to enforce California statutes and policies that require adequate disclosures to consumers.

(g)

Limitations of Equity

328. MasterCard presents the affirmative defense that the Court should not afford equitable relief because California consumers have an adequate remedy at law. *Prudential Home Mortgage Co. v. Superior Court*, 66 Cal. App. 4th 1236, 1249-50 (UCL claim precluded by adequate remedy at law). MasterCard suggests that Plaintiff should pursue a TILA claim against “appropriate defendants.” The Court holds that whereas there may be a limitation on equitable claims against a party where a legal claim against that party will suffice, there is no limitation on equitable claims against a party just because there may be a legal claim against a third party.
329. The claim against MasterCard in this action is different from a claim under TILA that might be asserted against MasterCard’s member banks in the MDL. The UCL claim in this action concerns Visa’s and MasterCard’s practice of embedding currency conversion fees in the data files so the fee can be charged to consumers without adequate disclosure and the remedy sought is to have Visa and MasterCard require adequate disclosure and provide restitution of any fees received by Visa and MasterCard. A TILA claim against a member bank would presumably concern the adequacy of specific disclosures made to consumers and the remedy would be to improve the disclosures by the member banks and award any appropriate damages against the banks.

F.

Remedies

330. The award of relief under the §17200, whether injunctive relief or restitution, is an equitable matter addressed to the sound discretion of the court. *Cortez v. Purolater Air Filtration Products Co.*, (2000) 23 Cal. 4th 163, 180-81. Defendants suggest the equities are in their favor because when they began to develop their respective currency conversion systems they did so in good faith in an effort to bring order to an old system that was in a state of “chaos.” The defendants point out that the one percent currency conversion fee is a very favorable rate, particularly when compared to the traditional retail currency conversion market. The fact that the one percent currency conversion rate is favorable to consumers is not seriously disputed. Defendants also assert that they have suggested disclosure of their currency conversion processes be made by their issuing member banks.
331. The Court finds that the equitable considerations in favor of the defendants are not sufficient to deny plaintiff affirmative equitable relief. What weighs most strongly in the Court’s consideration of the equities in this case is the intentional concealment by Defendants of the currency conversion fee from consumers who are thus denied access to market relevant information about the full cost of foreign currency conversion. Defendants strongly contest this finding by the Court urging the Court to strike its findings of intentional concealment. The Court will put it another way, that while the concealment of currency conversion fees by Defendants was not malicious, it was also not inadvertent. In weighing the equities, it is not enough that the old system was chaotic and similarly flawed with regard to disclosure. The Court is mindful that one of the failures of the old system was the susceptibility of consumers to advantage taken by foreign acquiring banks through opportunistic use of processing delays and market fluctuations in foreign currency conversion. While the currency conversion systems developed and implemented by Defendant’s have surely conferred a benefit upon US consumers in the form of lower currency conversion costs, the embedding of a concealed fee, favorable or not, does not outweigh the harm done consumers by denying them full disclosure of market relevant information thereby inhibiting the workings of a free market.

332. Defendants assert that injunctive relief is inappropriate. It is argued the Court should defer to the FRB in these matters citing *Ford Motor Credit v. Milhollin* (1980) 444 U.S. 555 at 568 (“judges ought to refrain from substituting their own interstitial lawmaking for that of the Federal Reserve.”) The Court has visited the issue of TILA preemption elsewhere in this decision and will not repeat the points here. Defendants further contend that it is inappropriate to require that defendants become regulators of their issuers’ regulatory compliance. *Emery v. Visa Int’l Serv. Ass’n*, (2002) 95 Cal. App. 4th 952. The remedies afforded by the UCL are independent of those provided for in the underlying statutes. *Farmers Ins. Co. v. Superior Court*, (1992) 2 Cal. 4th 377, 383. Section 17203 permits courts to enjoin ongoing wrongful business conduct in whatever context such activity may occur. The Court may make such additional orders and judgments “as may be necessary” to accomplish either of two purposes: (1) “to restore to any person in interest any money or property . . . which may have been acquired by means of such unfair competition”; or (2) “to prevent the use or employment by any person of any practice which constitutes unfair competition.” Bus. & Prof. Code §17203.
333. As discussed elsewhere herein, the Court finds that MasterCard and Visa conceived, designed and implemented their present currency conversion systems with the intent that the currency conversion fees assessed by Defendants be passed directly to, and paid by, the cardholders. The Defendants designed the system knowing that the fee would be embedded in the transaction amount and would not be effectively disclosed to the cardholder. Further, it is undisputed that Defendants have extensive authority over their member banks in the management and control of the Visa and MasterCard brands as well as the function and operation of their respective network systems. This control is authorized pursuant to the by-laws, operating rules and regulations, and membership agreements of Visa and MasterCard. Defendants enforce their rules and regulations by fines, termination and other means. In light of these facts, the Court finds injunctive relief appropriate by issuing narrowly tailored injunctive orders requiring MasterCard and Visa adopt rules, regulations and bylaws that will require

adequate disclosure of currency conversion fees that are assessed by the networks and ultimately paid by the cardholder.

334. Equitable remedies, including restitution and injunction are available under the UCL if the business practice is deceptive or unfair or unlawful. *Podolosky v. First Healthcare Corp.*, (1996) 50 Cal. App. 4th 632, 647. The purpose of the UCL is to deter unlawful, deceptive and unfair business practices and to “foreclose retention by the violator of its ill-gotten gains.” *Bank of the West v. Superior Court* (1992) 2 Cal. 4th 1254, 1267. The Supreme Court in *Bank of the West*, at page 1267, went on to observe “[t]he Legislature considered this purpose so important that it authorized courts to order restitution without individualized proof of deception, reliance, and injury if necessary to prevent the use or employment of an unfair practice.”
335. Defendants argue that the Court’s order of restitution in its Proposed Statement of Decision is erroneous. They contend that such an order is in excess of the Court’s authority, is punitive, and violates equitable principles. Defendants argue that the Court is simply ordering Defendants disgorge ill-gotten gains in order to deter future unfair business practices and that such a disgorgement order exceeds the Court’s authority. Defendants argue that the goal of deterring future unfair business practices under the UCL may only be reached in the context of making victims of the unfair business practices whole by restoring to them, through an order of restitution, that which was improperly taken. Defendants posit that deterrence and prevention of ill-gotten gains are not remedies independently available *under* the UCL. Defendants cite the Court to *Korea Supply Company v. Lockheed Martin Corporation*, et. al, filed March 3, 2003, California Supreme Court No. S100136. *Korea Supply* is the California Supreme Courts most recent explication of the restitution remedy available under the UCL. The Court joins with Defendants in their analysis of *Korea Supply* up to a point.

336. In particular, the Court's reading of *Korea Supply* reveals the following parameters for relief under §17200:

- a. While the scope of conduct covered by the UCL is broad, its remedies are limited. A UCL action is equitable in nature; damages cannot be recovered;
- b. There is a difference between the remedy of "disgorgement" and the remedy of "restitution"; An order for "restitution" is defined as one compelling a UCL defendant to return money obtained through an unfair business practice to those persons in interest from whom the property was taken, that is, to persons who had an ownership interest in the property or those claiming through that person; "Disgorgement" is a broader remedy than restitution. Disgorgement may include a restitutionary element, but is not so limited. Disgorgement may compel a defendant to surrender all money obtained through an unfair business practice even though not all is to be restored to the person from whom it was taken; Disgorgement is only available as a remedy under the UCL to the extent it constitutes restitution. Restitution is the only monetary remedy expressly authorized by the UCL;
- c. A court cannot, under the equitable powers of section 17203, award whatever form of monetary relief it believes might deter unfair business practices; The UCL is not an all-purpose substitute for a tort or contract action; The overarching legislative concern of the UCL is to provide a streamlined procedure for the prevention of ongoing or threatened acts of unfair competition. Because of this objective, the remedies provided are limited and do not include claims for damages. To allow recovery of nonrestitutionary disgorgement under the UCL would enable parties to obtain tort damages while bypassing the burden of proving the elements of liability under traditional tort analysis.

337. While Defendants embrace the foregoing parameters of equitable remedies under the UCL, they divine further constraints on this Court's authority to order restitution

based on *Korea Supply* (supra), *Cortez v. Purolator Air Filtration Products co.* (2000) 23 Cal. 4th 163, and the recently decided case of *Olson v. Cohen* (March 11, 2003) 2003 Cal App LEXIS 369. Specifically, Defendants argue that the Court's order of restitution is merely an order for disgorgement without the necessary restitutionary element. Such an order is, in effect, one for damages without the attendant liability and damage proof requirements or due process protections. The result, Defendants argue, is what *Korea Supply* expressly prohibited, the turning of this UCL action into an "all purpose substitute for a tort or contract action." It follows, according to Defendant's argument, that Plaintiff must show proof that cardholders have suffered injury before they are entitled to an order for restitution under the UCL. Defendants refer to the newly decided *Olson* case as being on point. *Olson* concerned a §17200 class claim brought against a law corporation seeking disgorgement of all legal fees collected by a law firm for failure to register as a law corporation. While the Court of Appeal did note in denying relief from demurrer that plaintiff suffered no injury and was not entitled to restitution, it did so while observing that the restitution sought was in the context of rescission of the contracts for legal services. There are several key factors which distinguish *Olsen* from the case at bar. First, the Court in *Olson* appears to limit its holding to the facts before the Court. (p.1, slip opinion.) Second, the Court noted the equitable nature of a UCL claim, and the equities weighed strongly in favor of defendant. Third, there was no reliance by the plaintiff on the corporate status of defendant in seeking legal services. Fourth, there were no allegations of injury suffered by plaintiff nor any claim of legal malpractice. Lastly, the restitution claim was made in the context of rescission of a contract. While the *Olson* case concerns restitution under the UCL, its facts are appreciably different from those before this Court.

338. Defendants cite *Cortez v. Purolator Air Filtration Products Co.* (supra) and *Olson v. Cohen* (supra) in support of their assertion that Plaintiff must show proof that cardholders suffered injury before they are entitled to restitution. Defendants rely on language in *Cortez* at page 174 where the *Cortez* Court appeared to define restitution

as “the return of the excess of what the plaintiff gave over the value of what the plaintiff received.” Visa’s counsel offered by way of example that if he had purchased a Greek vase for \$10,000.00 that was falsely represented by the seller to be an antique, that in order to obtain restitution of his money from the seller he would have to return the vase. Applying this argument to the case at bar, since Visa and MasterCard cardholders have received the best currency conversion rate available in the market, they have suffered no injury and therefore are not entitled to restitution because the value of what they parted with is equal to or exceeded by the value of what they received. Further, since what defendants rendered were services (currency conversion), cardholders are unable to return what they received from Defendants in exchange for restitution of the one percent conversion fee. Defendants conclude that at best, Plaintiff is entitled to injunctive relief, and no restitution.

339. Defendant’s arguments limiting restitution to facts where the party seeking restitution suffers an injury miss the mark. The analysis must begin with the language of the §17203 providing “The court may make such orders ... as may be necessary to restore to any person in interest any money or property, real or personal, which may have been acquired by means of such unfair competition.” The Supreme Court in *Korea Supply*, at page 13 of the slip opinion, holds “Under the UCL, an individual may recover profits unfairly obtained to the extent that these profits represent monies given to the defendant or benefits in which the plaintiff has an ownership interest.” *Korea Supply* continues at page 13 and 14 “... an order for restitution is one compelling a UCL defendant to return money obtained through an unfair business practice to those persons in interest from whom the property was taken ... The object of restitution is to restore the status quo by returning to the plaintiff funds in which he or she has an ownership interest.” The language of §17203 and analysis of *Korea Supply* do not expressly constrain the UCL’s only monetary remedy of restitution to instances where there is a showing of injury by the plaintiff. Such an interpretation conflicts with the broad mandate of the UCL. Indeed, as stated elsewhere herein, the UCL provides streamlined procedures with the goal of preventing ongoing or threatened acts of

unfair competition. In furtherance of this goal, the Act imposes strict liability (no intent required), for unfair practices that may otherwise be lawful, with relaxed standing requirements permitting actions to be brought by individuals in their own interest or on behalf of the general public (§17204), and no proof of actual deception, reliance or actual injury is required (see *People v. Cappuccio* (1998) 204 Cal. App. 3d 750; *Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197). The Court finds the discussion of restitution in *Day v. ATT* (1998) 63 Cal. App. 4th 325 helpful. The Day Court at page 338 seizes upon the word “restore” in §17203, finding the legislature’s use of the word significant insofar as what is required of offending defendants when money is acquired by means of unfair competition. The Court in *Day* cites the Oxford Dictionary definition of “restore” as meaning “to give back, to make return or restitution of anything previously taken away or lost.” The *Day* Court continues at page 339 observing that in the statutory scheme of §17203 the definition of restore operates “only to return to a person those measurable amounts which are wrongfully taken by means of an unfair business practice. The intent of the section is to make whole, equitably, the victim of an unfair practice.” Nowhere in *Day* or in any of the decisional authority speaking to the UCL have courts required a showing of injury or damage among claimants seeking restitution under the UCL.

340. The Defendants’ argument that cardholders have suffered no measurable loss is also without merit. Quite simply, the loss suffered by cardholders is the one percent currency conversion fee that was taken from cardholders without their knowledge or consent through the use of an unfair business practice on the part of the Defendants. It is immaterial that the fee was small and that the overall currency conversion costs using a Visa or MasterCard was the best deal available to cardholders. To hold otherwise would permit the unjust enrichment of the Defendants. As provided in the Restatement on Restitution §1, comment e, where a benefit has been received by the defendant but plaintiff has not suffered a corresponding loss, or in some cases, any loss, but nevertheless the enrichment of the defendant would be unjust, the defendant

may be under a duty to give plaintiff the amount by which the defendant was unjustly enriched. This result is entirely consistent with the broad policy goals of the UCL and does not constitute improper disgorgement in the case at bar. The restitution contemplated herein is to cardholders who parted with the one percent currency conversion fee. There is no order of disgorgement into a liquid recovery fund for the benefit of people who never paid the fee. To embrace the defendants argument in this area would mean to winnow away the otherwise robust restitutionary authority of the courts under the UCL. It would be a simple matter for defendants to defeat claims for restitution by requiring each claimant to prove by some benefit of the bargain analysis that what they had parted with was less than what they received. There would be little to deter Defendants from engaging in unfair business practices were they permitted to defeat claims of restitution by merely showing that consumers were benefited overall by the unfair practice.

341. Defendants also urge the court to refrain from ordering restitution or injunctive relief because it will impact entities that are not before the court. Visa and MasterCard argue that the Court may not order them to change their operating regulations and require the member banks to make disclosures. The Court holds that it may order Visa and MasterCard to amend their operating regulations. First, the regulations are internal to Visa and MasterCard and completely within their control. In *United States v. Visa U.S.A., Inc.* (S.D.N.Y. 2001) 163 F. Supp. 2d 322, 408, the Court entered similar relief. Specifically, the Court stated, “the court orders that: (1) defendant Visa U.S.A., Inc. shall repeal By-law 2.10(e); (2) defendant MasterCard International Incorporated shall repeal the Competitive Programs Policy, and (3) each defendant is enjoined from enacting, maintaining, or enforcing any by-law, rule, policy or practice that prohibits its issuers from issuing general purpose or debit cards in the United States on any other general purpose network.” The orders of this Court are no greater. Second, injunctions frequently have an effect on persons who are not parties to the litigation. In *Broughton v. Cigna Healthplans*, 21 Cal. 4th 1066, 1080 fn 5, the Court stated, “It is true, of course, that many injunctions will have effects beyond the parties

themselves.” The Court notes that injunctions should be used with caution where they may substantially affect the interests of third parties. *Farley v. Cory*, 78 Cal. App. 3d 583, 590-591 (suggesting caution before issuing mandatory injunction compelling the Controller to conduct an examination and audit of banks with respect to funds subject to escheat). In this case the banks are not parties to the action, but they have already willingly subjected themselves to comprehensive regulation by Visa and MasterCard with regard to the operation and function of the credit card networks. See Findings ¶¶ 56, 64, 75, 146, and 147. Having already agreed to comprehensive regulation, the incremental impact on the banks of a change in Visa’s and MasterCard’s regulations should be minimal.

IV

CONCLUSION

The common features of all collectivist systems may be described, in a phrase ever dear to socialists of all schools, as the deliberate organization of the labors of society for a definite social goal. That our present society lacks such “conscious” direction toward a single aim, that its activities are guided by the whims and fancies of irresponsible individuals, has always been one of the main complaints of its socialist critics.

F.A. Hayek, *The Road to Serfdom* (1944)

The reference to “our present society” in the above passage is of course to the free market democracies of Western Europe and America. Hayek is barely able to contain his enthusiasm and appreciation for the free market spontaneity that is responsive to the whims and fancies of consumers of all stripes, including the sophisticated and knowledgeable as well as the uniformed and irresponsible. However, the exercise of our individual decision making freedoms as consumers becomes meaningless without full access to market relevant information. The Court concludes that the currency conversion practices of Defendant’s, as well intended and beneficial as they might be, are nonetheless injurious to consumers and their expectation of a free market with attendant full disclosure of market relevant information.

It is well understood in this case that Visa and MasterCard are credit card networks in the nature of input joint ventures. MasterCard and Visa do not compete with one another in any meaningful sense. Robert Norton, MasterCard's general counsel, noted the lack of competition between Visa and MasterCard:

“When one board acts with respect to a matter, the results of those actions are disseminated to members which are members in both organizations. As a result, each of the associations is a fishbowl and officers and board members are aware of what the other is doing much more so than in the normal corporate environment. Members which necessarily underwrite the network's costs view the associations as complimentary and are displeased when one attempts to enhance itself at the expense of the other. MasterCard and Visa simply do not compete in any conventional business sense.”

As has been noted several times herein, this case is not about conspiracy or violation of antitrust laws. The Court's decision is not based in any measure on the lack of competition between the Defendants. However, the commonality in the conceiving, designing and implementation of the respective currency conversion systems of Visa and MasterCard make appropriate the rendering of substantially similar injunctive and restitutionary relief as to both Defendants.

Having found liability and determined that some form of restitution is appropriate, it is necessary to formulate the mechanics of effecting restitution. Plaintiff asserts that the Court should enter judgment and retain jurisdiction over the mechanics of effecting restitution. MasterCard and Visa argue that the judgment should include the details of how restitution will be made so that those issues may be addressed on appeal. The Court holds that the best course of action is to determine the mechanics of restitution with reasonable certainty and include those details in the judgment. Under the facts of this complex case, the means of effecting restitution may be as significant as the order of restitution itself.

Having determined to make restitution part of the judgment, the Court must devise a workable plan for restitution. The parties have not identified which party has the burden of presenting a plan of restitution. Plaintiff has the burden of proof at trial. Because the Court has found MasterCard and Visa liable, the burden of devising a plan of restitution may shift to the defendants. *Kraus* (supra) holds that the Court may order defendants to “identify, locate, and repay to each [consumer] the full amount of funds improperly acquired.” This shifting of responsibility after a finding of liability is consistent with other areas of the law. See *Brawthen v. H & R Block, Inc.* (1975) 52 Cal. App. 3d 139, 147-148 (Once plaintiff has established the basis for a loss of anticipated profits with reasonable certainty, then any other uncertainties that arise necessarily in calculating the amount of anticipated profits should be resolved against the party causing the breach.); *Thiessen v. GE Capital Corp.* (10th Cir. 2001) 267 F.3d 1095, 1106 (In a class action with a bifurcated trial, if the plaintiff class prevails in the liability phase, then the individual plaintiffs are entitled to a presumption at the damages phase that the employer had discriminated against them.)

NOW, THEREFORE, THE COURT HEREBY ORDERS AS FOLLOWS:

Judgment shall be entered following further proceedings as set forth hereafter in favor of Plaintiff against Defendant Visa International Corporation, Visa International Service Association, Inc., and Visa U.S.A., Inc., for injunctive relief and restitution as follows:

1. Visa is located in California, so the business practices at issue emanate from California and the judgment against Visa may concern its actions that affect both California consumers and consumers located outside the state of California. “Visa consumers” are defined as those persons who at the relevant time had or have a Visa branded credit card with a billing address located in the United States.
2. Visa is hereby ordered to amend its operating rules, regulations and member agreements as necessary to require all of its U.S. members who issue Visa branded credit cards, and who bill their cardholders a currency conversion fee, to make full and effective disclosure of Visa’s currency conversion fees to Visa consumers. It is in the discretion of Visa to determine the nature and extent of amendments necessary to comply with this order. The required disclosures must be made in cardholder billing statements (also known as periodic statements), solicitations, applications and cardholder agreements. The disclosure in the billing statements must reflect the amount of the current currency conversion fee assessed by Visa and enable the cardholder to determine the amount of fees incurred during the billing cycle, either in gross or on a per transaction basis;
3. Visa must amend its operating rules, regulations and member agreements as provided above not later than 90 days after the entry of the judgment in this matter. The amendments must take effect not later than 180 days after the entry of judgment in this matter;
4. Visa must make good faith efforts to require its effected member banks to comply with the disclosure requirements provided herein;
5. Prior to filing any action for civil contempt for violation of this judgment, any plaintiff must serve a written demand on Visa seeking enforcement of the disclosure obligations of the judgment herein. Said written demand must reference the judgment herein, identify the member bank, and attach a copy of the solicitation, application or billing statement which fails to make disclosure of currency conversion fees. No action may be brought against Visa until 90 days after service of the written demand on Visa. During said 90 day period, Visa may investigate and remedy the alleged

violation, if any. The actions of Visa following service of the written notice may serve as a defense to any such action.

6. Visa is hereby ordered to restore the one percent currency conversion fee to all Visa consumers who were charged and who paid the one percent currency conversion fee to Visa from February 15, 1996 to the present. The Court orders further briefing and a further hearing on whether restitution should be effected through (1) a dispersal or credit process (Visa must identify, locate and repay or credit to each visa branded cardholder the full amount of funds improperly acquired) or (2) a claims made process (Visa branded cardholders must submit claims). A dispersal process would further the Legislative goal of providing restitution of all funds improperly obtained, but at a greater administrative burden on defendants and the third party banks. A claims made process would provide a means to explain the distinction between the claims in this action and in those in the MDL action, and for claimants to waive privacy rights and execute appropriate releases. However, placing the burden on cardholders to submit claims may reduce the amount of restitution ultimately made. See *Anthony v. General Motors Corp.* (1973) 33 Cal. App. 3d 699, 704 (class members must be informed of potential risks associated with participating in benefits of litigation). Among the factors to consider are the relative amounts of restitution to be made to individual cardholders and the cost of effecting restitution.
7. Following the indication in *Kraus* that Defendant may be required to devise a plan of restitution, Visa must file its proposal on or before April 28, 2003. Plaintiff must file his proposal and/or response on or before May 12, 2003. Visa must file its reply on or before May 19, 2003. The hearing is set for May 23, 2003, at 9:00 a.m. The briefing should address which process is better and a proposal for how each process would work. Because this concerns a collateral matter over which the Court will have continuing jurisdiction after entry of judgment, the briefing may be supported by evidence that was not admitted at trial.
8. Payment of restitution to Visa consumers may be conditioned on execution of an acknowledgement that the payment is in full settlement of claims against Visa related

to disclosure of the currency conversion fee. *Kraus*, 23 Cal. 4th at 138-139.

9. Although Visa's member banks are not parties to this action, payment of restitution to Visa consumers may be conditioned on execution of an acknowledgement that the payment is in full settlement of claims against Visa's member banks related to disclosure of the currency conversion fee. The Court may place this condition on any award of restitution to further the judicial principle that a party may not recover twice for the same injury. *Kraus*, 23 Cal. 4th at 160 (Werdegar, J., concurring and dissenting) (noting the equitable principles that empower courts to craft remedies and preclude double recovery). The potential for double recovery is implicated in this case because Visa's currency conversion fee is charged only once, but (due to the intertwined relationships between Visa and its member banks) consumers could seek recovery from either Visa or its member banks.
10. The Court will retain jurisdiction of this matter in order to assist the parties as necessary to effect restitution.
11. Plaintiff may apply for an order for reasonable attorneys fees and costs from Visa.

Judgment shall be entered following further proceedings as set forth hereafter in favor of Plaintiff against Defendant MasterCard International, Incorporated, for injunctive relief and restitution as follows:

12. The territorial limits of the UCL limit the judgment against MasterCard to its actions that have affected and will affect California consumers. "MasterCard California consumers" are defined as those persons who at the relevant time had or have a MasterCard branded credit card with a billing address located in the State of California.
13. MasterCard is hereby ordered to amend its operating rules, regulations and member agreements as necessary to require its U.S. members who issue MasterCard branded credit cards to California consumers, and who bill their California cardholders a currency conversion fee, to make full and effective disclosure of MasterCard's currency conversion fees to MasterCard California consumers. It is in the discretion

of MasterCard to determine the nature and extent of amendments necessary to comply with this order. The required disclosures must be made in cardholder billing statements (also known as periodic statements), solicitations, applications and cardholder agreements. The disclosure in the billing statements must reflect the amount of the current currency conversion fee assessed by MasterCard and enable the cardholder to determine the amount of fees incurred during the billing cycle, either in gross or on a per transaction basis;

14. MasterCard must amend its operating rules, regulations and member agreements as provided above not later than 90 days after the entry of the judgment in this matter. The amendments must take effect not later than 180 days after the entry of judgment in this matter;
15. MasterCard must make good faith efforts to require its effected member banks to comply with the disclosure requirements provided herein;
16. Prior to filing any action for civil contempt for violation of this judgment, any plaintiff must serve a written demand on MasterCard seeking enforcement of the disclosure obligations of the judgment herein. Said written demand must reference the judgment herein, identify the member bank, and attach a copy of the solicitation, application or billing statement which fails to make disclosure of currency conversion fees. No action may be brought against MasterCard until 90 days after service of the written demand on MasterCard. During said 90 day period, MasterCard may investigate and remedy the alleged violation, if any. The actions of MasterCard following service of the written notice may serve as a defense to any such action.
17. MasterCard is hereby ordered to restore the one percent currency conversion fee to all MasterCard California consumers who were charged and who paid the one percent currency conversion fee to MasterCard from February 15, 1996 to the present. The Court orders further briefing and a further hearing on whether restitution should be effected through (1) a dispersal or credit process (MasterCard must identify, locate and repay or credit to each MasterCard branded cardholder the full amount of funds improperly acquired) or (2) a claims made process (MasterCard branded cardholders

must submit claims). A dispersal process would further the Legislative goal of providing restitution of all funds improperly obtained, but at a greater administrative burden on defendants and the third party banks. A claims made process would provide a means to explain the distinction between the claims in this action and in those in the MDL action, and for claimants to waive privacy rights and execute appropriate releases. However, placing the burden on cardholders to submit claims may reduce the amount of restitution ultimately made. *See Anthony v. General Motors Corp.* (1973) 33 Cal. App. 3d 699, 704 (class members must be informed of potential risks associated with participating in benefits of litigation). Among the factors to consider are the relative amounts of restitution to be made to individual cardholders and the cost of effecting restitution.

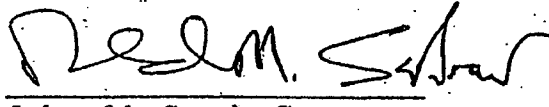
18. Following the indication in *Kraus* that Defendant may be required to devise a plan of restitution, MasterCard must file its proposals on or before April 28, 2003. Plaintiff must file his proposal and/or response on or before May 12, 2003. MasterCard must file its reply on or before May 19, 2003. The hearing is set for May 23, 2003, at 9:00 a.m. The briefing should address which process is better and a proposal for how each process would work. Because this concerns a collateral matter over which the Court will have continuing jurisdiction after entry of judgment, the briefing may be supported by evidence that was not admitted at trial.
19. Payment of restitution to MasterCard California consumers may be conditioned on execution of an acknowledgement that the payment is in full settlement of claims against MasterCard related to disclosure of the currency conversion fee. *Kraus*, 23 Cal. 4th at 138-139.
20. Although MasterCard's member banks are not parties to this action, payment of restitution to MasterCard California consumers may be conditioned on execution

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- 21. The Court will retain jurisdiction of this matter in order to assist the parties as necessary to effect restitution.
- 22. Plaintiff may apply for an order for reasonable attorneys fees and costs from MasterCard.

Dated April 7, 2003



Judge of the Superior Court