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Updating our Understanding of the Role of Lawyers: Lessons from MasterCard

Scott R. Peppet†

In the last several years, MasterCard has been involved in two of the most interesting and complex legal negotiations in recent memory. The first was the 2003 settlement of the largest antitrust class action on record, involving some of the nation’s largest domestic retailers against MasterCard, Visa, and their owner banks. The second, which is the topic of Professor Fleischer’s Case Study, was the announcement and structuring of the May 2006 MasterCard IPO. This Comment argues that it is difficult to understand the latter without delving a bit into the former. Moreover, once we examine them together, interesting lessons emerge about both legal negotiation and the role of lawyers in modern practice.

Professors Fleischer and Wright also link the IPO to MasterCard’s antitrust litigation, arguing that by becoming a single entity MasterCard has reduced some of its antitrust exposure.1 This Comment tells a slightly different, but certainly complementary, story. I argue that in addition to transforming MasterCard from a consortium of competitor member banks into a single entity, the IPO also serves to distance MasterCard from another source of its litigation headaches: Visa. By rearranging its corporate structure, MasterCard has taken one more step in what is now a clear evolution towards real independence from its historical charge card ally. This, in turn, may help MasterCard both reduce its antitrust liability and, perhaps as important, improve its leverage in ongoing negotiations with merchants, merchant banks, and regulators. In contrast to their “single entity” theory, I call this, with some tongue in cheek, the “dual entity” theory of the IPO.

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After describing the MasterCard litigation and the IPO, and after delving more into this theory of "duality"—or separation from Visa—this Comment closes by drawing lessons from MasterCard about both negotiation and the role of lawyers in modern practice. Although some of these refer primarily to the MasterCard litigation rather than to the IPO, they are too good to pass by at a symposium sponsored by a journal dedicated to negotiation.

I. **MASTERCARD'S RECENT LEGAL HISTORY**

Visa and MasterCard dominate the general-purpose credit card market, together holding roughly seventy percent market share.² (Importantly, Visa holds roughly forty-seven percent of the market, whereas MasterCard holds twenty-six. American Express accounts for twenty percent; Discover for six percent.) Historically, each was a not-for-profit membership organization with thousands of financial institutions as its members. (In 2003, MasterCard became a private corporation—MasterCard, Inc.—with the owner banks as shareholders.) Although they were theoretically competitors, Visa and Mastercard cooperated to a great extent. Member banks could, for example, belong to both associations, the two companies generally set similar card policies for both consumers and merchants, and their fees were often similar. Because of their combined market strength, merchants rarely succeeded in negotiating to change such terms or fees. As one merchant processor stated, "because Visa and MasterCard have control of the market, they can do what they want and get away with it."³

A decade ago, this era of dominance began to unravel. In 1996, Wal-Mart Stores fired the first shot by bringing suit against Visa and MasterCard, alleging that the two networks were illegally tying their credit and debit products.⁴ The theory of the case was simple: under Visa and MasterCard's historical "honor all cards" rule, if a retailer wanted to accept a MasterCard credit card, MasterCard also required that retailer to take the same brand's offline (signature-based) debit

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card. The suit alleged that MasterCard and Visa were making excessive profits on these debit transactions. Whereas credit cards carry with them an inherent credit risk of default, debit cards, which draw funds directly from the user's bank, should theoretically be less costly to operate. Plaintiffs argued that Visa and MasterCard were requiring retailers to take such debit cards at "inflated" rates through this anticompetitive tying arrangement. In addition, the plaintiffs pointed to evidence that this tying arrangement was hurting consumers—whereas similar ATM networks, which process PIN-based debit transactions, routinely charged roughly fourteen to thirty cents to route a $100 debit card transaction, MasterCard and Visa were charging roughly $1.50 for their signature debit card transactions.\(^5\)

The case was not just about tying, however, nor primarily about remedying past damages. The real objective of the merchant plaintiffs was to improve their bargaining leverage with the charge card industry going forward. The merchants knew that by gaining the right to refuse certain charge card products (such as signature debit transactions), they could later use that right as a bargaining chip for other desired concessions (e.g., agreeing to continue to accept signature debit transactions in exchange for lower interchange fees).\(^6\)

In 2000, the case became a class action, with the lead plaintiffs representing approximately five million retailers and ultimately seeking roughly $24 billion in damages. The economics of a case of this magnitude are far from simple. The legal fees and other costs in a class action involving most of the nation's major retailers, on the one hand, and practically all of the nation's leading banks, on the other, were enormous.\(^7\) In addition, conducting a cost accounting to compare credit card costs to debit card costs, though possible, is in itself a monumentally expensive discovery task.

In April 2003, MasterCard settled its case on the courthouse steps, only a week prior to the start of trial. Although it initially postured that it planned to continue litigation, Visa followed suit two days later. Under the terms of the settlement, MasterCard agreed to pay roughly $1 billion in damages to the merchant class over ten years, and Visa to pay $2 billion. In addition, retailers won the right

\(^5\) Jennifer Bayot, Lawyers Seek $609 Million Fee for Negotiating Deal for Retailers with Visa and MasterCard, N.Y. TIMES, Aug. 19, 2003, at C4. MasterCard and Visa argue that their debit transactions were not the same, because when a consumer uses a debit card she must sign for the transaction, whereas ATM transactions are PIN-based.


\(^7\) The plaintiffs' lawyers ultimately sought $609 million for their work. Bayot, supra note 5.
to accept credit cards but not debit cards, or to accept only debit cards processed using a user PIN number rather than the user's signature (for which the retailers pay far less in fees). Finally, both MasterCard and Visa agreed to lower their transaction fees for an interim period from August to December 2003, and then to set fees based on market indicators.

In December 2003, the presiding Federal District Court approved the $3 billion settlement. The settlement “untied” credit and debit, such that as of January 1, 2004, a retailer could no longer be required by MasterCard to accept debit cards in order to be permitted to accept credit cards. The theory of the settlement was that increased competition between Visa and MasterCard would lead to lower transaction fees.8

The game had changed. Almost immediately after the settlement, Wal-Mart announced that it would begin offering only PIN-based debit transactions. Other retailers similarly began experimenting with their credit and debit policies. As one commentator noted, “The primary significance of these cases is that merchants have become a much stronger bargaining partner in negotiations over the responsibilities and fees associated with credit card transactions.”9

Almost simultaneously, Visa and MasterCard were dealt another blow, this time by the Justice Department. In October 2004, the government prevailed in a 1998 suit against Visa and MasterCard that ultimately opened the door for American Express and Discover to do business with the Visa/MasterCard member banks.10 Whereas historically MasterCard had prevented member banks from also issuing American Express or Discover cards, it could no longer do so. Member banks immediately began taking advantage of their new opportunity – historical MasterCard issuers like Citi and Bank of America have begun issuing American Express, and General Electric's consumer credit branch now issues Discover.11

These monumental changes in the charge card industry placed MasterCard and Visa in a relatively new, and uncomfortably competitive, situation. The 2003 settlement showed that the charge card industry was vulnerable and could be forced to bargain. The credit giants now faced ongoing negotiations with merchants over product fees and terms. Simultaneously, the two companies faced new pressure from their member banks, as banks began experimenting with new card products after the Justice Department victory. Finally, consumers were also placing pressure on MasterCard and Visa, demanding more robust charge card products that could respond to new threats of identity theft and Internet fraud.

It was time for something completely different.

II. Lessons From MasterCard

A. The Dual Entity Theory of the IPO

Because Professor Fleischer offers a complete description of the IPO in this issue, there is no reason to delve into the details here. Suffice it to say that the May 2006 IPO was the largest of the year to that point, and raised $2.4 billion.

As Professors Fleischer and Wright have described in their commentaries, the IPO transformed MasterCard into a single entity rather than a consortium of competitors, thereby reducing some of its exposure to antitrust litigation over interchange fees. Put differently, through the IPO, MasterCard has improved its leverage vis-à-vis its ongoing antitrust litigation/negotiation with the merchant banks by converting into a single entity that is no longer under the control of the member or issuer banks. As Brian Smith, a former General Counsel of MasterCard and now a private securities lawyer, stated, "as for the defensive aspects, this is a brilliant stroke."

This analysis seems right, particularly vis-à-vis the pending litigation over interchange fees. Nevertheless, it is worth noting that almost immediately after the issuance, plaintiffs in the merchant class litigation amended their complaints to attempt to unravel the IPO as an improper attempt by MasterCard to immunize itself from

12. For example, in June 2005, various small and midsize businesses brought suit against Visa and MasterCard, and their member banks, alleging anticompetitive price fixing on transaction fees.
13. Fleischer, supra note 1, at 144-47.
14. Id., at 150; Wright, supra note 1, at 229.
liability under Section 1 of the Sherman Act. The amended complaint asserts that "the purported single entity will operate in the same way as the current member banks' cartel: the member banks will control the setting of interchange fees collectively and will maintain artificially high fees by refusing to compete on price, while preventing new entry into the relevant market."\textsuperscript{16} Plaintiffs even alleged that if it gained Section 1 immunity through the IPO, MasterCard would gain market power, making anticompetitive behavior more likely.\textsuperscript{17} Whether such claims succeed is to be determined.

In addition to this analysis of the impact of the IPO on the interchange litigation, I speculate that the IPO also improves MasterCard's negotiation position vis-à-vis the other competitive struggles in which it finds itself. Put simply, the IPO is a way for MasterCard to distance itself from, and increase competition with, its historical ally Visa.

i. Responding to the Merchants and Merchant Banks. As a first explanation of this "dual entity" theory of the IPO, consider MasterCard's ongoing negotiations with merchants and merchant banks. As MasterCard bargains with merchants -- such as Wal-Mart -- over the issues raised by the 2003 tying case and over product placement, co-branding of charge cards, etc., the new, public MasterCard may have an advantage over the historical MasterCard. First and foremost, it will be much harder for merchants to lump MasterCard and Visa together as one entity or indistinguishable class of defendants. Whereas historically the owners of the two associations were essentially identical, and even the governing bodies were intertwined, MasterCard's IPO allows it to take a significant step away from Visa (and Visa's much larger market share). It will no longer be controlled by the same member banks that control Visa, and thus, it will no longer be possible to make the argument that the two charge card giants are colluding to inflate fees, suppress competition, or engage in other questionable activities.

The historical relationship between Visa and MasterCard was a powerful weapon for both companies from their inception until the 2003 Wal-Mart settlement. At that point, however, MasterCard must have realized the liability that close association with Visa could create. Even had MasterCard wished to defend itself in court, its link

\textsuperscript{17} Id.
to Visa—and Visa’s market share—made it too vulnerable. It was forced to settle, in part, because of its close association with Visa.

The historical Visa/MasterCard relationship can only be described as overly cooperative. At least from an antitrust perspective, “the level of network competition was less than overwhelming . . . Neither Visa nor MasterCard were seen to compete aggressively against one another. Moreover, Visa and MasterCard consistently increased interchange fees (the effective charge to merchants for handling transactions) in lock-step fashion for years.”¹⁸ The rules of the two associations allowed issuer banks to control them both: “almost all of the large card issuing banks ha[d] representatives on one of the associations’ boards of directors, as well as representatives on the important committees that influence policy for both networks.”¹⁹

However, since the 2003 Wal-Mart settlement, and the Department of Justice “duality” judgment of the same year, MasterCard has been distancing itself from its ally. Indeed, prior to the judgment, MasterCard was already separating its governance from Visa, as the market demanded more competition. As David Balto has noted:

Throughout history the associations have been on the same side of the courtroom, defending nearly identical rules against an onslaught from private antitrust lawyers, government antitrust enforcers, merchants, and rival networks.

Now that the associations are taking on distinctly different membership, competitive philosophy and governance, they find themselves at odds, particularly in the debit environment.²⁰

The two giants, in short, have been pulling away from each other and becoming truly independent competitors. In my view, the IPO is one more step in that process.

¹⁸. David A. Balto, Impact of ‘Visa’ Decision, NATL. L.J., (Nov. 29, 2004). It is important to distinguish between two types of competition in the charge card industry: competition between networks for issuer banks, and competition between networks in the market for merchant acceptance and adoption. In the former, Visa and MasterCard had begun to compete, even prior to the Wal-Mart and Department of Justice suits. In 1998, for example, Visa and MasterCard entered a rate war, each increasing their interchange fees in response to raises by the other. Such increases inure to the benefit of issuer banks—and to the harm of merchants and merchant banks. Although the two networks claimed that the increases were cost driven, “the bidding war seemed to provide incentives solely for issuers.” Balto, supra note 3, at 215-16. On the merchant side, however, there was little competition between the associations.


Put differently, the MasterCard IPO in some ways marks the end of the era of cozy cooperation between MasterCard and Visa, and the beginning of a new era that will most likely be marked by Brandenburger and Nalebuff's somewhat awkward term "coopetition." Clearly the two companies will continue to cooperate in many ways – for now they remain the giants of the charge card industry. At the same time, the IPO signaled to the market, and to adversaries, that the two companies can no longer be treated as one. (One more example of this separation – and of increased pressure by merchants on the charge card giants – occurred on September 5, 2006, when MasterCard announced that it would begin posting on its website all interchange rates that apply to U.S. merchants. As of December 15, 2006, Visa had not yet followed suit.)

From a doctrinal standpoint, this separation does not guarantee MasterCard immunity – the courts have already ruled that MasterCard has market power independently of Visa. (This could, of course, change if Discover and American Express gain market share – which the Wal-Mart and Department of Justice cases make possible. Paradoxically, at the very moment that Wal-Mart succeeded in having MasterCard's market power recognized by the courts, Wal-Mart may have begun the undoing of that market power.) Even with market power, however, it will become more difficult for plaintiffs to show collusive or market distorting activities by MasterCard once the company is no longer in such close association with Visa. Put differently, the MasterCard IPO changes the symbolic landscape in the charge card industry – it was too vulnerable when it was in lock-step with Visa, and it will now be a far more difficult target.

ii. Increasing Competition with Visa for Issuer Banks. The IPO has another important effect that distances the two historical allies: it is a way for MasterCard to compete with Visa in the market for issuer banks.

As Professors Fleischer and Wright explain, the IPO provides increased immunity for MasterCard issuers – above and beyond what Visa can currently offer those issuers. Although as of this symposium there has been much discussion on Wall Street about a possible Visa

IPO, the company has not announced plans to go public. In their competition for issuer banks, therefore, the IPO may give MasterCard an advantage.

Not only will separation from Visa shield MasterCard's member banks from liability to some extent, the IPO will also permit the banks to exit the MasterCard network by cashing out. Although no banks have yet indicated a desire to do so, it is expected that some of them will. A new, public MasterCard might then set up licensing arrangements so that banks can issue cards without owning a share of the company — something that the membership structure did not allow.

This will further distinguish MasterCard from Visa by allowing for a change in ownership of MasterCard as banks exit. Given the liabilities of recent litigation and the possible desire of some banks to have increased flexibility, this will be to the competitive advantage of MasterCard vis-à-vis Visa.

This benefit for issuer banks is particularly important at this moment because the charge card giants are now severely restricted in their ability to raise interchange fees to provide more to their issuer banks. The Wal-Mart and Department of Justice litigation and the ongoing interchange fee litigation all limited the industry's freedom of movement. MasterCard and Visa are caught between a rock and a hard place — on the one side, the merchant class now has the leverage to negotiate lower fees, while on the other side, their issuer banks have also won the right to adopt competing products (e.g., Discover and American Express) and are demanding more concessions as well. The IPO creates benefits (e.g., immunity and exit) that, for now, only MasterCard can offer its issuers.

Overall, this increased competition on both sides should be good for consumers:

"Only where networks truly compete for both sides of the equation, card issuing banks and merchants, and merchants have the right and ability to use lower cost networks to route transactions to card issuers, can consumers be assured that interchange fees are not just a hidden tax from consumers to banks." 24

B. Negotiation Lessons

This Section explores some of the negotiation advice one might glean from MasterCard’s experience.

i. Don’t Play Chicken With Wal-Mart. First and foremost, the 2003 antitrust litigation illustrates a simple rule: “Don’t Play Chicken with Wal-Mart.” This advice has been painfully learned by many corporations over the last few years, but has somehow escaped the negotiation textbooks. It is clear in hindsight that Wal-Mart has had a profound impact on the charge card industry, as it has in many other areas of the global economy. Prior to the 2003 settlement, merchants had been largely unsuccessful in negotiating with Visa and MasterCard over transaction fees and terms of card use. Since the settlement, as discussed above, these negotiations have changed dramatically.

The change did not come because of Wal-Mart alone, of course. The real power came from the coalition of merchant plaintiffs that formed around Wal-Mart.25 That coalition presented a relatively unified front, and it had the resources to pursue litigation fully. It also offered a complete settlement of the various antitrust issues, so that MasterCard and Visa could avoid piecemeal and protracted bargaining with many different merchants over many years. Finally, by bringing together the entire merchant class, the coalition symbolically represented all of the charge card industry’s most important customers. As Noah Hanft, MasterCard’s General Counsel, said at the time of the 2003 settlement, “we thought it was time to make peace with the merchant community, which is an important constituency.”26

What is particularly interesting is that to respond to this new and more coherent plaintiffs’ coalition, MasterCard is choosing to abandon its own coalition with Visa. This does not follow the typical formula, where one would imagine that remaining with one’s allies – “sticking together” – would best counter the formation of a powerful merchant class. Nevertheless, it is clearly in MasterCard’s interest at this point to go its own way. The MasterCard IPO improves its leverage vis-à-vis the merchant coalition by distancing MasterCard further from Visa.

25. Balto, supra note 6. (“One of the reasons merchants have been less effective in negotiating with the card associations in the U.S. has been their inability to act collectively. By bringing this case and having a class of merchants certified, the plaintiffs overcame this problem.”).

ii. One's “BATNA” is Always Dynamic, not Static. In teaching and discussing bargaining dynamics, negotiation scholars too often oversimplify the dynamic nature of one's “best alternative to a negotiated agreement” or “BATNA.”\textsuperscript{27} We teach our students to analyze their BATNA and to consider the other side's alternative as well. This advice sometimes implies, however, that once you determine your BATNA, it remains fixed. The MasterCard IPO is powerful proof that this is error – and that by recognizing the dynamic nature of one's legal alternative can greatly increase one's bargaining power.

The real drama behind the MasterCard IPO is that it illustrates a creative reengineering of the boundaries of MasterCard's antitrust negotiations. Typically, we assume that litigating parties share their BATNA – their alternative to settlement is court adjudication of their dispute. They may argue about the value of going to court, about their differing perceptions of the strengths of their legal claims, or about the distributive issues involved in settlement, but ultimately if they can't agree, they will adjudicate. The MasterCard IPO shows that in some instances, a creative party can shatter this assumption and engineer an entirely new alternative that radically changes the negotiation dynamics. By going public, MasterCard changed the value of the litigation by making an out-of-court move in the market that radically changed the in-court dynamics.

Other examples of such game-changing moves can be found, although we seldom focus on them. One occurred in my home town of Boulder, Colorado recently, and is worth recounting here. The City of Boulder had been negotiating with Macerich Company, one of the country's largest owners of retail malls, over the redevelopment of what is now known as the “29th Street” mall. Boulder had taken a hard line bargaining position for years, as had Macerich, over the scope of the redevelopment, city zoning concessions, and related issues. It was a classic case of tough bilateral monopoly bargaining – neither side could walk away easily, and as a result, hard bargaining tactics escalated.\textsuperscript{28} Ultimately, Macerich had had enough. In a game-changing move in some ways quite similar to MasterCard's, Macerich went ten miles south, to the neighboring town of Broomfield, and bought Broomfield's newest and most profitable mall – the Flatirons Crossing. It then threatened to simply close the existing facility at 29th Street, a threat made considerably more credible by

\textsuperscript{27} FISHER, URY & PATTON, GETTING TO YES 100 (2d ed. 1991).

its ownership of the local shopping alternative. Almost immediately, Boulder changed its tune, and the negotiations were resolved.

This story, like MasterCard’s IPO, underscores the importance of understanding that one’s alternative to accepting the other side’s deal terms is sometimes to change the fundamental assumptions of the market or context by making a bold market move. It is a lesson that negotiation students should remember—and that lawyers should incorporate into their repertoire.

iii. There’s Still Something Special About the Courthouse Steps. Federal District Judge John Gleeson called the 2003 MasterCard agreement an “11th-hour settlement.”29 At the same time, their late settlement may not be the parties’ responsibility alone. Many commentators thought that several pre-trial motion rulings made on April 1, 2003 to MasterCard’s detriment led the company to settle. In particular, Judge Gleeson found that debit cards and credit cards were separate products, thereby opening the door to the tying claim. As David Balto, a former director of policy at the Federal Trade Commission, said at the time, “April 1 was it; the judge’s decision basically signaled to these parties that he believed the plaintiffs had a very strong case.”30

Despite decades of advice from negotiation and alternative dispute resolution scholars urging parties to settle earlier by reducing uncertainty, it is clear that in “bet the company” litigation in fields with inherent doctrinal uncertainty, settlement can be extremely difficult. Uncertainty is notorious in antitrust cases, where the doctrine is broad and new products—such as debit cards—are often difficult to classify. Although millions of dollars were spent on legal fees and decision analysis in the Wal-Mart litigation, it is clear that nothing quite persuades like a judge’s ruling.

iv. Where Were the Mediators, Arbitrators, and other Conflict Specialists? From a dispute resolution perspective, one of the most interesting aspects of all of this recent charge card litigation is the apparent absence of mediators or other conflict specialists. Despite the enormous litigation costs involved, and the “bet the company” nature of these suits, there is no reported evidence that the parties sought neutral assistance in any of these cases.

If this is accurate—and it is difficult to know, absent full disclosure by the parties, who aren’t talking—it seems to support Bernie

30. Id.
Mayer’s recent argument that the field of conflict resolution is in a deepening crisis of irrelevance. Mayer starts with the observation that “[c]onflict resolution professionals are not significantly involved in the major conflicts of our times,” and goes on to argue that this is largely due to the field’s over-identification with neutral roles and under-investment in other forms of more partisan or advocacy-based conflict intervention. Whether or not one accepts Mayer’s entire argument, the general observation is powerful, and disquieting.

C. Lessons About the Lawyer’s Role

In addition to these lessons for students of negotiation, the MasterCard experience illustrates a key insight of modern practice: the lawyer’s role is difficult to pigeon hole.

Drawing neat distinctions between litigators and transactional attorneys, for example, is neither accurate nor helpful. In some instances, such as the MasterCard IPO, creative lawyers blur these lines – finding transactional solutions to litigation problems, or (obviously) bringing litigation to solve transactional concerns. Lawyers can lead in corporate life, rather than simply respond – they can initiate major corporate initiatives rather than merely serve as scriveners or even transaction cost engineers. More and more, the role of prominent in house counsel is recognized as a central part of corporate leadership, and legal moves as a central part of corporate strategy.

Fleischer’s analysis of the “branding” aspects of the IPO concludes with encouraging words for attorneys – such creative lawyering opens up new possibilities for the legal profession as branding agents rather than mere scribes. I am not entirely convinced that lawyers will take on public relations and marketing concerns as primary objectives, although I agree with the general notion that these deals do have branding implications. I am certain, however, that lawyers were deeply involved in coming up with the MasterCard IPO structure as a creative means of reducing antitrust exposure, and that is enough for me. It shows that litigation lawyers can consider and use transactional lawyering to their advantage, and that they can think beyond the next motion or discovery request. Moreover, it shows that some attorneys – particularly general counsel – remain sufficiently “generalist” in orientation and training that they can switch easily from one legal modality to another.

32. Id. at 17.
III. Conclusion

This Commentary has argued that the MasterCard IPO served to partially free MasterCard of its historical affiliation with Visa, and that this will increase its bargaining power in various ongoing legal battles going forward. In addition, I have drawn negotiation lessons from the IPO and from MasterCard's antitrust litigation generally, to illustrate that good lawyering can sometimes make a real difference in the course of complex modern litigation. The MasterCard IPO is a useful case study, not only of the intricacies of antitrust liability in the charge card industry but also of the creative potential of the lawyer's role.