

Two-sided markets and the credit card industry: are antitrust authorities missing the big picture?

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I. INTRODUCTION.

The world is becoming smaller and on a daily basis all kinds of transactions involve more and more different geographic markets, different suppliers, different goods or services, and inevitably different ways to pay¹. Because of the intense mobility of consumers, card payment systems have proven particularly effective in terms of reliability, ease of use, reduced transaction costs, general availability of credit (a number of virtues sometimes termed as “transactional benefits”)². What we observe in a credit card payment transaction is that a user gives a merchant a piece of plastic with certain features, the card is slipped in a handheld device and the payment goes through. Easy and rapid standard gesture for a somehow more complex operation, which implies a bundle of invisible relationships of cooperation and coordination among the financial entities that run the payment system.

In the ordinary course of business, credit card associations use arrangements and remuneration methods (such as honor-all-cards rule, no-discrimination rule, and the interchange fee) aimed to deal with the need to attract to card’s use both cardholders and merchants. Because such rules are agreed upon at a horizontal level, coordination among banks raises straightforward concerns for competition laws.

Antitrust authorities both in the U.S. and in Europe have analyzed wide parts of such mechanisms, including the honor-all-cards rule, the no-discrimination rule, the

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¹ According to a standard definition proposed by Edward L. Rubin and Robert D. Cooter, *The payment system: Cases, materials and issues*, 2nd ed., West Publ., St. Paul, Minn., 1994, at 1, “Payment instruments are devices for transferring value from one person to another, with value being defined as the power to purchase goods and services in the market”.

² Availability of credit for general purpose cards is a positive virtue of such payment system: see Rubin and Cooter, *supra note 1*, at 713. A comparison among different electronic payment systems is provided by Hsiao-Cheng You, Kuo-Hua His, Pei-Jen Kuo, *Electronic payment systems: an analysis and comparison of types*, 24 *Technology in Society* 331 (2002). One of the most comprehensive sources on the credit card industry is David S. Evans and Richard Schmalensee, *Paying with Plastic*, MIT Press, Cambridge, 2005. For a more disenchanted reading of the virtues of credit cards, see Ronald J. Mann, *Charging Ahead. The growth and regulation of payment card markets*, Cambridge University Press, 2006. Notably, in the U.S. the Congress, in order to cope with serious consumers’ overuse problems with credit cards passed a federal law, the Credit Card Accountability Responsibility and Disclosure Act (CARD Act) in 2009.

price structures such as the interchange fee, and the rules governing access to payment schemes by banks and other financial entities³. Sometimes authorities privileged implicitly a ‘discrete’ approach in the analysis and did not consider the overall functioning of the industry in deciding the compatibility of its peculiarities with competition rules.

Now the regulatory framework for the card industry, in Europe and abroad, is becoming richer. In Europe, there are at least two initiatives, at two different levels, that concur to define the contours of this new framework, together with principles and rules framed by competition authorities.

The European Union passed Directive 2007/64/EC at the end of 2007 (the so called Payment Services Directive, hereinafter referred to also as the “PSD”) with the purpose of harmonizing the conditions for the creation of an internal market for payments, the Single European Payment Area (SEPA)⁴. The scope of the PSD includes all payment systems in Europe and the PSD has the ambitious goal to level the playing field for all banks and financial institutions willing to set a EU-wide payment system. The rules laid down by the PSD also concern the credit cards industry and to some extent the European Union was able to transfer in the Directive some of the tenets that inspired the Commission’s enforcement strategy towards card associations.

The starting point of the Commission in working out the new regulatory framework was the acknowledgment of an insufficient level of inter-system competition in Europe, due to a lack of transnational initiatives⁵. The absence of a harmonized set of operational rules, as well as of provisions ensuring an adequate degree of protection for users, was credited as being the main reason for the insufficient number of private initiatives in the European payment industry. The new regulatory framework should be conducive to a more competitive market.

A second remarkable source of regulation is coming from the bodies of provisions set by the European Payment Council (hereinafter, the “EPC”). The EPC is a private body formed by representatives of the European banking industry. Its main task has been the development of payment schemes and frameworks necessary to realize the Single European Payment Area (that is to say, the internal market for payments). In a collaborative and spontaneous setting, the EPC is mainly responsible for the adoption and the implementation of those fundamental rules and standards concerning the

³ For an account of the antitrust treatment that credit cards receive in several countries see, further to the contributions quoted in other parts of this manuscript, Avril McKean Dieser, *Antitrust Implications of the Credit Card Interchange Fee and an International Survey*, 17 *Loyola Consumer Law Review* 451, 471 (2005).

⁴ Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC, in *Official Journal* December 5, 2007, L 319. For a comment, see Ruth Wandhöfer, *The Payment Services Directive – support or challenge for SEPA?*, in *Revue Européenne de Droit Bancaire & Financier*, 2009, 16. The rationale behind the regulation purposes of the European Union in the card industry is explained by A. Heimler, Sean F. Ennis, *Competition and Efficiency in Payment Cards: Which Options for SEPA?*, 31 *World Competition* 19 (2008). For a comprehensive reading of the entire evolution of payment systems in Europe see Ruth Wandhöfer, *EU Payments Integration: The Tale of SEPA, PSD and Other Milestones Along the Road*, New York, Palgrave Macmillan, 2010.

⁵ Importantly, Directive 2007/64 opens up the market for payments to institutions that are not banks; see Heimler and Ennis, *supra* note 4, at 32.

technical functioning of a payment system⁶. The EPC works on all the payment systems (credit transfer, direct debit, cards, mobile and cash payments) and has also adopted the so called SEPA Cards Framework (SCF), as a policy document providing rules that operators must comply with in order to have a SEPA-compliant card circuit⁷.

Thus, the new regulatory framework the European Commission has been advocating and implementing is not made just by the detailed provisions of the PSD that Member States were supposed to transpose within November 1st, 2009⁸; yet, it includes a rather complex web of sources and, among those, the case law developed so far, as well as those expressions of self-regulation (very common in the card industry) such as the rules laid down by the EPC. Quite remarkably, the understanding of the evolving regulatory framework of the card industry can only be complete when the experience of the United States is duly considered; on the other side of the Ocean courts have dealt with the same issues now emerging in Europe and have provided legal solutions for an industry that is as pervasive as the use of credit cards may be. There are initial elements to say that legislators, regulatory agencies and courts in Europe and in the United States experiment converging approaches overtime, so transnational solutions are necessarily part of the evolving regulatory framework.

II. CURRENT PROBLEMS WITH ANTITRUST ANALYSIS IN THE CREDIT CARD INDUSTRY.

Different business models currently in use in the card industry have increasingly raised antitrust concerns⁹. Three-party systems and four-party systems compete each others to sign as many users (cardholders and merchants) as they can. For a system to work there needs to be a coordination among its members. As they are competitors, their agreements trigger justified antitrust suspects¹⁰. As far as four-party systems are specifically concerned, two aspects have been scrutinized so far by national authorities in several counties¹¹; first, the aspect related to ‘access’ problem; second, the aspect related to pricing.

⁶ The EPC is the real forum for discussion within the banking industry in Europe and the industry body that is part of the process towards the creation of the SEPA, whose origins can be traced back to the Lisbon Agenda in 2000.

⁷ See European Payment Council, *SEPA Card Framework*, version 2.1, December 18, 2009, available at <http://www.europeanpaymentscouncil.eu/knowledge_bank_detail.cfm?documents_id=330> (last visit October 21, 2010). The SEPA Card Framework concerns card-issuing banks, bank servicing card-accepting merchants and other service providers that can be involved in processing a transaction.

⁸ As of this writing the PSD has been transposed in all Member States.

⁹ For a historical excursus on the industry of credit cards and account of business models see Evans and Schmalensee, *supra* note 2, at 65. For a more detailed description of the business modes see, *infra*, paragraph III.

¹⁰ Evans and Schmalensee, *supra* note 2, at 268.

¹¹ On 29 March 2006, the Italian Antitrust Authority (IAA) opened an investigation against the Italian Bank Association (ABI) and CO.GE.BAN., a major joint venture among Italian banks for the management of BANCOMAT trademark. BANCOMAT is the most popular ATM network in Italy. See IAA I661 (*Accordi interbancari – “ABI-COGEBAN”*), in *Bollettino* 12/2006. The case was closed later the same year, after the IAA accepted a proposed change in the rules of the agreement by the parties. The card payment sector, nonetheless, is constantly under scrutiny in Italy since 2003. See, e.g., IAA decision N. 47 on August 4, 2003, *Servizi interbancari*, in *Bollettino* 20/2003 and, subsequently, decision N. 13434 on July 28, 2004, *Cartasi – American Express*, in *Bollettino* 31/2004.

The access problem refers to the card-issuing side and to the conditions under which entrants can become part of an existing card association. The pricing problem concerns the merchant-servicing side and the way the service is remunerated. Both problems might be regarded under the same light, when assessing the ability of card associations to raise prices while preventing others to enter the market.

As to the access problem, exclusionary rules and conducts by card associations have been in the past, and currently are, analyzed as potentially restrictive for competitors (not necessarily banks) willing to join the association while running another proprietary card program (a situation often referred to as ‘duality’). The access problem has been dealt with by courts in U.S. and by antitrust authorities in Europe and it appears that a general trend is emerging that disfavors provisions preventing duality¹². Importantly, the European legislator took express position in the Directive 2007/64/EC that prevents payment systems to impose on payment service providers and users “any restrictive rule of effective participation on other payment systems”¹³.

The card industry also raises the pricing problem, that is to say the way issuers receive a remuneration for making the card available to cardholders and for buying the ‘paper’ (in technical parlance¹⁴) processed by the acquiring banks. Commonly, the issuer charges cardholders with an annual membership fee. Main returns for issuers come from small fractions of the amount processed for each transaction (the so called

¹² See *United States v. VISA U.S.A.*, 163 F. Supp. 2d 322 (S.D.N.Y. 2001), *affirmed*, 344 F.3d 229 (2d Cir. 2003), *certiorari denied*, 125 S. Ct. 45. In *SCFC ILC, Inc. v. Visa USA, Inc.*, 819 F. Supp. 956 (D. Utah 1993), *affirmed in part, reversed in part*, 36 F.3d 958 (10th Cir. 1994), *certiorari denied*, 515 U.S. 1152, the Court of Appeals for the Tenth Circuit recognized that an exclusionary conduct by Visa against the access to the system by a subsidiary of Dean Witter (owner at the same time of a proprietary card scheme) was unlawful. Assessed under the rule of reason, the rule of exclusivity is unnecessary to prevent that allowing member banks to issue cards of rival networks would endanger the cohesion of the system. Dean Witter was willing to launch a Visa card. Dennis W. Carlton and Alan S. Frankel, *Antitrust and Payment Technologies*, in *Federal Reserve Bank of St. Louis Review*, 1995, 41, 46, claim that if Dean Witter had the chance to issue no-fee cards, customers would have been better off. For a discussion on standards for access David A. Balto, *Access Demands to Payment Systems Joint Ventures*, 18 *Harvard Journal of Law and Public Policy* 623 (1995). U.S. courts have been discussing the exclusivity rule since 1970s. In *Worthen Bank & Trust Co. v. National BankAmericard Inc.*, 345 F.Supp. 1309 (E.D.Ark. 1972), *reversed*, 485 F.2d 119, *certiorari denied* 415 U.S. 918, 94 S.Ct. 1417, 39 L.Ed.2d 473, a District Court in Kansas held that the the exclusivity rule was a *per se* violation. On appeals, the decision was reversed and the rule of reason declared applicable. The Supreme Court of the United States denied certiorari. Evans and Schmalensee, *supra* note 2, at 284, oppose the (possibility of) duality on the ground it is potentially disruptive for co-operative systems and eventually harmful for inter-system competition.

¹³ See art. 28, paragraph 1, of Directive 2007/64/EC. The parallel case on access in Europe is CEC Comp/D1/37.860 – *Morgan Stanley Dean Witter/Visa*. The EU Commission issued a Statement of Objections, concerning the membership rules of Visa International, after Morgan Stanley/Dean Witter – running the proprietary Discover card and program – applied to Visa network and the application had been rejected. Eventually the Commission found Visa in violation of art. 81 (now 101 of the Treaty on the Functioning of the European Union) denying Morgan Stanley Dean Witter access to Visa Europe. See decision on October 3rd, 2007, OJ C183 of August 5th, 2009, at 6. This case confirms that in the new regulatory framework both the PSD and the case law concur and the policies show a good level of consistency. As far as other experiences are concerned, it is not yet clear if a restriction in the use of the exclusivity rule produced appreciable positive effects. At least in the U.S. the number of cards increased almost up to the maximum bearable extent. Doubts are expressed by Robert S. Pindyck, *Governance, issuance restrictions, and competition in card networks*, NBER Working Paper Series N. 13218 (July 2007).

¹⁴ The term paper derives from the transaction in checks that historically has been always processed with paper instruments. For a short account of the payment industry cf. William F. Baxter, *Bank Interchange of Transactional Paper: Legal Perspectives*, 26 *Journal of Law and Economics* 541 (1983).

interchange fee, IF, also as “multilateral”, MIF) which is usually agreed upon at system level as a service fee for the issuer. The pricing structure is relatively easy in a three-party system, where the same entity issues cards and signs merchants (clearing internally the amounts processed). In a four-party system, the pricing strategy is more complex and it is aimed at coordinating issuers and acquirers; the same price or remuneration schemes need necessarily to be amenable by *both* categories of clients—cardholders and acquired merchants. According to modern economic theories, the whole architecture proves particularly complex and its rules are aimed at keeping the association among issuers and acquirers alive and running. Nevertheless, because members of the associations (normally banks) operate at the same level of the market their agreements amount to a horizontal coordination among competitors and demand antitrust analysis, typically as price fixing arrangements¹⁵.

The great deal of literature and courts’ opinions that so far have dealt with competition in the market for card payments have maintained what I will refer to as a ‘discrete’ approach. In many notable examples, commentators, judges and antitrust agencies have sometime either concentrated on the interchange fee alone or on some operational rules of cards associations and their effects on competition. Antitrust authorities mainly in Europe have cleared associations’ rules assuming such perspective and in some instances courts granted rule of reason standard to inter-banks arrangements to run a payment scheme.

In Europe, the EU Commission (as antitrust enforcement agency) has initially followed (deliberately) the discrete approach issuing two different (and apparently unrelated) decisions on the Visa’s payment scheme, including the IF¹⁶. These decisions state the conclusion that, although restrictive in principle, certain clauses used by card associations have off-setting pro-competitive effects and can be exempted under EU antitrust laws. Under a different paradigm of analysis, in a more recent case the Commission held more sharply that the interchange fee is an agreement on prices that restricts competition and could be replaced by less restrictive provisions¹⁷.

¹⁵ A rich stream of articles and comments has dealt with the pricing problem in the card industry and with the regulatory approach that some financial authorities have taken. Among the most recent works see Timothy J. Muris, *Payment Card Regulation and the (Mis)Application of the Economics of Two-Sided Markets*, 2005 Columbia Business Law Review 515 (2005); Richard A. Epstein, *The Regulation of the Interchange Fees: Australian Fine-Tuning Gone Awry*, 2005 Columbia Business Law Review 551 (2005); Carolyn Carter, Elizabeth Rennart, Margot Saunders, Chi Chi Wu, *The Credit Card Market and Regulation: In Need of Repair*, 10 N.C. Banking Inst. 23 (2006).

¹⁶ Litigation started from a complaint lodged in 1997 by Eurocommerce against Visa rules. Such rules had been notified in 1977 by Ibanco (the name of Visa International at the time) under EC Regulation 17/62. The Commission accorded individual exemption. The comfort letter had been withdrawn once the investigation started. Among other issues, Eurocommerce raised the problem with the interchange fee. For reasons that are not clear from official documents, the Commission decided to answer the questions with two separate decisions. In 2001, the exemption was granted for no-discrimination rule (NDR) and for the honor-all-cards (HAC) rule, together with the so called ‘no issuing before acquiring’ rule (which will be not discussed in this article). See CEC Comp/D1/29.373 – *Visa International* (O.J. L 293 10 November 2001); I will refer to this decision as *Visa I*. For sake of completeness, against the ‘no issuing before acquiring’ rule, First Data filed a petition before the Tribunal of First Instance against the Commission decision (Case T-28/02). The Commission decision on the interchange fee was adopted in 2002 (2002/914/EC, O.J. L 318 22 November 2002); the exemption for the IF was set to expire at the end of 2007 (the Commission refers to this decision as *Visa II*; to avoid confusion, I will use the short formula *MIF*).

¹⁷ See EU Commission, decision on December 19, 2007, *Europay (Eurocard-MasterCard)* (O.J. C 264 6 November 2009, at 8; summary of an otherwise 241-page long decision). Hereinafter I will refer to

Interestingly from a comparative standpoint, at about the same time some U.S. courts revealed scepticism and became more sophisticated in assessing the whole industry, after an initial, more lenient treatment¹⁸. Controversial cases, such as the *Wal-Mart* litigation¹⁹, were settled before the court arrived to deliver an opinion on the merits; nevertheless, inputs have been provided that current permissive views could change in the future. Sure enough, after an initial period of inconsistent decisions, final results of antitrust analyses reached in the U.S. and in Europe (including U.K.²⁰) tend to converge. Antitrust authorities are becoming more sophisticated about economic analysis and sometimes they find arguments by the investigated parties unconvincing.

As a matter of fact, divergences in antitrust treatment for card associations require highest care, especially when considering a number of factors. First of all, in a global economy with expanded commercial opportunities card associations at the stage of their formation need reliable decisions by competition authorities, in order for banks and financial intermediaries to have proper incentives to invest in larger trans-national payment networks to the benefit of users. Fragmentation in competition policy and enforcement can result in a dramatic rise of transaction and administrative costs²¹.

the decision as *MasterCard*. For the reasons spelt out in the text, the decision is important in several respects; it ends (at least temporarily) a series of cases concerning the multilateral interchange fee that involved Visa (COMP 34.579 – *Mastercard*; COMP 36.518 – *Eurocommerce*; COMP 38.580 – *Commercial Cards*). Importantly, on May 25, 2006, MasterCard went public with an initial public offering. Rumors were circulated that the transformation of MasterCard Incorporated and its access to the stock exchange were necessary to deal with the need to collect the money for the settlement with antitrust authorities.

The last decision on the interchange fee relates to a case (COMP 39.398 – *Visa MIF*) closed with a Commission’s decision to accept the commitment by Visa Europe Limited, after the initial statement of objection issues by the Commission in 2009 for alleged violation of art. 101. Commission’s concern was that the agreement on the interchange fee would restrict competition by object and by effect. Almost immediately Visa and the other defendants (Visa Inc. and Visa International Services Association) proposed a commitment to cut the interchange fee. The proposal has been accepted on December 8, 2010 (O.J. C 79 12 March 2011, at 8).

¹⁸ *National Bankard Corp. (NaBanco) v. VISA U.S.A., Inc.*, 596 F. Supp. 1231 (S.D. Fla 1984), affirmed 779 F.2d 592 (11th Circ. 1986), certiorari denied, 479 U.S. 923 (1986).

¹⁹ *Wal-Mart et al. v. VISA U.S.A., In re Visa Check/Mastermoney Antitrust Litigation*, 280 F.3d 124 (2nd Cir. 2001); *Id.*, 2003 WL 1712568 (E.D.N.Y. Apr. 1, 2003).

²⁰ The *MasterCard* case in U.K. started in year 2000 after Mastercard had notified to the Office of Fair Trading (OFT) its domestic rules (Memorandum and Articles of Incorporation). On 25 September 2001, the OFT notified a statement of objection (at that time called Rule 14 notice, according to the UK Competition Act of 1998). The individual exemption expired with the entry into force of EC Regulation 1/2003. On 11 February 2003 and 10 November 2004, after changes in Visa rules, the OFT issued two further statements of objections. On 6 September 2005, a final decision was adopted declaring restrictive the multilateral interchange fee (MIF) as in force between 1 March 2000 and 18 November 2004. On this latter date, Visa adopted a new system to determine the MIF. The whole case has not come to an end, since the OFT declared that even the new Mastercard rules appear to be restrictive and investigations continue. The background of the U.K. antitrust enforcement can be easily found in Don Cruickshank, *Competition in UK Banking. A Report to the Chancellor of the Exchequer*, London, Banking Review, March, 2000 (also known and hereinafter referred to as the “Cruickshank Report”). Further to the Cruickshank Report there have been a number of initiatives headed by the OFT. See for instance Office of Fair Trading, *Second annual progress report of the Payment Systems Task Force*, May 2006.

²¹ This point is made clear by the Communication from the Commission to the Council and the European Parliament concerning a New Legal Framework for Payments in the Internal Market, COM(2003) 718 final, 2 December 2003, where the EU Commission highlighted the opportunity of a harmonized European legal framework to improve cross-border payment system. It followed a Proposal for a Directive of the European Parliament and of the Council on payment services in the internal market

Second, although clauses and schemes used by card associations are the same in US and EU (representing a straightforward example of *lex mercatoria*), they initially receive partially different consideration and different treatment; as the analysis becomes more sophisticated, solutions tend to converge²². More specifically, it is the EU Commission, as European antitrust authority, that progressively took into account combined effects of arrangements in use in the card industry.

Third, some of the EU decisions were rendered under the old framework of European antitrust enforcement, when the Commission was the only authority empowered by art. 101.3 of the Treaty on the Functioning of the European Union (TFEU) to clear *ex ante* horizontal agreements among competitors. The situation can be even more troublesome nowadays, under the modern framework of decentralized EU antitrust enforcement introduced by Regulation (EC) No. 1/2003.

In EU competition law, horizontal agreements among competitors are dealt with under art. 101 TFEU²³. The rule requires a two-step analysis. First, it has to be determined if an agreement, a decision of association of undertakings, or concerted practices restrict or distort competition within the relevant market. If an agreement is restrictive, then it can be exempted from antitrust, as long as it has pro-competitive effects and it meets the conditions set forth by art. 101.1. In particular, in order for the agreement to be exempted it has to contribute to improving the production or distribution of goods or to promote technical or economic progress, while allowing consumers a fair share of the resulting benefit. Before Regulation (EC) No. 1/2003 of 16 December 2002 (implementing the so called modernization package), the exemption was granted by the EU Commission at European market level upon formal notification of the agreement by interested participating undertakings. The entry into force of Regulation 1/2003 reshaped the system thoroughly. Article 1 of the Regulation states that agreements, decisions and concerted practices caught under art. 101.1 which satisfy the conditions of art. 101.3 are not prohibited, no prior decision to that effect being required. At any time after the formation of the agreement, the EU Commission or national authorities can object the agreement on the ground it is unbearably restrictive and they can require the infringement to be brought to an end even if this would result in a complete reshape of the inter-firm arrangement.

Under such new setting, players on the market bear the burden to assess *ex ante* whether an agreement meets the requirements of art. 101.3 and falls outside the prohibitions laid down in paragraph 1 of art. 101. For credit card associations, absent a reliable indication of what can be considered restrictive or exempted, the new framework represents a serious challenge; it would be extremely frustrating to invest in the creation of a trans-national payment infrastructure under the risk that an antitrust authority starts an investigation at a later stage. The situation changed overtime and, although less permissive for card payment schemes, yet it is at least becoming more definite. Under the original mainstream of the EU Commission (under *Visa I* and *MIF*),

and amending Directives 97/7/EC, 2000/12/EC and 2002/65/EC (COM/2005/0603 final). The whole process ended up with the approval of the PSD. See, *retro*, note 4.

²² According to Johannes Abermann, *Interchange Fees in Card Payment Systems in the US and Europe*, 26 European Competition Law Review 223, 230 (2005), the two approaches are consistent, even if in EU the IF is more cost-oriented and more transparent.

²³ Until 1981, banks in European countries have enjoyed substantial freedom from EC antitrust rules. The EC Court of Justice 14 July 1981, case C-172/80, *Gerard Zuechner v. Bayerische Vereinsbank AG*, (1981) ECR, at 02021, held that banks are to be considered as undertakings and definitely subject to competition rules within the meaning of article 106 TFEU (former 90 of the EC Treaty).

the IF and other operational rules of card associations seemed compatible with art. 101 at European level. The new regulatory framework and the ability to pursue a more sophisticated analysis modified the previous setting. The *MasterCard* decision represents now a significant departure from the original approach, since the IF is considered a mechanisms of price fixing defined among competitors and the Commission found no persuasive evidence that it could have redeeming virtues in light of art. 101.3²⁴.

III. BUSINESS MODELS IN THE CARD INDUSTRY AND THE TWO-SIDED MARKET THEORY.

A. *Three- and Four-Party Systems.*

Two alternative business models are currently adopted in the card industry²⁵. In a proprietary, closed-loop system (also known as three-party system), the same entity issues cards to cardholders and signs up merchants in the card program. In open-loop, non-proprietary schemes, acquiring and issuing banks differ (for this reason such a system is also termed four-party system²⁶). A four-party Visa-like setting requires horizontal coordination among banks to ensure a transaction is processed all the way whenever an acquiring bank turns to an issuing institution to have the credit cleared²⁷. If

²⁴ See *MasterCard*, *supra* note 17. Article 101.3 TFEU requires that the agreement improves the production or distribution of goods or promotes technical or economic progress, while allowing consumers a fair share of the resulting benefit, and does not (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

²⁵ See Howard H. Chang and David S. Evans, *The Competitive Effects of the Collective Setting of Interchange Fees by Payment Card Systems*, 45 *Antitrust Bulletin* 641, 644 (2000). See also Cruickshank Report, *supra* note 21, at 253.

²⁶ According to Chang and Evans, *supra* note 26, at 646, it can be said that it is a five-party system, when considering the system itself as part of the transaction.

²⁷ The Visa network is a genuine expression of self-organization and self-regulation; Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 *U. Pa. L. Rev.* 1643, 1647 (1996), considers Visa an example of the “new law merchant”. See also Baxter, *supra* note 14, at 577 (“Compared to the checking system, the bank credit card system has evolved so far under less government intervention with respect to the transfer fee”). In a sense, credit card payment networks represent already an integrated payment area, just as the dollar or the euro built unified internal markets for cash payments across several states. The creation of a single Euro Payment Area (SEPA) has been at the core of EU Commission’s efforts to integrate the European market for payment services since at least 2001, when EC Regulation (EC) No 2560/2001 of 19 December 2001 (OJ L 344 of 28 December 2001, at 13) was introduced. In the Whereas 6, the Commission noted: “the level of charges for cross-border payments continues to remain higher than the level of charges for internal payments”. Such circumstance “is hampering cross-border trade and therefore constitutes an obstacle to the proper functioning of the internal market”. Thus, the reason for regulation was found in the level of costs for cross-border payments. On 12 April 2006, the Commission issued an *Interim Report I. Payment Cards. Sector inquiry under Article 17 Regulation 1/2003 on retail banking*, Bruxelles, 2006, noting that the European market is still fragmented, particularly the card payment market, and pointing out possible remedies (among which antitrust enforcement or regulation) for all the issues identified (*id.*, at vii). Eventually, in order to complete the process of creation of the payment market following the PDS, Regulation 2560/2001 was repealed and replaced by Regulation (EC) No 924/2009 of the European Parliament and of the Council of 16 September 2009 on cross-border payments in the Community and repealing Regulation (EC) No 2560/2001 (O.J. L 266 9 October 2009, at 11) which introduced the principle of equality of charges.

the cardholder buys (and pays for with the credit card) a good or a service from a merchant that is signed by the same bank which issued the card, the transaction is processed internally by the same common bank for cardholder and merchant. In this situation the transaction is said to be ‘on us’ and it does not imply costs or coordination problems as all the bank does is to transfer the credit acquired from merchant’s to cardholder’s account²⁸. They both are its patrons. When such a situation occurs, the interchange fee either does not exist at all or equals zero²⁹.

The situation changes significantly in case of so called ‘foreign transactions’, that is to say when the acquiring bank is not the same bank that issued the card to the cardholder. When such authentically four-party transaction takes place, the issuer bank finds itself in a position in which it is the only one that can buy all debits to be charged on its customer/cardholders’ account. Provided an inter-bank market for transactional paper can be defined, the issuer’s position in this case is considered to be, at least descriptively, as one of monopsony (monopoly on the side of buying) on that very same relevant market³⁰. As Justice Hoeveler has put it in the U.S. *NaBanco* case:

If there is a “market”, it is a monopsonistic one as there is normally only one issuer bank willing to “purchase” any particular merchant bank’s receivable³¹.

Because acquirers and issuers are not the same financial institution and since processing the transaction presumably brings about some costs, the issuer is only willing to buy the paper from the acquirer if a balancing mechanism is agreed in advance, taking into account the costs borne³². The issuer is ultimately the one assuming risks of non-payment or fraud or cardholder’s default and those risks alone generate a cost³³. At the same time, the issuer is in the best position to profit from the whole arrangement as it can buy insurance against frauds and can pass its costs onto the acquirer, regardless the fact the card is issued for free and hence no other remuneration exists for the card issuing service. Furthermore, it can profit from the cardholder providing him with a loan to clear the balance of the monthly statement or other credit-

²⁸ Onofrio Troiano, *I servizi elettronici di pagamento. Addebiti in conto non autorizzati: un’analisi comparata*, Giuffrè, Milan, 1996, at 3, pointed out that “on us” transactions in electronic fund transfers are a minority.

²⁹ Stuart E. Weiner and Julian Wright, *Interchange Fees in Various Countries: Developments and Determinants*, Paper prepared for “Interchange Fees in Credit and Debit Card Industries: What Role for Public Authorities?”, Federal Reserve Bank of Kansas City, Santa Fe, NM, May 4-6, 2005, at 3. See also Baxter, *supra* note 14, at 575.

³⁰ The idea that the acquirer is in a monopsonistic position is exposed firstly by Baxter, *supra* note 14, at 562, as far as check transactions are concerned.

³¹ *NaBanco*, *supra* note 18, at 1261.

³² On differential of prices, Baxter, *supra* note 14, at 575.

³³ In some instances, banks and credit card associations claimed also another kind of costs—those associated with the provision to cardholders of an interest-free period. This is undeniably a cost, even though it is hard to conclude it should be taken into account when determining the interchange fee, as the service is rendered to the cardholder and not to the merchant. The Office of Fair Trading in U.K. in a Rule 14 Notice to Mastercard in February 2003 concluded that if “the cost of the interest-free period is instead included in the calculation of the MIF, this will lead to higher retail prices, which will be paid by all consumers, including the many consumers who do not use credit cards or receive interest-free credit” [See OFT, *supra* note 21, at § 8]. An explanation of risks and costs borne by a bank in a credit card transaction is provided by Baxter, *supra* note 14, at 578. Professor Baxter pointed out that, unlike check payment, in card payment schemes the issuing bank bears the risk of cardholder’s default and the risk of floatation. (The merchant usually benefits because of the shift of the risk on issuers).

related services; by its very position the issuer can transform the set of stand-alone, short-term, interest-free risky credits in a far more convenient long-term, low risk, interests bearing, mass credit.

On the acquiring side, also the acquirer bears costs against the merchant to process the transaction. Costs can be different for acquirers and issuers and such a difference may require a settlement.

Economic theory predicts that, absent some sort of *ex ante* agreement at inter-firm level, the whole system would not work properly, for the issuer (because of its monopsonistic position) could hold up the acquirer (when this tries to recover the credit that has been bought against the merchant) and could decide for each transaction the level of the commission to charge or could even refuse to accept the paper³⁴. Although individual pricing strategies could lead to an optimal level of price for the issuer, independent pricing choices by issuers and acquirers would make impossible for a four-party system to work, as the issuer could use arbitrary powers to decide whether to accept a transaction or not, and could discriminate cards charging different prices, in a typical hold up situation³⁵. Again in Justice Hoeveler's words:

While each and every issuer bank might not behave monopsonistically, the incentive is certainly there for opportunistic behaviour by some issuer banks which would take advantage of the situation by trying to exact higher and higher fees from merchant banks³⁶.

On the other hand, *ex post* negotiated agreements would spawn enormous transaction costs. Associated with the hold up problem, transaction costs would make a four-party system difficult to work properly³⁷. Some have drawn the conclusion that, absent an *ex ante* multi-lateral regulation among members (issuers and acquirers), the system would eventually end³⁸; in a typical non-cooperative situation, individual strategies (although perfectly rational) and interests to extract as much value as possible from a transaction would pre-empt the collective interest in the survival of the system. As a consequence, four-party systems would not survive and inter-system competition would decline in favour of three-party models³⁹.

For the reasons above, four-party systems are by their very nature cooperative and are organized as joint ventures. However, coordination among competitors deserves in

³⁴ As put it by Evans and Schmalensee, *supra* note 2, at 167, co-operatives are constantly threaten by the “ugly spectre of opportunism”. A set of bilateral agreements to govern the transaction is feasible in principle, although it creates enormous transaction costs and it amplify the risk of hold up; Baxter, *supra* note 14, at 556.

³⁵ Christian Ahlborn, Howard H. Chang, David S. Evans, *The problem of interchange fee analysis: Case without a cause?* in 5 European Competition Law Review 304, 307 (2001).

³⁶ *NaBanco*, *supra* note 18, at 1261.

³⁷ In *MasterCard* the Commission apparently maintained the view that a mechanism is necessary to prevent opportunistic behaviors. Yet, it was not persuaded that the fallback MIF is the less restrictive possible means. “The alternative solution would be a rule that imposes a prohibition on ex-post pricing on the banks in the absence of a bilateral agreement between them” (*MasterCard*, *supra* note 17, at 554). For criticism about the Commission's view see Katz, *supra* note 62, at 10.

³⁸ Ahlborn, Chang, Evans, *supra* note 36, at 310, admit that open systems (the way four-party systems are also called) require a horizontal collective action which is not harmful though for competition; quite the contrary, coordination is exactly what allows such system to survive.

³⁹ Carlton and Frankel, *supra* note 12, at 49, point out that inter-system competition is not the only issue for card payments (probably not even the most important); they report cases where the number of networks decreased, while competition increased.

principle antitrust scrutiny; while allowing the system to survive, the agreement could be restrictive for competition and the fact an equilibrium could be reached among participants does not warrant *per se* benefits for consumers.

B. *The Heuristics of Two-sided Markets Theory.*

Both three-party and four-party systems face what the most recent economic theory describes as ‘two-sided’ market⁴⁰. In a two-sided market, two sets of customers exist for the same good or service and they both need each other for the transaction to take place⁴¹. Market is then a ‘platform’ or an ‘interface’, and businesses usually act as ‘matchmakers’, facing a joint demand⁴².

Two-sided markets theory applies to most, if not all, industries characterized by network effects⁴³. There should be a multisided platform enabling groups of customers to get together⁴⁴. Network externalities are a key element for two-sided markets as individual welfare is a positive function of the number of users for the same platform⁴⁵. Yet, unlike simple network markets, in two-sided markets positive network externalities work in a somehow different way, as there are two groups of users for the same good or service. The value for a member of a group increases as the participants to the other group specifically increase, not just because the platform gets more general acceptance⁴⁶. A positive or a negative variation in the number of participants to one group triggers a spiral in the same direction within the other group. I shall refer to such peculiar feature as to a “crossed” positive externality, to distinguish it from the positive simple externalities affecting traditional one-sided network markets. Others referred to such platform businesses as simply characterized by “indirect” network externalities⁴⁷.

An intermediary is anyhow necessary to internalize the externalities created by one group of customers to the advantage of the other group⁴⁸. Parties alone would not be able to internalize the value as individual choices and conducts do not take into account appropriately the entire value generated by the existence of a network⁴⁹. In the credit card example, the issuer’s incentive to maximize its own individual returns from a transaction can supersede the collective interest towards the platform’s equilibrium.

⁴⁰ Chang and Evans, *supra* note 26, at 650.

⁴¹ The same argument was proposed by Baxter, *supra* note 14, at 544, as regards check transactions.

⁴² See Chang and Evans, *supra* note 26, at 648.

⁴³ Network externalities have spawned a massive literature in economics and the law. Among several contributions, see Carl Shapiro and Hal L. Varian, *Information rules*, Harvard Business School Press, Boston, 1999, and Mark A. Lemley and David McGowan, *Legal Implications of Network Economic Effects*, 86 Calif. L. Rev. 479 (1998); Roberto Pardolessi and Andrea Renda, *How Safe is the King’s Throne? Network Externalities on Trial*, in Antonio Cucinotta, Roberto Pardolessi, Roger Van Den Bergh (Eds), *Post-Chicago Developments in Antitrust Law*, Edward Elgar Publishing, 2003.

⁴⁴ Evans and Schmalensee, *supra* note 2, at 134.

⁴⁵ David S. Evans, *The Antitrust Economics of Multi-Sided Platform Markets*, 20 Yale Journal of Regulation 325 (2003); Carlton and Frankel, *supra* note 12, at 41.

⁴⁶ As the Court in *NaBanco*, *supra* note 18, at 1260 pointed out: “[...] the more cardholders in the system, the more attractive the system is to merchants. At the same time, the more merchants in the system, the more attractive the card is to cardholders”.

⁴⁷ Evans and Schmalensee, *supra* note 2, at 135.

⁴⁸ Baxter, *supra* note 14, at 548.

⁴⁹ As Evans, *supra* note 46, at 333, has put it: “Firm profit themselves and society by figuring out ways to internalize these externalities”. See also Evans and Schmalensee, *supra* note 2, at 136.

According to some economists, the interdependence of parties' behaviors within a platform and the more complex conditions under which an industry maintains an equilibrium demand a possibly different scrutiny with respect to the conventional economic analysis of one-sided markets with no positive external effects⁵⁰. The main legal implication from such a different analytical approach would be the need for a peculiar antitrust treatment⁵¹.

1. *Paradigm of competition revised. The concept of co-opetition.*

In a credit card transaction, the same card needs to be accepted by merchants *and* cardholders. Merchants only sign on a circuit for a given card if enough customers bring that card to pay. On the other side, cardholders are willing to bring cards in their pockets and use them if a high number of merchants accepts cards of that brand for payment⁵². Merchants' and cardholders' demand functions although distinct are nevertheless interdependent⁵³. As a consequence, the card institution (whether lone firm or banks' association and other financial entities), at least in an early-stage market, faces the so called "chicken-and-egg" dilemma and has to solve the problem of getting both sides on board by making the card appealing at the same time for merchants and cardholders⁵⁴. Pricing and other entry strategies need to prove effective in this regard; pricing in particular is influenced by feed-back effects between distinct customer groups⁵⁵—unattractive prices for one set would trigger a spiral down for the other set of patrons and eventually determine a loss in the business.

A four-party system is even more troubled due to the presence of issuers and acquirers; coordination is a condition to survive. Issuers and acquirers are in a peculiar relationship; at the same time competing to attract more cardholders and/or merchants (intersystem competition), while cooperating to ensure the system actually works⁵⁶. This is a manifestation of a general paradigm of inter-firm behavior for some industries and it has been defined as co-opetition.

Co-opetition describes the unusual situation within four-party systems, where competitors find themselves helping each other in processing transactions, thus allowing the system to survive, and to compete with other (three- or four-party) systems⁵⁷.

⁵⁰ Evans and Schmalensee, *supra* note 2, at 295, conclude that "Many courts and authorities have also had difficulty understanding the two-sided aspect of the payment card industry along with its implications for pricing, investment, and other business decisions, and the different capabilities of co-opetitives and go-it-alones to balance the two sides".

⁵¹ One of the recent scholarly works suggesting that antitrust and regulatory approaches are flawed (as to the attempt of regulating the IF) is Steven Semeraro, *Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty*, 14 *George Mason Law Review* 942 (2006-2007).

⁵² In this way credit cards enjoy what is a common feature of a means of payment, that is to say its universality.

⁵³ As Evans and Schmalensee, *supra* note 2, at 143, point out: "the demand on each side vanishes if there is no demand on the other—regardless the price".

⁵⁴ Among others see K. Kemppainen, *Competition and regulation in European retail payment systems*, Bank of Finland Discussion Paper, 16-2003.

⁵⁵ See Evans and Schmalensee, *supra* note 2, at 139 (on feedback effects).

⁵⁶ See, specifically, Jean-Charles Rochet and Jean Tirole, *Cooperation Among Competitors: Some Economics of Payment Card Associations*, 33 *RAND Journal of Economics* 549 (2002).

⁵⁷ Co-opetition is a common situation in sports. See *NaBanco*, *supra* note 18, at 1255 ("Like the sports association, the VISA system is an example of an association where cooperation is as much a necessary part of the "game" as competition").

Insofar as the membership rules allow parallel participation both to three-party and four-party systems (the dual membership already mentioned⁵⁸), the overall market relationship can be even more convoluted, since banks can be both members of an association while running their own proprietary system⁵⁹. In such case, they cooperate (and compete) *within* the system to issue cards or acquire merchants; at the same time, they compete *with* the system in an intersystem relationship. Intersystem competition can be described as taking place among proprietary systems and among proprietary and non-proprietary systems. We will discuss later what is the relevant market when intersystem competition takes place⁶⁰.

Because cooperation is of the essence for an open system to exist, some economists and legal scholars draw the conclusion that a differentiated and more lenient antitrust treatment is in order to ensure four-party systems can compete with three-party systems and ultimately to maintain inter-system competition. This view is not accepted to its fullest extent by antitrust authorities, as the case law demonstrates⁶¹.

2. Pricing structures and the interchange fee for open-loop systems.

According to some authors, pricing strategies in two-sided markets cannot be inspired by the usual idea that marginal revenues have to equal marginal costs as a profit-maximizing condition, the reason being that there are two demands for the same good or service and no coincidence in the demand functions of platform's users⁶². In the credit card industry it is unlikely that cardholders' and issuers' demand functions are overlapping or so close that a card association can fix optimal prices. The consequences of any pricing choice are undoubtedly dependent on the relationship between the two sides of the market. Too high a price for cardholders (typically, membership fee) would discourage them to sign up for the card program, making the system poorly appealing for merchants. At the opposite, a heavy fee on merchants would induce them not to become part of the card program, with the consequence that customers would not have incentive to use and, first and foremost, to apply for the card. It has been said that

⁵⁸ See, *retro*, paragraph II.

⁵⁹ In *U.S. v. Visa USA, Inc.* (see, *retro*, at 12), the U.S. Court of Appeals for the Second Circuit granted rule of reason analysis to rules preventing participation to competing card schemes and yet upheld the conclusion reached by the district court that found "no evidence to suggest that allowing member banks to issue cards of rival networks would endanger cohesion in a manner adverse to the competitive process". For the discussion about the duality rule see, *retro*, note ... and accompanying text. The point of view of the Second Circuit is not the general wisdom. In *SCFC ILC, Inc., v. Visa* (see, *retro*, note 12, at 970) the Court of Appeals upheld the contention of Visa that exclusivity rules are necessary to prevent the free ride by other issuing institutions. Thus, the denial to grant access to the Visa circuit is not technically a refusal to deal or a group boycott, but a legitimate measure "reasonably necessary to ensure the effective operation of its credit card services" (*id.*).

⁶⁰ See, *infra*, paragraph IV.

⁶¹ See *MasterCard*, *supra* note 17.

⁶² On pricing on the credit card four-party scheme, see also Steven Semeraro, *The Antitrust Economics (and Law) of Surcharging Credit Card Transactions*, 14 *Stanford Journal of Law, Business, and Finance* 343, 365 (2009). Also Evans, *supra* note 46, and Michael Katz, *What do We know about Interchange Fees and what does it Mean for Public Policy*, 6 June 2005, at 10; Evans and Schmalensee, *supra* note 2, at 149: "With multiple yet interdependent business constituencies to serve, costs offer little guidance for pricing strategies". Without necessarily dealing with the problem of regulating the IF, the implication for a characteristic of costs not being the main indicator to set prices is that cost-oriented regulation may prove not effective and hazardous. More in general, any intervention on prices not governed by market forces could alter an otherwise complex equilibrium.

double marginalization is more a likely strategy of pricing, as firms in the card industry tend to sell complementary products, to use the price as a leverage⁶³, or that trial-and-error is more an effective path of fine-tuning the right price level⁶⁴. All this would bring to safely say that when considering a four-party system the pricing problem cannot be simply regarded as a matter of price level; rather, it is primarily an issue of optimal pricing structure⁶⁵.

According to the main card associations, the optimal pricing structure for a four-party system is the interchange fee, fixed internally by the associations itself together with all other terms of the membership⁶⁶. “The ‘interchange fee’ is a transaction-specific payment made from the bank that processes the transaction for the merchant to the bank that issued the card to the cardholder”⁶⁷. At least in theory, the IF reflects differentials in costs for banks (issuers and acquirers) on both sides of the markets; as a matter of fact, the IF is an amount of money charged by the issuer on the acquirer in a ‘foreign’ transaction⁶⁸. Again in theory, the IF should be determined on the basis of the costs borne by the issuers and related, among other things, to the risks described above⁶⁹.

There exist two different and possibly conflicting views about the interchange fee.

In the genuine spirit of a two-sided market, some authors claim the IF is nothing more than a spontaneous mechanism set by card associations to solve the endemic four-party coordination problem⁷⁰. “The interchange fee determines the extent to which the issuer and the acquirer share the joint costs and joint benefits arising from the decision by a cardholder to use the card at a merchant’s store that takes that card brand”⁷¹. By its very nature, it is dependent on the way a four-party transaction takes place and on the presence of independent players. Specifically, the IF is supposed to be a predetermined adjustment means to continuously keep a system in equilibrium when transactions are processed by two separate banks with two different cost structures⁷²; this makes the difference with pricing in traditional single-sided businesses⁷³. For such a reason, the IF

⁶³ Evans, *supra* note 46, at 332.

⁶⁴ A sort of ‘experimental’ pricing appears to be a common trait of many matchmaking industries that enjoy network effects. Internet Search Engines supported by advertising is an example. For a detailed description of Google’s business model see Hal R. Varian, *The Economics of Internet Search*, Eight ‘Angelo Costa’ Lecture, 16 January 2007 (subsequently published in *Rivista di politica economica*, 2006). Of course, the absence of a pricing model poses serious problems for antitrust analysis, as it is shown in the text for card programs.

⁶⁵ See also Gabrielle Damange and David Gale, *The strategy structure of two-sided matching markets*, 53 *Econometrica* 873 (1985).

⁶⁶ David S. Evans and Richard Schmalensee, *The Economics of Interchange Fees and Their Regulation: An Overview*, Paper available at <http://www.aei.brookings.org/admin/authorpdfs/page.php?id=189> (last visit 30 January 2007).

⁶⁷ See David S. Evans and Richard Schmalensee, *Economic Aspects of Payment Card Systems and Antitrust Policy Toward Joint Ventures*, 63 *Antitrust Law Journal* 861, 863 (1995).

⁶⁸ Ahlborn, Chang, Evans, *supra* note 36, at 305, conclude that because the IF is a mere transfer of costs, “it does not provide a source of profits to the co-operative or its members”.

⁶⁹ For an explanation see, *infra*, note 113 and accompanying text.

⁷⁰ Evans and Schmalensee, *supra* note 2, at 153. See also Weiner and Wright, *supra* note 30, at 5. Baxter, *supra* note 14, at 584, championed the idea that the IF can only be determined collectively.

⁷¹ Chang and Evans, *supra* note 26, at 653.

⁷² Evans and Schmalensee, *supra* note 68, at 891.

⁷³ Evans and Schmalensee, *supra* note 2, at 137 (“single-sided business might vary their prices according to the demand by various customers segments, but they do not engage in the fundamental balancing act that characterizes multisided platforms, where relative prices help harvest externalities”).

is sometime considered indispensable for a four-party system to survive. To be sure, it is one of the possible methods to keep the system going; as a consequence, at least in principle, it propels intersystem competition because it allows the survival of open-loop systems *vis-à-vis* closed systems⁷⁴. Different arrangements, such as charging the whole cost of a transaction on cardholders in terms of higher membership fees would be ineffective as payers would rather choose other payment systems or other cards with lower or null membership fee when deciding how to pay for a purchase.

The straightforward consequence of reading the IF as a spontaneous mechanism of adjustment of a card system is that any external intervention on the IF would be less than optimal and would alter the market structure⁷⁵. The implication of such view is that IF should not be authoritatively regulated.

At the opposite, others consider the IF by no means different from horizontal price fixing⁷⁶, eventually negative for consumers, because of passing on effects. What happens in the real world, indeed, is that the IF is paid by the acquirer to reward the issuer for having collected the credit against the cardholder. Once paid up, the IF is passed on to the merchant by the acquirer as a fraction of the so called ‘merchant discount’⁷⁷. Plausibly, the ultimate strategy for the merchant is to pass the costs on to all customers in terms of higher prices, rather than ‘internalize’ the corresponding amount as an overhead cost. Under this light, the IF can prove regressive, as it hits in terms of consequently higher prices also those customers who prefer traditional cash payment or other payment systems⁷⁸. Apart from positive effects when a new system is created (that is—when the IF is used for short terms), harm to consumers is normally expected to offset any other virtue⁷⁹.

The two views of IF have radical practical differences. If the IF helps the system to survive and to grow, the higher the number of cards issued, more likely a decrease of

⁷⁴ Chang and Evans, *supra* note 26, at 641, and Ahlborn, Chang, Evans, *supra* note 36, at 304.

⁷⁵ On this very point, the views of the defendants and of the Commission in *MasterCard* differed radically. MasterCard took the view that market forces would bring about an optimal level of IF. The Commission observed that because of the structure of the IF intersystem competition exerts an upward pressure on the IF, since “issuing banks are attracted by revenues from a MIF and a card scheme operating with a MIF will take this into account in its competitive behavior towards other schemes (with or without MIF)” (*MasterCard*, *supra* note 17, at §§ 467 and 499).

⁷⁶ According to David A. Balto, *The Problem of Interchange Fees: Costs Without Benefits?* 4 ECLR 215 (2000), the IF exists only “under a narrow and tenuous exception to the traditional antitrust scepticism towards collective price fixing”.

⁷⁷ The merchant discount (also termed as the merchant service charge, MSC) is technically the price charged by the acquirer to process the transaction in favour of the merchant. The IF is a remarkable 80% of the merchant discount. The OFT in U.K. provided information according to which the MIF accounts for between 66 and 80% of the merchant discount (see OFT, *supra* note 21, at 6). Balto, *supra* note 77, at 221, reports that in the U.S. the IF amounts to about 90% of the merchant fee. According to Katz, *supra* note 62, at 4, the IF is not withheld by the network; it is rather naturally passed through from one participating institution to another.

⁷⁸ Balto, *supra* note 77, at 222. Ahlborn, Chang, Evans, *supra* note 36, at 311, confirm that the IF is passed through, although they deny it is regressive. Indeed, any sort of free service provided by a merchant (*e.g.*, free parking) is paid also by customers who do not enjoy that service (*e.g.*, do not use cars to go shopping).

⁷⁹ If we were to address the issue of the optimal number of cards for a given country, it could be well argued that this mechanism provides excessive incentives to issuance activities. It has been noted that credit card payments at merchants’ point of sale are like free parking for grocery stores; only patrons with car enjoy the benefit of the parking, while the corresponding cost is borne by all customers. Under a different light, it could be questioned if the presence of the free parking does not alter consumers’ incentives to use the car.

fees to provide cardholders with a card (and more likely additional services offered). At the opposite, if the IF is an unnecessary cost, it will be passed on until it reaches the universality of customers as a negative externality of cards' use by a subset of users⁸⁰.

As stated before, there are normative implications for the above-mentioned views; according to the former, the IF is a genuine and efficient expression of self-regulation of a rather complex and vibrantly competitive industry⁸¹; in no event an external regulator could do better in determining its level than the spontaneous market forces⁸². Others claim that the IF damages consumers and should be either forbidden, or allowed only under narrow circumstances, or regulated and possibly brought to zero⁸³.

After initial hesitance, the European Commission took the view that the MIF is restrictive in the market for acquiring⁸⁴: “the setting of the interchange fee rates is not akin to a contentious process such as price negotiation [...]. Rather, all banks eventually share a common interest that merchants pay a higher price than they would in a fully competitive environment”⁸⁵. A remarkable difference between the *Visa* and the *MasterCard* decisions is about economic justifications that could allow the IF to survive, notwithstanding its restrictive effects. In *MasterCard* the Commission still admits that the IF can, in principle, contribute to economic and technical progress, within the meaning of art. 101.3, but it also recognizes that the IF “may be used by banks to achieve efficiencies as well as to extract rents”⁸⁶. This statement sets the new standard for the burden of proof of efficiencies, that must “be founded on a detailed, robust and compelling analysis that relies in its assumptions and deductions on empirical data and facts”⁸⁷.

3. *Honor-all-cards and no-discrimination rules.*

Notably, the same argument that has been adopted to justify the IF as a structure that keeps a four-party system going is also applied as a rationale for some clauses that issuers and acquirers negotiate within card associations and that are eventually imposed on merchants as part of the card payment program they sign up. The first term is known as the honor-all-card rule (HAC); the second one is the no-discrimination rule (NDR, also in the version of no-surcharge rule).

The honor-all-card rule imposes a duty on the merchant to accept all cards from the same association, “irrespective of the nature of the transaction, the identity of the issuer, the type of card being used or the personal characteristics of the cardholder”⁸⁸. In recent cases, the honor-all-card rule has been charged of tying, since allegedly the card association bundles several products (cards such as credit, debit or prepaid) which

⁸⁰ Both consequences are explored in Weiner and Wright, *supra* note 30, at 7, 8.

⁸¹ Evans and Schmalensee, *supra* note 2, at 296.

⁸² Ahlborn, Chang, Evans, *supra* note 36, at 309 (to explore possible regulation options and presumable consequences).

⁸³ The idea of eliminating the IF or bringing it to zero was proposed by Heimler and Ennis, *supra* note 4, at 29, as an allegedly easy solution to the problem caused by the fact that any external party could not be able to efficiently regulate the IF.

⁸⁴ For the definition of the relevant market see, *infra*, paragraph IV.D.

⁸⁵ *MasterCard*, *supra* note 17, at § 499.

⁸⁶ *MasterCard*, *supra* note 17, at § 730.

⁸⁷ *MasterCard*, *supra* note 17, at § 731. It seems a clear rebuttal of the abstractness of the two-sided market theory that the Commission criticizes in several occasions.

⁸⁸ See EU Commission (*Visa I*), *supra* note 16, at § 29.

are distinct and which would be otherwise purchased or used separately. Whether the rule is a tie-in and produces certain anticompetitive effects requires an assessment of market power. Importantly, advocates of its lawfulness seek support in the two-sidedness of the market⁸⁹. The rule is aimed at ensuring any cardholder that his card will be accepted and no payment will be refused. Without such a certainty cardholders would be rather oriented to other cards and the system would become less appealing. In this regard, the rule performs the same function of the IF, that is to say, it allows the system to survive and compete with other systems. It is worth adding that in principle the clause can perform the same function also for three-party system, since an American Express-type card could be refused as well. The HAC rule is of potential application any time a card association or a company running a card program offers consumers different cards with different terms of usage (and different associated costs)⁹⁰.

The no-discrimination rule is aimed at preventing that the merchant ‘steer’ consumers towards other payment means, charging different prices depending on the card the customer chooses to use⁹¹. When concerned with the Visa system, the EU Commission so describes the rule:

The NDR [in the Visa international card regulations] prohibits merchant from adding charges to cardholders who pay with their Visa card. In addition, the Visa NDR prohibits merchants from giving consumers discounts for paying with other means of payments, such as, for example, cash⁹².

Although the rule can have positive effects (it could work as a ‘low’, minimum fixed price, preventing an increase in prices by merchants), it also throws rigidity in prices and leaves no choice to merchants but to bear passively costs associated with a card. Again, some argue that the rule’s function is to perpetuate the parties’ disposition, on both sides, to use the card vis-à-vis other payment systems.

Two-sided market theory has a strong descriptive power and it is fascinating in its implications about interrelations between the two sides of the joint demand of a network good. Courts and agencies sometimes have resorted to it to analyze the credit card industry and indulged to its explanations for current settings in four-party systems and its corollaries for antitrust analysis⁹³. The IF, the honor-all-cards rule and the no-discrimination rule, together with others, have sometime received positive antitrust treatment on the assumption that the systems themselves would not survive without those mechanisms. Singularly taken the features of four-party schemes have been all deemed suitable to favor intersystem competition. And yet there appears to be a slight and slow change in the view of antitrust authorities.

IV. HONOR-ALL-CARDS RULE, NO-DISCRIMINATION RULE, AND THE PRICING STRUCTURE. A REASSESSMENT.

⁸⁹ See, for instance, Ahlborn, Chang, Evans, *supra* note 36, at 309.

⁹⁰ It is well known that also payment schemes as American Express offer more than one card, depending on the status of the potential customers.

⁹¹ See ITM Research, *The abolition of the No-discrimination Rule*, Report prepared for Competition DG, Amsterdam, 2000, at 7 (hereinafter quoted as ITM Report).

⁹² EU Commission (*Visa I*), *supra* note 16, at §§ 21. In the same notice the Commission recalls that the rule has been cancelled in Sweden, UK, and the Netherlands.

⁹³ See *MasterCard*, *supra* note 17, at § 259.

Theoretical arguments that support the current configuration of four-party schemes in the card industry abound. Old precedents by U.S. courts spouse the idea that the interchange fee and its corollary rules serve the sole role of getting both sides of the market on board. Recently though some courts reconsidered the effects on the market of restraints in four-party systems. The *Visa* litigation in Europe seriously challenged and eventually reversed the exclusivity rule and, most importantly, the *Wal-Mart* litigation in the U.S. was a major thrust to see the card arrangements under a possibly different light⁹⁴.

Current domestic changes in the law of a given legal system are not as meaningful as when they become a yardstick to assess the consistency of other countries' approaches. Worldwide, IF and the other four-party rules are not generally and easily accepted. In several remarkable instances, antitrust authorities are investigating domestic agreements. Probably the most interesting and somehow contradictory situation is in Europe, where the EU Commission originally exempted from art. 101.1 the IF, the HAC and the NDR with arguments that appear inconsistent with current trends, especially in the U.S., and with arguments the Commission itself lately adopted in the *MasterCard* case⁹⁵. One of the reasons explaining the change in the Commission's view can be found in the progressive adoption of a non discrete approach in the analysis, that is to say, the increased predisposition to consider the IF, the HAC rule and the NDR not in isolation, but as parts of a comprehensive architecture of cards associations with potentially restrictive combined effects.

Unfortunately, a comparison between EU Commission's decisions and U.S. courts' opinions on credit cards is not always easy because of the style the Commission adopts; scarcely motivated, rapid, and apodictic decisions do not allow for a deep reconstruction of the legal reasoning and of economic theories adopted. The bulky *MasterCard* decision is an exception. In the perspective of a decentralized application of the EU competition law, national courts and antitrust authorities would certainly benefits from far-reaching and well motivated decisions. For the time being, commentators currently must rely on thin opinions, which are not always useful to market players when framing business decisions that must comply with antitrust policy.

A. *The honor-all-cards rule and the no-discrimination rule.*

The largest card payment network in the world is the Visa, four-party system. Visa's operational rules, comprising the HAC and the NDR, have been scrutinized by antitrust authorities on several occasions both in the U.S. and in Europe⁹⁶. In some of the initial decisions, the EU Commission concluded that the HAC and the NDR do not even fall under art. 101 TFEU, whereas the IF arrangement, even though restrictive in principle, can be exempted under art. 101.3 because of its pro-competitive effects. So

⁹⁴ David A. Balto, *Impact of 'Visa' Decision*, in *The National Law Journal*, Nov. 29, 2004 ("Antitrust enforcement presents the opportunity for massive restructuring of a single industry").

⁹⁵ Of course, Commission's decisions seem difficult to accept even when compared with the OFT's decision and arguments in U.K. See OFT, *supra* note 21, *passim*.

⁹⁶ See Luc Gyselen, *EU Antitrust Law in the Area of Financial Services*, published in "Fordham Corporate Law Institute, 23rd Annual Conference on International Antitrust Law and Policy", available at <http://europa.eu.int/comm/competition/speeches/text/sp1997_005_en.html> (last visit Aug. 8, 2005) for an account of the position of the EU Commission in cases involving restrictions in the payment industry until 1996.

far, two streams of decisions appeared. In the *MIF* case, the defendants were able to show (although arguably) positive effects of the IF, whereas in *MasterCard* there was insufficient evidence of such effects and the Commission refused to exempt the IF from art. 101.1⁹⁷.

It is still not clear why the two aspects of the same case (HAC and NDR, on the one side, IF on the other) relating to the Visa joint venture have been decided separately by the EU Commission⁹⁸. It could be argued that the enforcement choice of the EU Commission of a discrete view of the several arrangements has biased conclusions while obscuring the full understanding of the overall effects a specific four-party scheme generates.

In its decision on non-discrimination rule and honor-all cards, the EU Commission concedes that the Visa rules have a vertical effect (acquirer-merchant), even though agreed upon at a horizontal level, among competing banks (issuer-acquirer)⁹⁹. The vertical effect explains why, both in Europe and in the U.S., merchants have been constantly sensitive to the choice of card associations to use this rule¹⁰⁰.

As regards the NDR, despite serious and convincing arguments brought by merchants, the Commission in 2001 concluded that the clause as a matter of fact is restrictive of merchants' freedom and this may have effects on competition. However, rather surprisingly the Commission found possible effects not appreciable. Even more surprisingly, the Commission reached this conclusion not through a positive showing that the clause is not restrictive or it is necessary for the system¹⁰¹; quite the opposite, it relied on the observation that the absence of that arrangement, in countries where the no-discrimination rule had been abolished, did not cause benefits in terms of merchants' choice to charge cardholders¹⁰². Furthermore, according to the Commission, most merchants reported that the abolition of the rule did not have effect on the merchant fee¹⁰³.

Such a conclusion raises quite few, but serious issues: can the absence of an action be conclusive evidence that it is anyhow useless to remove a formal ban to that action? The fact merchants did not surcharge when allowed to do so can justify a restriction in their freedom to price or to steer consumers towards other payment systems even when the choice of an alternative payment scheme benefits the consumers in terms of discounts or lower prices? And does it alone positively suggest something about those markets where the clause is still in force? Is surcharging what we should expect from a rational merchant in a competitive market once he is given the chance to discriminate among payment systems? Are merchants unsatisfied with NDR because

⁹⁷ See *MasterCard*, *supra* note 17, at § 747 (“The MasterCard MIF does not allow consumers to obtain a fair share of possible efficiencies”).

⁹⁸ The case originated by a complaint by EuroCommerce against Visa's rules (see, *retro*, note 16).

⁹⁹ See EU Commission (*Visa I*), *supra* note 16, at § 10.

¹⁰⁰ Some of them even argued about the existence of a link between the no-discrimination rule and the multilateral interchange fee; see EU Commission (*Visa I*), *supra* note 16, at § 25.

¹⁰¹ In *SouthTrust Corporation v. Plus System, Inc.*, 913 F.Supp 1517 (N.D. Ala. 1995), at 1524, a court of Alabama concluded that the no-surcharge rule was beneficial to an ATM network, because it “creates price certainty, so that costumers do not have to spend large amount of time seeking the lowest fee for an ATM transaction”. Such conclusion is either wrong or a good suggestion to reconsider the usual idea that this term is a device that helps to get both sides of the market on board and ultimately indispensable for a four-party system. Indeed, in *SouthTrust* it is considered functional to a typical three-party architecture, such as an ATM network.

¹⁰² EU Commission (*Visa I*), *supra* note 16, at § 54 and § 55.

¹⁰³ See, *infra*, note 142 and accompanying text.

they cannot charge additional costs onto consumers or because they must pay regardless the kind of transaction, the person involved, the amount of the purchase?¹⁰⁴

The Commission implicitly recognized that there can be some nexus between the NDR and the merchant fee; nevertheless, it initially maintained the conclusion that “the abolition of the no-discrimination rule has had no effect on their merchant fees”¹⁰⁵. The same position is held in the *MasterCard* decision, even though in that case the charge is not towards NDR, but directly to the IF¹⁰⁶.

The same line of arguments is applied to the far more dangerous HAC rule.

The Commission agrees with Visa that the honor all cards rule promotes the development of its payment systems since it ensures the universal acceptance of the cards, irrespective the identity of the issuing bank¹⁰⁷.

Whereas there can be some justification in stating that the HAC rule ensures the universality of the credit card as payment system (at least at its beginning), it is not at all clear to what extent such a rule is indispensable to a four-party system more than to a three-party system. Here, the Commission does not even take steps to figure out what could happen were the rule repealed. Thin motivation to conclude that the two rules do not fall under art. 101.1.

The result is paradoxical if compared with the outcome of the *Wal-Mart* litigation¹⁰⁸. The U.S. District Court for the Eastern District of New York granted in part the merchants’ motion for summary judgment against the Visa’s usage of the HAC to tie acceptance of its credit cards to acceptance of its debit cards. The case was settled for a huge amount of money¹⁰⁹. The Court refused to apply a *per se* rule to the HAC, but it can well be conceded that there is nothing conclusive in the decision. Yet, the motion was granted as judges recognized that the actual market effects of HAC and its justifications need to be tried¹¹⁰. Also, indications were provided that Visa could have market power and the accusation of tying would be everything but unlikely¹¹¹.

Scattered facets of an unfinished picture; yet, the suspect grows that past conclusions and approaches demand a reassessment.

B. The interchange fee.

As regards the setting of the interchange fee, there have been several conjectures about its nature. When economic theory was not yet aware of multi-sided market and network effects, William Baxter argued that

¹⁰⁴ Suppose the cardholder is willing to pay with his card a 10€ transaction and the merchant fee is invariably 1% of the purchase, then the net benefit to the merchant would be 10€ - 1% = 9.90€.

¹⁰⁵ EU Commission (*Visa I*), *supra* note 16, at § 56. Some skepticism was expressed by Heimler and Ennis, *supra* note 4, at 24 (“Should the no-discrimination rule be eliminated, the success of a collusive strategy pursued via a high interchange fee is weakened, but not annulled”).

¹⁰⁶ See, *infra*, note 158.

¹⁰⁷ EU Commission (*Visa I*), *supra* note 16, at § 67.

¹⁰⁸ See *Wal-Mart et al. v. VISA U.S.A.*, *supra* note 19, at 124.

¹⁰⁹ The whole story of the *Wal-Mart* litigation can be found at the following URL: <<http://www.inrevisacheckmastermoneyantitrustlitigation.com/>> (last visit, December 19th, 2010).

¹¹⁰ *Wal-Mart et al. v. VISA U.S.A.*, *supra* note 19, at 17.

¹¹¹ In *Wal-Mart et al. v. VISA U.S.A.*, *supra* note 19, at 21, the judges identified “debit card services as a well-defined submarket, characterized by an inelasticity of demand and universal recognition by the public, the parties, and the industry as a whole”.

To an unsophisticated observer this collective process of equilibration resembles horizontal price fixing, but (...) it should not be so treated¹¹².

At least at the beginning of Visa's system, the interchange fee was set as a reimbursement fee. Its name reflected the function. Since 1971 it was called the "Issuer's Reimbursement Fee" (IRF)¹¹³. Still in 1984, U.S. courts tended to consider the IF as a "device for sharing costs within the VISA system"¹¹⁴. Because costs are positive, the IF is naturally greater than zero, but this is the only weak conclusion we can draw. Two-sided markets theory was not as developed as it is today but its seminal implications for the industry were already grasped by judges:

IRF serves to share substantial costs and risks between VISA members, and interchange transactions are an integration because in such transactions two different members combine their activities in order to offer a service to a cardholder and a merchant¹¹⁵.

Efficiencies achieved through the IF have been convincing evidence for U.S. courts to grant rule of reason analysis to it. The court in *NaBanco* clearly states that "IRF enables VISA to exist as a viable competitor in the payment systems market"¹¹⁶. This virtue was considered sufficient to offset presumed restrictive effects and to assert full lawfulness for the IF scheme.

As economic theory became more sophisticated, the idea that IF was a mechanism to simply track costs appeared trivial. Quite interestingly, few years later Europe came to reject the transfer-of-costs theory. The EU Commission in 2002 pointed out that the IF restricts competition within the meaning of art. 101.1. Conflicting views between U.S. courts and the EU Commission about the IF are only apparent; the practical outcome of alternative readings does not change much, as also in Europe the IF is considered restrictive not *per se* or, in the words of art. 101.1, by object. Antitrust has rather to look at the effects to assess whether it has redeeming virtues under art. 101.3¹¹⁷.

However, Commission's arguments falls short of persuasive economic clarity about possible countervailing effects to the restrictions in competition caused by the IF. At least in the *MIF* decision, the Commission itself appears as not completely persuaded that the IF is not a price fixing and that (questionable) positive effects can be easily

¹¹² Baxter, *supra* note 14, at 586. Weiner and Wright, *supra* note 30, at 25, report that as of year 2005, in 8 countries antitrust authorities took the initiative to investigate or to regulate the IF—namely Canada, U.S., EU, Denmark, the Netherlands, Spain, Sweden, and the UK.

¹¹³ *NaBanco*, *supra* note 18, at 1239.

¹¹⁴ *NaBanco*, *supra* note 18, at 1252. Even today Ahlborn, Chang, Evans, *supra* note 36, at 308, reject the idea that the IF is a price (a price implies a vertical image of the market which does not exist in the card industry).

¹¹⁵ *NaBanco*, *supra* note 18, at 1253.

¹¹⁶ *NaBanco*, *supra* note 18, at 1261. Balto, *supra* note 77, at 219, considers *NaBanco* unique as it approved a price fixing on a give cost account. Surprisingly, courts in the U.S. applied the same holding of *NaBanco* to justify the existence of an interchange fee in ATM circuits, which adopts three-party schemes. See *SouthTrust Corporation v. Plus System*, *supra* note 101, at 1523.

¹¹⁷ The issue of the restrictive character of the MIF by object or by the effects was raised again in the *MasterCard* case and the Commission found no merit for the argument, since it was clear that the IF set by MasterCard had restrictive effects, being a floor for the price that merchants must pay for accepting payment cards.

shown. For instance, it does not accept that the IF is a transfer of costs from merchants to issuers, as two-sided markets theory does not allow the conclusion that there is a joint supply of a single product¹¹⁸. At the same time, it refuses to call the IF a price; it resorts to fancy formulas such as “agreement between competitors, which restricts the freedom of banks individually to decide their own pricing policies”¹¹⁹. And in the following passages, “a MIF is not a price charged to a consumer, but a remuneration paid between banks who must deal with each other for the settlement of a card payment transaction”¹²⁰. Eventually, the Commission concedes that the “the MIF is a wholesale price only”¹²¹.

In any event, according to the Commission the IF can be pro-competitive; it matches the four conditions set forth in art. 101.3 and as a consequence art. 101.1 is declared inapplicable. The decision in *Visa* was reached after the association proposed a modified IF scheme, where three categories of costs are identified, standing as an objective benchmark¹²². It can be said that the IF is not framed in terms of transfer of costs, although in Europe is now undeniably cost-based¹²³. The solution eventually approved by the Commission to reduce the IF and make it cost-oriented has been sometime marked as a pseudo-regulatory approach¹²⁴. The Commission has defended its position on the ground that the solution was reached within the market, not outside. It appears quite clearly though that an unpersuasive view about the IF forced an “original” antitrust enforcement¹²⁵. Indeed, in the following *MasterCard* decision, after a thorough and even verbose motivation, the Commission found that the MIF does not meet the conditions of art. 101.3 for an exemption. Fresh data and a more sophisticated and disenchanting analysis favored the new position.

¹¹⁸ EU Commission (*MIF*), *supra* note 16, at § 65 (the Commission does not accept that the MIF is a transfer of costs between undertakings which are cooperating in order to provide a joint service in a network characterised by externalities and joint demand. The Commission does accept that a four-party payment scheme is characterised by externalities, and that there is interdependent demand from merchants and cardholders, but not that there is joint supply of a single product).

¹¹⁹ EU Commission (*MIF*), *supra* note 16, at § 66.

¹²⁰ EU Commission (*MIF*), *supra* note 16, at § 79.

¹²¹ EU Commission (*MIF*), *supra* note 16, at § 93.

¹²² Costs considered by the Commission are (1) cost of processing transactions; (2) cost of the free funding period for cardholders; (3) cost of providing the “payment guarantee”. EU Commission (*MIF*), *supra* note 16, art. 1(2)(b). As to costs for free funding period, the Cruickshank Report, *supra* note 21, at 264 - 265, concluded that the “supply of credit to holders of credit cards – including the fifty or so days – is fundamentally not a payment service supplied to retailers. Rather, it is a credit service supplied by credit card issuers to credit card holders” and that “recovering the costs of offering an interest free period through interchange fees creates a pattern of cross subsidies between participants within a particular card scheme”. Importantly, the same conclusion was shared by the OFT in its 2005 decision (*supra* note 21) on Visa domestic MIF where such costs were considered “extraneous costs” and a mechanism that eventually determines a general increase in the costs to provide cards to cardholders.

¹²³ Also in its 2003 Notice the OFT maintained that an IF cost-oriented would have been acceptable (see OFT, *retro* note 21, at § 3.12).

¹²⁴ Some commentators referred to the authorities’ practice to approve agreements upon condition that the IF is cost-oriented as a “audited self-regulation”; see Marcello Condemi and Guerino Ardizzi, *La tutela della concorrenza nei sistemi di pagamento*, in Giuseppe Carriero and Vittorio Santoro (eds), *Il diritto del sistema dei pagamenti*, Milano, Giuffrè, 2005, at 51.

¹²⁵ The decision was not satisfactory even for those advocating the importance of IF for the survival of co-operative systems; see Evans and Schmalensee, *supra* note 68, at 897 (‘In any case, it is hardly the role of antitrust law or policy to seek to regulate the fine structure of pricing policies’).

C. HAC, NDR, IF in a comprehensive reading of inter-banks agreements.

Let us assume for a second that things are not quite as some economists suggest and how the EU Commission used to read the whole arrangement within credit card associations and let us try to think in a more straightforward economic logic.

In a four-party system coordination is indispensable and the system can only survive if there is some sort of *ex ante* regulation and coordination among banks. As even the Commission recognizes, the only necessary agreement that must pre-exist is the one imposing on the issuer a duty to accept transactional papers from acquiring banks as arbitrary behaviors are the ultimate threat for the entire system¹²⁶. All other arrangements are not superfluous, not indispensable; as we shall see in a while, if they exist it is because they serve other purposes.

Some commentators argue that the IF is crucial to the functioning of a four-party system “because of the problem associated with opportunistic behavior”.¹²⁷ Absent the IF, the issuer is “a monopolist buyer of the merchant bank’s transaction paper”¹²⁸. Such a conclusion proves too much because it implies that the IF itself is a duty to deal imposed by agreement on the issuer, whereas conceptually one can imagine of a duty to deal with no IF or with an IF set to zero¹²⁹.

In a card association there are issuers and acquirers. Many banks play both roles. Any issuer, whether also acquirer or not, accepts receivables against the cardholder and bears some costs. It is reasonable to presume that costs for processing a transaction are decreasing as clearing and settling are done electronically and costs related to information technologies are generally falling¹³⁰; costs for free funding periods are a means to attract cardholders and to convince them to pay with credit cards¹³¹; costs for assuming the risk of fraud are only those for insurance and are negligible because of the high number of transactions.

Because of its monopsonistic position, the issuer can also charge acquirers (in any kind of transaction) to earn something for the service provided¹³². When the transaction is ‘on us’, costs of the kind recognized by the Commission still exist (except for processing costs, probably); nevertheless, ‘on us’ transactions are cleared at par—that is

¹²⁶ EU Commission (*MIF*), *supra* note 16. See also *MasterCard*, *supra* note 17, at § 752.

¹²⁷ Evans and Schmalensee, *supra* note 68, at 889.

¹²⁸ Evans and Schmalensee, *supra* note 68, at 890.

¹²⁹ Evans and Schmalensee, *supra* note 68, at 890, tend to overlap these two conceptually distinct aspects. The same assumption, that the IF is in itself nothing else than a obligation to pay transactional paper, is in Chang and Evans, *supra* note 26, at 655. It is true that imposing an IF implies a duty to process transactional paper, but it is not always true that imposing an *ex ante* duty to deal on the issuer commands an (even null) IF. Indeed, there are four-party systems in the world where the issuer is bound to pay the acquirer bank but the system works without IF. See for instance the ec-Karte scheme in Germany, that the EU Commission recall in its Statement of Objections following EuroCommerce’s complaints.

¹³⁰ See also Balto, *supra* note 77, at 216 (for the U.S. market starting from 1998), and Victor Stango, *Strategic Responses to Regulatory Threat in the Credit Card Market*, 46 *Journal of Law & Economics* 427, 436 (2003) (on cost-reducing technologies).

¹³¹ Of course, the provision of a free-funding period is not available for all cards, so the argument cannot be generalized.

¹³² In theory, a fee could be also introduced to select customers. Those able to pay a high fee signal themselves as good debtors.

to say, assuming the IF (if any) equals zero¹³³. In ‘on us’ transactions, no IF is ever applied; indeed, issuers and acquirers are the same entity. The transaction can have a cost (even if it is not an interchange cost in a technical sense), but the issuer clears it internally as if it were a three-party situation. Accordingly, we can thus assume that in a foreign transaction, because acquirers are not the same subjects as issuers, issuers decide to claim costs under the form of an interchange fee. It is also safe to maintain that the IF for the acquirer is a cost; it is an amount of money that the acquirer has to pay back to the issuer and that the acquirer will subtract from revenues generated for services rendered to merchants. Thus, the IF, at least in principle, is such a cost for the acquirer in every transaction that the overall amount paid by the issuer to buy the paper is somehow less than what the acquirer has spent downstream to buy the credit form the merchant. In financial terms, for the acquirer the IF is a cost, since it lessens final profits. For this very reason, any rational acquirer, whether contemporaneously issuer or not¹³⁴, has an incentive to pass the costs of the IF on to the merchant, together with its own costs to process the transaction, all bundled in the merchant’s discount¹³⁵.

Also for the merchant the IF is a cost. Again, if the story ended here, the IF would be for merchants a pure cost, doomed to cut profits because directly curtailing revenues. At merchant’s level though, easy assumptions are not granted any further¹³⁶. At least in theory, a rational merchant, *coeteris paribus*¹³⁷, would find no other choice but to pass the *entire* IF on the consumers in terms of higher prices. Some commentators claim that when such passing on happens, the IF shows its pernicious nature as it benefits issuers at final consumers’ costs. The IF in this regard creates a negative externality and it really works as an indirect (regressive) tax since it hits all consumers, regardless the fact they possess and use a credit card to buy or enjoy services related to the use of a card¹³⁸.

Far from being pretentious, this argument needs to be taken seriously especially by European competition authorities because art. 101.3, positively requires an assessment in terms of benefits for consumers stemming from an otherwise restrictive agreement¹³⁹. General availability of credit, universality and other features of a payment with plastic are definitely positive traits of an efficient credit card payment system; however, it should be noted that all this does not come for free and that associated costs can be prohibitive. Because fact-situations and consumers attitudes (and related

¹³³ For some reason which is usually not confessed in economic literature, card associations found unsuitable the settlement at par (see Evans and Schmalensee, *supra* note 2, at 66), which is standard rule in check transactions.

¹³⁴ Even if the acquirer is an issuer can have an incentive to pass on the costs downstream; we assumed above that in ‘on us’ transactions some costs still exist.

¹³⁵ See Weiner and Wright, *supra* note 30, at 6. For the definition of the merchant discount see, *retro*, note 62.

¹³⁶ Alternative scenarios for merchants are explored by Weiner and Wright, *supra* note 30, at 34. See also Heimler and Ennis, *supra* note 4, at 24.

¹³⁷ We are still assuming that merchant’s freedom to pass the IF on is unfettered. As shown in the text, this assumption is not realistic and it will be promptly relaxed.

¹³⁸ The Cruickshank Report, *supra* note 21, at 265, is particularly concerned about cross subsidies that banks create for their financial (credit) activities, recovering costs of offering an interest free period through the interchange fee. The problem is somehow related to that pointed out, *retro*, note 79, about the negative effects of the interchange fee in terms of excessive incentives to issuance.

¹³⁹ See, *supra*, note 24. Among other elements, art. 101.3 requires that the agreement contributes to improving the production or distribution of goods or to promoting technical or economic progress, and at the same time it has to allow consumers a fair share of the resulting benefit. Because of potential negative effects of a restrictive agreement, evidence of benefits should be clear and convincing.

consequences) can be different across various countries¹⁴⁰, where cards do not get yet general acceptance, it would be worth exploring possible welfare effects, since costs engendered by a minority are borne by all customers¹⁴¹.

Conclusions so far drawn relied on the implicit assumption that merchants can positively adopt the same strategy of acquirers, that is—pass the costs of processing the card payments on to cardholders. Such an assumption needs to be promptly relaxed and the outcome to be reconsidered.

Freedom of merchants to increase prices and recover the IF is not unfettered. The presence of a no-surcharge rule could not change results¹⁴². Freedom of merchants to surcharge or to discriminate depends, among other things, on at least two conditions: (a) the elasticity of demand for the goods or services sold by the merchant and paid for with the card; (b) the elasticity of demand for payment systems¹⁴³. It is important to understand that costs of goods or services and costs associated to the payment means usage are usually undistinguishable and they are both reflected in the price of an item. If the merchant carries out his business in a highly competitive market (as it is in the majority of cases for retail goods or services) higher prices would likely result in a loss of consumers¹⁴⁴. The ability to increase final prices is thus limited. As a consequence, it is reasonable to assume that the cost of the IF cannot be passed on to cardholders in its entirety and a fraction of it actually cuts merchant's profits. In this respect, the Commission in *MasterCard* eventually concluded that merchants are in a passive position and are unable to negotiate a merchant fee below the costs of the IF¹⁴⁵.

Merchants are also prevented from increasing prices by consumers' willingness not to bear additional costs for choosing to use credit card¹⁴⁶. If consumers are sensitive to increased prices for the use of credit cards, one alternative for merchants would be to charge lower prices for those consumers who prefer different payment means; a discrimination in prices could be effective in order to avoid a general regressive effect¹⁴⁷. For the same reason merchants do not increase prices for customers willing to

¹⁴⁰ Weiner and Wrights, *supra* note 30, studied the determinants of the IF and its level in various countries and reached the conclusion (*id.*, at 43) that, despite insights from economic theory on IF, much remains to be explained. Pricing structures are also industry contingent, as pointed out by Rochet and Tirole, *supra* note 57, at 567.

¹⁴¹ I owe this thought to prof. Cristoforo Osti, who commented on a previous version of this paper at the first meeting of the Italian Association of Law and Economics.

¹⁴² Note that in countries such as Sweden, where the no-surcharge rule has been abolished, merchants did not change the level of prices; nevertheless, they complained about the level of the IF and believed it should be eliminated or at least reduced. See IMA Market Development AB, *Study Regarding the Effects of the Abolition of the Non-discrimination Rule in Sweden*, Report prepared for Competition DG, Lerum, 2000, at 29 (hereinafter quoted as the IMA Report).

¹⁴³ Balto, *supra* note 77, at 220, provides an argument against the idea that demand for card payment is elastic. The author points out that plastic is a prevailing and exhaustive payment means.

¹⁴⁴ In the report produced on behalf of the EU Commission by IMA it is clearly stated that in Sweden (where the IF is forbidden) merchants did not surcharge, the main reason being that the foresee negative cardholders' reaction leading to loss of customers. See IMA Report, *supra* note 143, at 23.

¹⁴⁵ *MasterCard*, *supra* note 17, at § 503.

¹⁴⁶ Indeed “[t]he second virtue that a payment instrument should possess is inexpensiveness, since the cost of making a payment is a burden upon the underlying transaction”; Rubin and Cooter, *supra* note 1, at 2.

¹⁴⁷ I am not addressing here the issue of substitutability of credit cards with other payment methods (an issue that would trigger a discussion about the relevant market); for the time being, I am only assuming that a rational merchant could discriminate in her pricing policy so to leave on cardholders the costs related with their choice to use the card.

pay with plastic, they tend to avoid discounts for cash users. This is consistent with what happened in some countries, where the abolition of the no-surcharge rule did not produce massive changes in prices by merchants¹⁴⁸.

Merchants' choice to discriminate or even to refuse payments with cards is really a situation that fits the two-sided market paradigm. In a competitive market they need to retain costumers, which means merchants would never be completely free to steer consumers or to act freely on prices, bearing the risk of loosing a part of them¹⁴⁹. However, if merchants were given a certain degree of freedom to act on prices, issuers would certainly have an incentive to keep the IF as low as possible or even to offer a settlement at par. Freedom for merchants means that they could show prices for good or services sold and prices for the use of a payment method¹⁵⁰; in such a case, customers would realize how expensive is the good or the service purchased and how expensive is the decision to use a given card (charge, debit, or credit) or another substitute for payment. Once end-customers have the chance to discriminate among payment means, card associations are forced to keep the cost of card use (*i.e.*, the interchange fee) as low as possible for customers can react by choosing to pay cash or alternatively to resort to payment means with lower costs.

Quite paradoxically economic theory predicts that with strong intersystem competition card associations may have an incentive to increase the IF in order to attract or retain banks and give them an incentive to issue more cards¹⁵¹. In a two-sided market scenario, if more cards are issued more merchants would join the program, thus making it appealing for cardholders, and issuers' returns would increase¹⁵², regardless market conditions¹⁵³. If returns increase, issuers could be able to offer rebates to cardholders or additional services to make the card more appealing¹⁵⁴. If a given card program is attractive because of rebates or complementary services provided (which could be the signal of a virtuous competition on the supply side), IF can still remain higher since its effects are borne by merchants. These arguments should alert that the IF has a natural upward pressure and its setting has the effect of a *de facto* floor (as the EU Commission concluded¹⁵⁵). If left to natural forces of the market, the IF generally tends to increase

¹⁴⁸ See ITM Report, *supra* note 92, at 8, as concerns the situation in the Netherlands.

¹⁴⁹ Katz, *supra* note 62, at 13, explains that merchants' resistance to higher fees is reduced because of externalities among merchants. See also Cruickshank Report, *supra* note 21, at 251. The same phenomenon is explained by Rochet and Tirole, *supra* note 57, at 551, in terms of endogenous preferences of merchants in promoting cards and such variable is usually neglected in economic analysis.

¹⁵⁰ If this does not happen, IF can have allocative effects, see Dennis W. Carlton and Alan S. Frankel, *The Antitrust Economics of Credit Card Networks*, 63 *Antitrust Law Journal* 643, 660 (1995).

¹⁵¹ As Katz, *supra* note 62, at 8, noted: "Economic theory thus suggests that the level of an interchange fee (or the levels of network fees more generally) can have significant effects on card use and resulting levels of economic welfare and efficiency" (footnote omitted). Weiner and Wright, *supra* note 30, at 14, point out that in most countries IF have declined or are declining with the notable exception of the U.S.

¹⁵² Katz, *supra* note 62, at 14 ("high interchange fee can result in a transfer of surplus from consumers to issuers through an inefficient mechanism: excessive card use").

¹⁵³ Katz, *supra* note 62, at 9.

¹⁵⁴ See Carlton and Frankel, *supra* note 151, at 658 (stating that the use of rebate is a direct consequence not only of intensified competition among issuers, but also of high interchange fees). Evans and Schmalensee, *supra* note 2, at 117, admit that a passing on of benefits from issuers to cardholders is "hard to document".

¹⁵⁵ See also OFT, *supra* note 21.

and it can be brought and kept up as high as merchants show resistance¹⁵⁶. The more competitive the market for goods bought with the card, the stronger the resistance that merchant must have to remain on the market. In several occasions the Commission in *MasterCard* makes this point clear, by saying that “in the presence of a MIF the marginal cost of acquirers are [*sic!*] inflated, thereby setting a floor under the merchant fee” (§ 522) or that “the forces of inter-system competition do not sufficiently constrain the level of interchange fees in the MasterCard scheme and even exert an upward pressure” (§ 467).

If merchants can discriminate or refuse to accept cards, with a strong intersystem competition their countervailing power in the long run would favor those systems (not necessarily three-party¹⁵⁷) running with lower or null IF. More straightforwardly, it is very likely that with increased merchants’ freedom intersystem competition would unfold and four-party systems with higher fees would feel threatened not as much as to disappear but enough to put issuers’ extra-profits under risk. If that happened, the situation would become completely different—now issuers would be forced to reduce the IF level in order to retain merchants.

Yet, merchants cannot discriminate. We can reinstate the assumption that one of the three players among those considered (issuer, acquirer, and merchant), namely the merchant, does not have any countervailing power towards the pricing policy set up by the card association (comprehensive of issuers and acquirers) and no chance to make cards competing with other cards (in both intra-system and inter-system mode) or even with other payments systems. It is a realistic assumption, because merchants cannot do anything to oppose the IF and to have it set at an acceptable level, nor can they oppose the specific payment means that carries with it the IF. This is the conclusion now reached by the Commission in *MasterCard*¹⁵⁸. As we noted, HAC rule and NDR are precisely the contractual arrangements that remove this power from merchants. Even if according to recent surveys it is not proved that the abolition of the NDR does improve negotiating powers of the merchants¹⁵⁹, this does not change the conclusion¹⁶⁰. In such setting, merchants are the weak ring of the chain—pressed from the bottom by competition and from the top by the IF, their choice being actually limited by a contractual obligation to accept all cards and not to steer cardholders towards other payment methods¹⁶¹. NDR and HAC rule are exactly what in real life prevents

¹⁵⁶ Rochet and Tirole, *supra* note 57, at 565 (“In the absence of unobserved heterogeneity among merchants, an increase in the interchange fee increases the usage of payment cards, as long as the interchange fee does not exceed a threshold level at which merchants no longer accept payment cards”).

¹⁵⁷ As a matter of fact there are four-party card systems operating with zero IF, either for autonomous business choice or because antitrust and regulatory authorities have forbidden positive IF.

¹⁵⁸ See, on this point, *MasterCard*, *supra* note 17, at §§ 503 and 504.

¹⁵⁹ See ITM Report, *supra* note 92, at 16. See also *MasterCard*, *supra* note 17, at § 513.

¹⁶⁰ Semeraro, *supra* note 62, at 343, acknowledges that merchants are overcharged by the system; yet, it concludes that permitting surcharging would be harmful. The author suggests a solution that relaxes the HAC rule. *Contra*, Adam J. Levitin, *The Antitrust Super Bowl: America’s Payment Systems, No-Surcharge Rules, and the Hidden Costs of Credit*, 3 Berkeley Business Law Journal 265, 331 (2005) (“No-surcharge rules and state laws prohibiting credit card surcharges create an imbalance in the payment systems market that results in the inefficient overuse of expensive payment systems like credit cards at the expense of other payment systems”).

¹⁶¹ The situation is even more tough in Europe for merchants as the merchant discount and the IF curtail net profits, while being part of the taxable amount for the added value tax (VAT). This solution was given by the EC Court of Justice, May 25, 1993, case C-18/92, *Chausseurs Bally SA v. Belgian State*, (1993) ECR, at 02871, in an opinion which had to solve the issue whether merchants owe value added

merchants from triggering the positive backward spiral that should eventually force issuers (and acquirers) to reconsider their pricing strategies and what favors the highest possible level of the IF¹⁶².

It should be clear by now that the HAC rule and the NDR¹⁶³ taken as such are neither good or bad for competition and not even indispensable for the system to survive, as cases around the world demonstrate. Individually and separately considered, they have not an autonomous negative effect besides restricting merchants' freedom as any other contractual clause typically does. Their vertical effect within the context of an horizontal setting should confirm they are not restrictive by object, since they have not direct incidence on those parties who devise them. However, it is hard to deny they are not restrictive for the outcome they produce. If interpreted as an enforcement mechanism for the IF, the overall effect is all but pro-competitive¹⁶⁴. They become ancillary to another purpose and need to be necessarily assessed as they were intertwined traits of the same architecture. The point here is that when a mechanism is suspected of being price fixing, constraints on prices for firms not part of the agreement should be considered as highly suspect.

Even the IF *per se* (taken by itself) can be just a mere reimbursement or a transfer of costs and display redeeming virtues that justify both the rule of reason approach followed by some U.S. courts and the exemption under art. 101.3, TFEU. Yet, an IF that works as a *de facto* floor, and is fortified by clauses with vertical effect preventing any reaction by merchants, can only increase¹⁶⁵. The practical outcome is that merchants are trapped by the card scheme and cardholders use cards without any chance to know the

taxes (such as VAT) on the net amount received from card-issuing organizations after deduction of the fee, or on the gross amount (*i.e.*, the price of goods before deduction of the bank commission). In Belgium, where the case decided by the EC Court of Justice originated, certain financial activities (including card-issuing) are VAT-exempted. It follows that merchants bear the whole burden of VAT in a payment transaction where the fee is a revenue for the bank and the provision of cards is beneficial to cardholders. Petitioner Bally stressed the fact that merchants are forced to accept cards because of competition at retail level and, at the same time, are required to accept VAT as a pure cost, rather than pass it downstream. The EC Court rejected this argument on the ground that harmonization sought by Council Directive 77/388/EEC of 17 May 1977 (on the harmonization of the laws of the Member States relating to turnover taxes, OJ 1977, L 145, at 1) "could not be achieved if the taxable amount varied according to whether the calculation was for the VAT to be borne by the final consumer or for determining the sum to be paid to the revenue authorities by the taxable person" (*id.*, at § 14). Notably, the EC Court considered the commission as part of the consideration obtained from the purchaser (*id.*, at § 12).

¹⁶² As to the HAC, the Commission eventually concluded that "the 'honour-all-products' functionality reinforces the restrictive effects of the MasterCard MIF on price competition between acquiring banks" (*MasterCard*, *supra* note 17, at § 509), a decision somehow depending on the market definition adopted by the Commission. In *re Visa Check/Mastermoney Antitrust Litigation*, 280 F.3d 124 (2nd Cir., 2001), at 131 (the HAC rule prevents merchants even to ask "customers whether they would mind using a different payment system"). For reasons analogous to those expressed in the text see also Nicholas Economides, *Competition Policy Issues in the Consumer Payment Industry*, New York University Law and Economics Working Papers N. 163 (2008), at 14.

¹⁶³ Rochet and Tirole, *supra* note 57, at 562, point out that the effects of a no-surcharge rule are still unclear; rebates offered by merchants for cash users can determine higher costs for issuers and eventually lead to a sub-optimal level of diffusion of the card.

¹⁶⁴ The idea that the clause is essential to the system is not well-founded (see ITM Report, *supra* note 92, at 15).

¹⁶⁵ On the cost of the system in the United States and the effects of cards arrangements see the documented article of Levitin, *supra* note 161.

relative price of card's use or to benefit from rebates generated by the increased volume of card paid transaction.¹⁶⁶

As it should be clear by now, anticompetitive effects within the four-party scheme will not be evident until a discrete approach in the antitrust analysis is not replaced by a comprehensive reading of the inter-bank arrangements and their effects. The *MasterCard* decision confirms that the Commission's understanding of the credit card market is becoming more sophisticated¹⁶⁷. The PSD is consistent with this approach.

D. HAC, DNR and the relevant market

The assessment of the overall effect of a combination of NDR, HAC rule and IF implies a definition of the relevant markets, as a first step in the antitrust analysis. Modern economic theory has cast some doubt about the way product market should be defined for antitrust purposes in two-sided markets. Yet, it has not provided so far a viable alternative and reliable tool of analysis; as a consequence definition of the relevant market is still subject to current economic principles and current difficulties¹⁶⁸. An antitrust analysis without market definition cannot really exist and it is sound to use old tools more than to forgo a rigorous enforcement policy.

As far as credit card antitrust cases are concerned, U.S. and EU courts and antitrust authorities have shared different views about the relevant market, even though such a divergence did not prevent them from reaching the conclusions on a more general level illustrated above. Defining the market is a critical issue in credit card cases to determine whether customers of a payment scheme are affected by the alleged operation of NDR and HAC rules. In card associations, issuers and acquirers cooperate to build the system and compete to acquire merchants or sign cardholders. There is market power if collective actions produce higher prices or reduced output¹⁶⁹.

In *NaBanco*, the court defined the relevant market as

consisting of all nationwide payment services used in retail sales, including VISA, Mastercard, T&E cards, merchants' proprietary cards, merchants' open book credit, cash, travellers cheques, ATM cards, personal checks and check guarantee cards¹⁷⁰.

Under such a broad definition no one can be found to have market power except probably the state for cash still being used as the most frequent means of payment¹⁷¹. On other occasions, U.S. courts defined the market more narrowly as including

¹⁶⁶ By relative price I mean the price of a payment means expressed in terms of price of a substitute, according to standard economic definition.

¹⁶⁷ Also the length of the decision witnesses the attention paid by the Commission to the case.

¹⁶⁸ See *SCFC ILC, Inc. v. Visa USA*, *supra* note 12, at 966 ("There is no subject in antitrust law more confusing than market definition").

¹⁶⁹ Carlton and Frankel, *supra* note 151, at 654.

¹⁷⁰ *NaBanco*, *supra* note 18, at 1252. Also the court in *SouthTrust* reached the same conclusion; see *SouthTrust*, *supra* note 101, at 1524. Critiques to market definition in *NaBanco* have been expressed by Carlton and Frankel, *supra* note 151, at 652. The Cruickshank Report, *supra* note 21, at 248, found that cash does not compete with other payment systems ("there is no recognisable process of price competition between cash and other payment methods").

¹⁷¹ Another issue about such broad market definition is raised by Carlton and Frankel, *supra* note 151, at 653; a merger of all credit card systems under a market definition including all payment means would not trigger antitrust concerns and this is manifestly absurd.

payments with plastic¹⁷². The EU Commission refused initially the broader definition and came to the conclusion that the relevant market is that comprising all types of payment cards only¹⁷³. This same definition of the market was also adopted by the U.S. judges in the *Wal-Mart* litigation, which eventually found Visa having sufficient market power in order to force merchant to do something that in a competitive market would not do¹⁷⁴.

In the most recent decision on the IF (the *MasterCard* case), the Commission has explicitly rejected the market definition drawing from two-sided markets theory¹⁷⁵, concluding that a definition based on the idea of a joint supply “abstracts from the relevant architecture of a payment card scheme by ignoring the different level of interaction between the platform, the bank intermediaries and the banks’ respective customers”¹⁷⁶. Yet, the Commission also refused to rely entirely on the SSNIP test, since its results could be affected but the *cellophane fallacy*¹⁷⁷. For the purposes of the antitrust analysis concerning the operation of the IF, the Commission concluded that the relevant market is “the market for acquiring payment card transactions”¹⁷⁸.

Broader definitions of the market do not fit real situations. It is evident that in a transaction for the purchase of a pair of shoes in a store a bank wire transfer cannot be considered as a valid substitute for a credit card payment. As well as it is unlikely someone will purchase a 12-carat Tiffany diamond paying cash. Indeed, the right view on market definition is probably the less inclusive in terms of payment means. At the same time, it cannot be denied that in some instances cash and credit *can* be substitutes. This is not equivalent to say that they are substitutes in all possible instances.

In a market where cardholders consider credit cards, debit cards and charge cards as substitute products, the effect of NDR and HAC rules is to reinforce the natural bounds of the market. Merchants are prevented from creating competition among different payment means whenever those can be competing. In this way, the card association at a horizontal level can fix prices for the use of the card above natural level without running the risk users are induced to other payment means. In economic words, the purpose of the overall architecture is to make demand for credit cards as a payment system artificially inelastic¹⁷⁹.

For a merchant to expand cardholders’ choice, prices for goods or services and prices for payment methods need to be potentially distinguishable, which means that cardholders are allowed to compare costs associated with the use of each of them. In this way, users of a system can articulate a demand for the good or the service separately from that of competing payment means and do not have a specific incentive to use plastic more than to use cash. They can choose case by case which system is

¹⁷² See *SCFC ILC, Inc. v. Visa USA*, *supra* note 12. Discussion on the relevant market can be found in Evans and Schmalensee, *supra* note 68, at 868.

¹⁷³ EU Commission (*MIF*), *supra* note 16, at § 52.

¹⁷⁴ *Wal-Mart et al. v. VISA U.S.A.*, *supra* note 19, at 12, quoting *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984), at 13-14.

¹⁷⁵ Cf. Katz, *supra* note 37, at 11.

¹⁷⁶ See *MasterCard*, *supra* note 17, at § 259.

¹⁷⁷ See *MasterCard*, *supra* note 17, at § 287. In surveys run by the Commission with merchants, the answer was almost systematically that they would switch to other payment means in case of a small but significant and non-transitory increase in prices of the credit card service.

¹⁷⁸ See *MasterCard*, *supra* note 17, at §§ 307 and 316. Quite remarkably, the Commission noted that such definition is consistent with that adopted in *Visa I* and *MIF*.

¹⁷⁹ The same conclusion can be found in Katz, *supra* note 37, at 4: because of the honor-all-cards (declined as honor-all-issuers) rule, the default provisions about the level of IF tend to have more power.

more convenient; their choice would eventually affect issuers' revenues in terms of IF, forcing them to reconsider their pricing strategies.

If we turn our attention to other countries, the IF, the NDR, and the HAC rule have actually less comfortable life¹⁸⁰. Antitrust authorities challenged them and found them restrictive. In some instances they have been forbidden¹⁸¹. As the EU Commission notes, in some cases this has not caused a reduction of the IF or a change in pricing strategies by merchants¹⁸². While this data are controversial and disputable, they demonstrate at least that four-party systems can survive even without HAC rules, NDR and IF, or with IF down to zero. The idea that those terms are essential to a two-sided market industry is then falsified and this should be bottom line for any attempt of antitrust enforcement or for a choice of regulation.

The assertion by the Commission about the use of the NDR must be compared now with the solution adopted in the Directive 2007/64/EC, where it is stated that “the payment service provider [*i.e.*, the card association] shall not prevent the payee [*i.e.*, the merchant] from requesting from the payer [*i.e.*, the card holder] a charge or from offering him a reduction for the use of a given payment instrument”¹⁸³. Thus, under the new regulatory framework of payment systems in Europe, at least in principle merchants shall be free to discriminate among payment means used by their customers, as the NDR is forbidden. Yet, the same provision set out an exception: Member States (whom the Directive is addressed) “forbid or limit the right to request charges taking into account the need to encourage competition and promote the use of efficient payment instruments”¹⁸⁴. Implicitly, this provision recognizes that the use of the NDR can have the effect to steer (or retain) consumers towards one specific payment system. It can have positive effects, if the ultimate goal is to favor the use of a new payment instrument deemed to be more efficient than those already in use. It can have negative effects if, as it is in the credit card industry, it shields credit cards (and the price set by the card association) from competition with other brand cards or even with other payment systems.

While the Commission appears skeptical about surcharging as a viable solution for merchants, the Directive goes clearly the other way, forbidding in principle any no-surcharging policy and allowing it only under very narrow circumstances¹⁸⁵.

¹⁸⁰ I agree with Katz's conclusion that “Theory alone is not going to answer the question of whether public policy intervention, in general, or a specific form of intervention, in particular, will improve welfare; see Katz, *supra* note 62, at 16.

¹⁸¹ According to Maurizio Trifilidis, *Carte di pagamento e tutela della concorrenza. Funzione ed effetti della “commissione interbancaria multilaterale – MIF”*, in *Mercato Concorrenza Regole*, 2004, at 573, the NDR has been forbidden in 1984 in the U.S. [*sic!*], in U.K. (1991), in Australia (2002), Swiss (2002) and Sweden (1995). Nevertheless, the use of cards increased.

¹⁸² See *MasterCard*, *supra* note 17, at § 513. It should be clear by the arguments laid down in the text, reactions by merchants can be influenced by other reasons.

¹⁸³ Art. 52, paragraph 3. It is worth noting that this provision applies in general to all payment systems (including direct debit and credit transfer); yet, it is particularly conspicuous when referred to the credit card industry.

¹⁸⁴ Art. 52, paragraph 3, last sentence.

¹⁸⁵ In *MasterCard* the Commission believes that the freedom to surcharging does not affect merchants' behavior both because they do not know which scheme to sanction by surcharging (since fees for accepting Visa and MasterCard cards are ‘blended’) and because surcharging yields administrative costs to merchants (see, *supra* note 17, at §§ 517 and 518, respectively).

V. CONCLUSIONS.

The credit card service has been traditionally considered an example of self-regulation among firms in the payments industry. In the effort to create a Single European Payment Area, the European Union has regulated various aspects of payment systems (including credit cards) and has recently introduced the PSD to build a comprehensive pan-European regulatory framework. Yet, the new regulatory framework is not just simply a matter of harmonization with the Directive. Before the discussions of the PSD started, the EU Commission, as well as other antitrust authorities in U.S. and elsewhere, was actively investigating credit card schemes and providing indications on restrictive terms of agreements among competitors.

Probably because of an initial unsophisticated analysis of the rather complex credit card industry, antitrust authorities seemed to be more tolerant with regard to the terms set at horizontal level by banks and financial institutions, particularly as far as HAC, NDR and IF are concerned. As the case law increased and economic theory evolved, a different approach progressively emerged. Changes in antitrust analysis both in the U.S. and in Europe came to somehow consistent solutions. When the PSD was introduced, the debate was already mature to cast some of the views reached in the case law into the Directive. The result is one where the current definition of the new regulatory framework requires consideration of different sources, such as the PSD, the case law, and the expression of self-regulation still present in the industry (such as the EPC in Europe). Although the antitrust treatment of some terms used by credit card associations is stricter, yet a clearer framework should be conducive to investments in the industry and contribute to the creation of the Single European Payment Area.