

# THE ANTITRUST ECONOMICS OF CREDIT CARD NETWORKS

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## I. INTRODUCTION

It is easy to think of many instances where cooperative behavior among rivals is both necessary and desirable to achieve efficiencies. For example, in a sports league it is necessary for the proper functioning of the league that competing teams be permitted to have collective agreements on what rules to follow and when to schedule games.<sup>1</sup> Similarly, in industries in which products require standardization it is often necessary for rivals to come to a consensus in order to decide what standards to adopt for the products.<sup>2</sup> Finally, where firms engage in standardized transactions, such as financial exchanges, it is often necessary to construct rules by which such transactions can be efficiently communicated and settled.<sup>3</sup>

In many contexts, there is no concern about anticompetitive effects flowing from such cooperative behavior because it is obvious that the participating firms collectively cannot possess market power. For example, a joint venture among a few small corn farmers to share large, efficient farm machinery cannot possibly raise the market price of corn, even if the farmers act jointly in selling their harvest. A rule of thumb

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<sup>1</sup> See, e.g., *NCAA v. Board of Regents*, 468 U.S. 85 (1984).

<sup>2</sup> See, e.g., *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979) (finding that standardized blanket licenses for performances of music compositions and collectively determined fee schedules were procompetitive).

<sup>3</sup> For detailed discussions of the need for cooperation in networks, see Dennis W. Carlton, *The Economics of Cooperation and Competition in Electronic Services Network Industries*, in *ELECTRONIC SERVICES NETWORKS: A BUSINESS AND PUBLIC POLICY CHALLENGE 77* (Margaret E. Guerin-Calvert & Steven S. Wildman eds., 1991); Dennis W. Carlton & J. Mark Klamer, *The Need for Coordination Among Firms with Special Reference to Network Industries*, 50 U. CHI. L. REV. 446 (1983).

(from an economic point of view) is that complete freedom of action generally should be granted to members of joint ventures if merger of those same members would cause no competitive harm.<sup>4</sup>

In other cases, however, the joint venture may involve competitors that together account for a substantial share of (or even all) market sales and collectively possess market power. Where a joint venture possesses the potential for such collective power, there is a natural concern that the participating firms may be able to use the venture (which otherwise may be an efficient organization that expands output relative to that which the firms could produce independently) to restrict competition in ways unnecessary for the success of the joint venture. Price-fixing by cartels is an extreme example of collective action that usually can have only adverse consequences. In many cases, however, it is difficult to determine whether particular structures, rules, and actions of a joint venture are essential to the existence or efficiency of the joint venture, or whether their impact is anticompetitive instead. Indeed, some joint venture activities may have both kinds of consequences.<sup>5</sup>

Unfortunately, while it is simple to state the basic theoretical principle that antitrust intervention in joint ventures is justified only when the long-run, net present value of intervention to society is positive, in practice it can be difficult to discern whether the efficiency gains associated with a particular joint venture (or certain of its practices) are outweighed by the reduction in competition that may result from having competing rivals cooperate. It is our view that intervention in a joint venture can often cause more harm than good, and thus should be done rarely. We would support intervention only in those situations where there is clear evidence that the benefits from intervention will outweigh the harms. We discuss one such case later.<sup>6</sup> However, the mere theoretical possibility, without factual support, that intervention in an ongoing joint venture

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<sup>4</sup> See Carl Shapiro & Robert D. Willig, *On the Antitrust Treatment of Production Joint Ventures*, 4 J. ECON. PERSP. 113 (1990). One standard reason given for why certain joint conduct among competitors should be treated as illegal per se, whether or not the participants collectively have market power, is that some activities (such as naked price-fixing) are deemed so unlikely to have redeeming efficiency effects that it is simpler and less costly in the long run simply to ban those activities. See ROBERT H. BORK, *THE ANTITRUST PARADOX* 18 (1978).

<sup>5</sup> To avoid antitrust intervention, a clever joint venture might even seek to design its structures and rules in such a way as to "tie" its efficiency characteristics to cartelization characteristics.

<sup>6</sup> In light of the peculiar (and we believe misleading) title of the conference (Post-Chicago Economics: New Theories—New Cases?), we wish to point out that there is absolutely nothing non-Chicago about advocating intervention where a particular practice (e.g., exclusion) enables the firms in the joint venture to act like a cartel.

to alter a particular practice could help does not provide sufficient justification when there are plausible efficiencies associated with that practice.

In this article, we discuss the potential for anticompetitive harm to result from collective action by members of credit card joint ventures. We begin, in Part II, with an overview of the credit card industry, the flow of funds in typical credit card transactions, and the two most significant legal disputes involving credit card joint ventures—*National Bancard Corp. (NaBanco) v. VISA U.S.A., Inc.*<sup>7</sup> and *SCFC ILC, Inc., d/b/a MountainWest Financial v. VISA U.S.A., Inc.*<sup>8</sup> In Part III we show that a credit card joint venture such as Visa or MasterCard can have market power and can use collective decisions to exercise that market power. Finally, in Parts IV and V we evaluate the two types of collective action that have raised the greatest concerns about the exercise of market power by credit card joint ventures: (1) the ventures' collective setting of fees, and (2) the ventures' collective determination of membership policies.

## II. THE CREDIT CARD INDUSTRY, THE FLOW OF FUNDS IN CREDIT CARD TRANSACTIONS, AND TWO KEY ANTITRUST CASES

### A. THE CREDIT CARD INDUSTRY IN THE UNITED STATES

Credit cards are now ubiquitous in the United States. In 1991, over 111 million Americans held over 1 billion credit cards and used those cards for nearly one-half trillion dollars of spending, which is about 12 percent of total disposable personal income and 28 percent of retail sales of goods and services for which credit cards typically can be used.<sup>9</sup> Credit cards have two main functions: They act as a medium of exchange (i.e., they provide payment services), and they provide a flexible, unsecured, and discretionary line of credit with which consumers can finance purchases or obtain cash.

There are three types of credit cards, distinguished from one another by the nature of the card-issuing firm. *Retailer cards* are issued by an individual merchant (or, increasingly, by a third-party contractor) and

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<sup>7</sup> 596 F. Supp. 1231 (S.D. Fla. 1984), *aff'd*, 779 F.2d 592 (11th Cir.), *cert. denied*, 478 U.S. 923 (1986).

<sup>8</sup> 819 F. Supp. 956 (D. Utah 1993), *aff'd in part and rev'd in part*, No. 93-4105, 1994 U.S. App. LEXIS 26849 (10th Cir. Sept. 23, 1994). Carlton and Lexecon Inc. served as experts for the plaintiff in *MountainWest*.

<sup>9</sup> U.S. BUREAU OF ECONOMIC ANALYSIS, SURVEY OF CURRENT BUSINESS (July 1992), reprinted in U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1993, Tables 700, 817; THE NILSON REPORT, No. 478 (HSN Consultants Inc., Los Angeles, Cal.), June 1990.

allow the holder to make purchases at any of the merchant's stores. Each store is linked to a central corporate credit department or to an agent third-party processing firm. When a consumer presents a retailer card, a central computer is checked to verify that the account is in good standing and that a sufficient line of credit remains to cover the purchase. If there are no problems, the transaction is completed and the consumer is subsequently billed by the credit department for the full amount the consumer purchased from that and any other location in the merchant retail chain. Most credit cards in circulation in the United States are retailer cards, although spending on retailer cards represents only about one-fifth of all credit card spending.

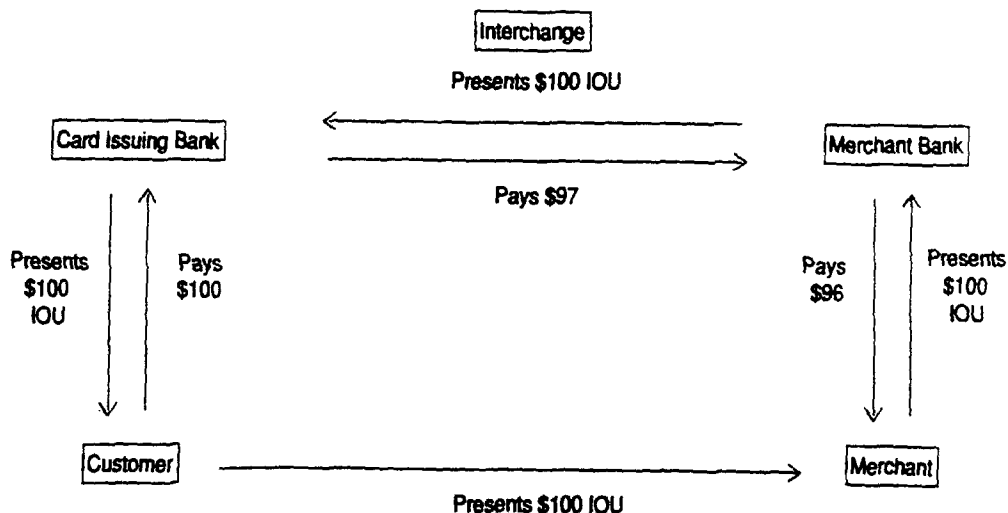
*Proprietary general purpose cards*, such as the American Express "Green Card" (and its cousins, including the Optima credit card), Discover Card (Dean Witter), and Carte Blanche and Diners Club (Citibank), are cards issued by a single firm that can be used to make purchases from many different and unrelated merchants. While the cards function in much the same way as retailer cards, a consumer can make purchases at far more merchant locations with a single general-purpose card than with dozens of typical merchant cards.<sup>10</sup>

Finally, *bank cards* are general purpose credit cards issued by any one of thousands of financial institutions that are connected to the networks operated by Visa or MasterCard, the "bank card associations." Bank cards differ from proprietary cards in that their networks do not link each merchant to a single card issuer, but rather connect each merchant to its own financial institution (or its processing agent), which is in turn connected through the networks to each card-issuing member bank.<sup>11</sup> The bank card associations allow customers of one financial institution to make purchases from merchants with bank accounts at different financial institutions. The associations' networks permit transaction authorization and clearinghouse settlement. The associations also engage in joint promotions, fraud control, and other collective activities. Bank cards typically are accepted at more merchant locations than proprietary general purpose cards.

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<sup>10</sup> Some card programs, such as American Express's "Green Card" and Citibank's Diners Club Card, do not extend credit past the due date on the monthly statement (i.e., they do not offer "revolving credit"), but even this "float" period until the due date represents the extension of credit. The industry calls these plans "charge" or "travel and entertainment" cards.

<sup>11</sup> Issuers of credit cards often rely upon third-party agents to process their credit card transactions.



**Figure 1.** Flow of funds in credit card transactions

### B. FLOW OF FUNDS IN BANK CREDIT CARD NETWORKS

The bank card associations allow card-carrying customers of one bank to make purchases from merchants who bank elsewhere. In Figure 1 we present a schematic diagram illustrating the flow of funds in a simple example of a Visa or MasterCard credit card transaction. Imagine that John uses a Visa card issued by John's bank (an "issuing member" of Visa) to buy shoes for \$100 from a merchant. John takes home the shoes while the merchant is left with a slip of paper that is essentially an IOU for \$100 from John's bank. The merchant gives the \$100 IOU to its bank (a "merchant acquiring member," which may also be an issuing member), and in return the merchant's bank pays the merchant not the full \$100 but a lesser amount, the difference representing a merchant discount fee paid by the merchant to its bank. In the example shown in Figure 1, the merchant discount rate is 4 percent, so for the purchase of a \$100 pair of shoes the merchant's account is credited only \$96. The merchant discount is a variable cost to the merchant of doing business with credit card customers. At the margin, increases in the merchant discount cause the merchant to earn lower profits unless prices rise to offset the increased cost.

The merchant's bank in turn takes the \$100 IOU from John and passes it along to John's bank. In exchange for the \$100 claim against John, the issuing bank also does not pay the full \$100, but instead deducts an interchange fee from that amount. In the example, the interchange fee is 3 percent, so the merchant's bank receives \$97, pays the merchant

\$96, and has \$1 left to cover its own costs and earn a profit. The interchange fee does *not* represent payment for the costs associated with operating the network and providing other collective services (such as advertising and fraud control) through the joint venture. For a typical transaction, the cost of providing those collective services is relatively small compared to the interchange fee and merchant discount and is paid for through small fees levied by the joint venture on its issuing and acquiring members.

Finally, the card-issuing bank in effect returns the \$100 IOU to the customer in the form of a monthly bill. The customer in turn pays the card-issuing bank \$100. Figure 1 represents a highly simplified example; there are several other sources of funds in the system that are not depicted here. For instance, if a customer fails to pay his bill in full and on time the card-issuing bank will assess a finance charge. Many card issuers also require customers to pay an annual fee for the privilege of having the credit card.<sup>12</sup>

Visa and MasterCard members collectively set rules on how they can communicate with each other and how they can settle financial transactions. The members also collectively set membership rules and the interchange fee they will charge each other. There are no collectively set rules on what merchant discount a merchant bank can charge. Nor are there any rules on what a card-issuing bank can charge a customer for finance charges or annual fees, or on how aggressive the banks can be in promotional activity to acquire new customers from other card-issuing banks or from the general population. Since the late 1970s, both Visa and MasterCard have been structured as open joint ventures which any financial institution meeting relatively minimal standards could join.

A significant change in the credit card industry began to occur in the mid-1980s with the entry of Dean Witter's Discover Card, and continued most recently with the introduction of innovative Visa and MasterCard programs, such as AT&T's Universal Card and the General Motors bank card. In these cases, there was a large-scale entry accompanied by massive promotional activity. Often the entrant announced that its new cardholders would pay no annual fee, and various rebates and incentives were offered to consumers who used the cards.

### C. ANTITRUST LITIGATION INVOLVING CREDIT CARD JOINT VENTURES

Two prominent antitrust disputes have involved collective action by credit card joint ventures—*National Bancard Corp. (NaBanco) v. VISA*

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<sup>12</sup> Annual fees were first introduced in the early 1980s when market interest rates moved to record highs but credit card interest rates were constrained by usury laws. For an

*U.S.A., Inc.*<sup>13</sup> and *SCFC ILC, Inc., d/b/a MountainWest Financial v. VISA U.S.A., Inc.*<sup>14</sup>

### 1. *The NaBanco Case*

In the early 1980s, NaBanco was a "third-party processor" of credit card transactions. It acted as an agent for members of Visa and MasterCard in processing merchant credit card transactions. It also recruited new merchants on behalf of its client banks and paid all interchange fees owed by its clients to card-issuing members. In return, NaBanco kept some or all of the merchant discount revenue it retained (again, on behalf of its clients) from the amounts remitted to merchants. NaBanco sued Visa, alleging that interchange fees charged by Visa issuing member banks inhibited NaBanco's ability to compete with Visa members in soliciting new merchant accounts. According to NaBanco, when a bank issued a significant fraction of the Visa cards that were likely to be presented to a particular merchant, it could offer a lower merchant discount rate than could NaBanco because transactions in which the bank both issued the card and serviced the merchant (called "on-us" transactions) incurred no interchange fee.

NaBanco argued that the relevant market consisted of credit card interchange services, and that Visa possessed market power in that market, as reflected in its ability to impose the interchange fee. Visa responded by arguing, first, that the relevant market includes other methods of payment besides credit cards, such as cash and checks, so that Visa did not possess market power. Second, Visa argued that even if the relevant market were limited solely to credit cards, interchange fees served to compensate the Visa issuers for their costs, and thus were necessary to facilitate the operations of the credit card network.

Siding with Visa, the trial court held that the relevant market included all payment systems, and thus concluded that Visa had no market power. The court also concluded that, "even if NaBanco had established that Visa had power in a relevant market and that [the interchange fee] had substantial anticompetitive effects, Visa established that [the interchange fee] is necessary to offer the Visa card—a pro-competitive benefit which offsets any anti-competitive effects."<sup>15</sup> The court further concluded that

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explanation of why this occurred, see Christopher C. DeMuth, *The Case Against Credit Card Interest Rate Regulation*, 3 *YALE J. ON REG.* 201, 218, 237 (1986). They persisted even after those usury limits were largely abolished, although they recently have fallen significantly, a phenomenon that we discuss below.

<sup>13</sup> 596 F. Supp. at 1231.

<sup>14</sup> 819 F. Supp. at 956.

<sup>15</sup> *NaBanco*, 596 F. Supp. at 1265.

no less restrictive alternative to the interchange fee was available.<sup>16</sup> On appeal, the Eleventh Circuit refused to reevaluate either the district court's weighing of the evidence on the relevant market or the district court's balancing of the alleged procompetitive and anticompetitive effects.

## 2. *The MountainWest Case*<sup>17</sup>

In the mid-1980s, Sears, Roebuck and Co., which already had a very large merchant credit card business and which owned Dean Witter, sought to become a major issuer of general purpose credit cards as well. At the time, Sears owned Sears Savings Bank, which was a small card-issuing member of Visa. Rather than expanding its Visa card participation, Sears decided to begin by launching a major new proprietary credit card brand, the "Discover Card." For that purpose, Sears acquired another financial institution, Greenwood Trust, which was not then a member of Visa.

After several years, the Discover Card became profitable and Sears sought to obtain the ability to participate in Visa card activity as well. Although Sears was issuing the Discover Card through Greenwood Trust at the same time that it owned Sears Savings Bank, Sears allowed the Visa membership of Sears Savings Bank to lapse. Instead, Sears had Greenwood Trust itself apply for Visa membership.<sup>18</sup> At that time, Visa membership was open to any financial institution (including Greenwood Trust) that qualified for federal deposit insurance. Visa requested Sears to consider converting its Discover Card into a Visa product, but Sears never replied. Visa then responded to Sears's application, and its unwillingness to convert Discover Card into a Visa product, by adopting a new rule that prohibited granting membership to any institution that issued, or was affiliated with an institution that issued Discover Cards or American Express Cards, or any other card "deemed competitive" by the Visa Board of Directors. (Neither MasterCard nor Citibank's Diners Club and Carte Blanche cards were "deemed competitive" under this Visa rule.)

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<sup>16</sup> *Id.*

<sup>17</sup> Some of the facts of the *MountainWest* case are still disputed. Our intention here is not to argue the underlying facts of the case, but rather to use the following interpretation of the basic facts, in Part V below, to illustrate the type of evidence that would allow one to come to the conclusion that intervention to compel access by a rebuffed would-be entrant to a credit card joint venture can be justified.

<sup>18</sup> Sears Savings Bank was a thrift institution, not a bank, and as such needed to have a certain minimum fraction of its assets invested in mortgage loans and securities in order for it to continue to be owned by a diversified company like Sears. Greenwood Trust, on the other hand, was a "nonbank bank" that could be owned by a diversified company without significant limitations on the percentage of its assets that could be invested in credit card loans and operations.

Sears then tried to enter Visa by purchasing MountainWest Financial, a thrift institution that already was a Visa issuer, with the aim of launching as its second major card program an aggressively priced and promoted new Visa card program, to be called "Prime Option," that would carry no annual fee and would offer an innovative discounted finance charge option.<sup>19</sup> Visa refused to allow MountainWest to issue additional Visa cards, and litigation ensued. (Sears has since divested Dean Witter, which owns Discover Card. We henceforth speak of Dean Witter, not Sears.)

Dean Witter claimed that Visa's selective exclusion of affiliates of firms that issue cards "deemed competitive" had two anticompetitive purposes and effects: it eliminated an aggressive price-cutting new Visa program, which would have generated significant consumer benefits directly and via competitive responses; and it erected a barrier to new card programs, because a potential proprietary card entrant (or new network) now would incur an additional cost, in the form of exclusion from Visa, for creating a new credit card brand.

In *MountainWest*, Visa abandoned its *NaBanco* position that all payment systems are part of the same relevant market, and stipulated for trial that the relevant market consisted of general purpose credit cards. Even in that narrower market, Visa maintained that it could not possess market power because prices to consumers were set independently by its (roughly) six thousand members. Visa argued that it should not be forced to admit a competitor into its network, especially when the competitor could gain access to the market even without Visa membership and potentially could exploit its access to the Visa network to free ride on the investments of early Visa members and to misappropriate sensitive Visa information. Finally, Visa counterclaimed that Dean Witter's membership in Visa would violate Section 7 of the Clayton Act by substantially reducing "intersystem" competition.

Following trial, a jury entered a verdict for Dean Witter.<sup>20</sup> The district court, while expressing views contrary to those of the jury on some questions, nevertheless upheld the jury's verdict.<sup>21</sup> Recently, however, a

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<sup>19</sup> The Prime Option program was to offer consumers a lower interest rate for recent purchases than for older purchases, so that a consumer could pay off an outstanding balance quickly and incur a very low finance rate, or pay more gradually at a higher rate.

<sup>20</sup> There were three specific jury interrogatories: Did Dean Witter prove that Visa's bylaw excluding issuers of cards "deemed competitive" by the Visa board had a substantially harmful effect on competition in the relevant market? If yes, then did Dean Witter prove that the harmful effect substantially outweighed any beneficial effect on competition in the relevant market? If yes, then did Dean Witter prove that it was injured by Visa's rule? The jury answered all three in the affirmative.

<sup>21</sup> The court tried Visa's counterclaim on the same factual record, and entered a verdict for Dean Witter.

panel of the U.S. Court of Appeals for the Tenth Circuit reversed the district court decision, holding that, as a matter of law, Visa could not exercise market power because it is made up of thousands of independent competitors.

### III. MARKET POWER

In evaluating the potential anticompetitive effects of collective action by members of credit card joint ventures, as a threshold matter one must determine whether market power can even exist in the credit card industry. If no set of firms in the credit card industry can collectively have market power, then it makes no sense to consider intervening to change a policy of any particular joint venture in that industry. In this section, we explore the two questions relating to market power that were raised by *NaBanco* and *MountainWest*. First, are there enough constraints on credit cards that even a monopolist of all general purpose credit cards could not have market power? Put differently, is there a relevant market limited to general purpose credit cards that does not contain other types of payment services? Second, even if credit cards do constitute a relevant market, and a monopolist of all credit cards would have market power, can a credit card joint venture with a significant share of that market exercise any market power if it has rules that permit each member to set some prices independently?

#### A. OTHER PAYMENT TECHNOLOGIES DO NOT PRECLUDE THE EXERCISE OF MARKET POWER IN CREDIT CARDS

In *NaBanco*, the court held that noncredit card payment systems, such as checks and cash, prevent any issuer of credit cards from exercising market power. That analysis, at least today, seems wrong for several reasons. First, the mere existence of substitutes does not eliminate the possibility of market power. This is the well-known *Cellophane* fallacy. In *United States v. E.I. du Pont de Nemours & Co.*,<sup>22</sup> sometimes called the *Cellophane* case, the Supreme Court held that the fact that other flexible wrapping materials were being sold successfully meant that the relevant market could not be limited to cellophane and that a firm controlling all cellophane sales could not have market power. Yet this is incorrect, for it ignores the possibility that with more cellophane competition the price of cellophane would have fallen, making those other products less desirable substitutes.<sup>23</sup> A firm or joint venture with market power always

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<sup>22</sup> 351 U.S. 377 (1956).

<sup>23</sup> See, e.g., George W. Stocking & Willard F. Mueller, *The Cellophane Case and the New Competition*, 45 AM. ECON. REV. 29 (1955); DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 804 (2d ed. 1994).

has an economic incentive to raise price to the point that further increases are unprofitable, because at high enough prices consumers begin to purchase substitute products. In the case of credit cards, the mere fact that cash can be used instead of credit cards says nothing about whether the current price of credit cards is elevated above what it would otherwise be if the credit card industry were more competitive.

Second, if one truly believed that cash, checks, and other payment technologies were part of the same market as credit cards, one would have to conclude that a merger of all the credit card systems in the United States would not raise any antitrust concerns. Moreover, one would also have to conclude that the elimination of competition in credit cards among banks, and implementation of collectively set annual fees, interest rates, and merchant discounts for credit cards, would not cause prices for credit cards to rise and therefore would not raise antitrust concerns.

Third, AT&T's recent entry into the credit card business with its Universal Card seems to have had a dramatic effect on the credit card industry. In 1990, AT&T entered the market with a zero annual fee "for life" bank card, providing instant benefits to many millions of card holders who took its offer. According to one report, following AT&T's large-scale entry with a no-fee card, over 400 other issuers began selectively waiving their own annual fees to keep customers from defecting to AT&T.<sup>24</sup> The subsequent entry of other no-fee cards has continued the trend and forced some existing issuers to lower or eliminate annual fees. Also, while there have been numerous reports in the trade press that AT&T's entry caused other credit card issuers to cut their prices, we are unaware of any claims that AT&T's entry caused checking account fees to decline.<sup>25</sup> If checks are in the same market as credit cards, then the entry of AT&T should have been observed to cause significant reductions in checking fees as well.

#### B. COMPETITION AMONG MEMBERS OF CREDIT CARD JOINT VENTURES DOES NOT PREVENT THE EXERCISE OF COLLECTIVE MARKET POWER

The appellate court in *MountainWest* held that Visa cannot exercise collective market power because Visa is composed of thousands of mem-

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<sup>24</sup> Eric J. Savitz, *Fate Worse Than Debt: Competition Is Rearing Its Ugly Head in Credit Cards*, BARRON'S, Feb. 18, 1991, at 12.

<sup>25</sup> For a small sample of press accounts describing AT&T's competitive impact on credit card competition and prices, see Saul Hansell, *Challenging the Credit Card Giants*, INSTITUTIONAL INVESTOR, Aug. 1990, at 51; David B. Hilder & Peter Pae, *Rivalry Rages Among Big Credit Cards: Reduced Fees, Special Offers Aid Consumers*, WALL ST. J., May 3, 1991, at B1; John Sims, *Looking Behind the New AT&T Card*, MONEY, Sept. 1990, at 98; Douglas R. Sease,

bers who compete with each other. We believe that this reasoning is wrong. In order to see why, one must distinguish decisions that are collectively made from those that are independently made. On those aspects of credit card pricing on which banks independently compete, such as interest rates, annual fees charged to customers, and discount fees charged to merchants, it is difficult to see how those uncoordinated decisions can, in isolation, lead to the exercise of market power. On the other hand, it is easy to see how collectively-made decisions by these same banks could lead to an exercise of market power. For example, suppose a group of banks collectively is able to exclude (or to expel from the venture) a large, innovative, low-cost, price-cutting producer that has the ability to expand rapidly. This could have a significant effect, causing price to be higher than it would otherwise be and output to be lower. In fact, several large Visa and MasterCard issuers sought to prevent AT&T from competing in the credit card industry through contemplated rule changes and regulatory actions that effectively would have terminated AT&T's program.<sup>26</sup> When such collective action results in elevated prices and reduced output (which likely would have been the case had AT&T been kept from issuing its bank cards), there is an exercise of market power.<sup>27</sup>

The same reasoning applies to other industries. For example, if all of the small town general stores in the United States had somehow prevented Sam Walton from entering the retailing business and developing WalMart, or alternatively prevented him from operating efficiently, we would characterize that as an exercise of their collective market power, because the effect of such collective action would be to deprive consumers of lower prices. In fact, in the early history of chain supermarkets, independent grocery retailers and wholesalers in many states, recognizing their collective interest in keeping out innovative, price-cutting competitors, lobbied successfully for special taxes on chain stores, thus deterring entry by chain stores and raising their costs.<sup>28</sup>

There are many other examples in which groups of otherwise competing firms have acted collectively to obtain legal protection from more

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*Citicorp Visa Is Taking Aim at AT&T Card*, WALL ST. J., June 27, 1990, at B1; Peter Pae, *AT&T Cuts Rate on Credit Cards One Point to 15.4%*, WALL ST. J., Mar. 17, 1992, at C17.

<sup>26</sup> See, e.g., *Visa Launches a Crackdown on Affinity Cards*, CREDIT CARD NEWS, Oct. 15, 1990, at 1. While the associations ultimately did not pass these rule changes, they did adopt rules to prevent the program from being duplicated by anyone else.

<sup>27</sup> For a discussion of how exclusionary conduct that prevents prices from falling to lower levels (that would otherwise prevail) can be an exercise of market power, see Thomas G. Krattenmaker et al., *Monopoly Power and Market Power in Antitrust Law*, 76 GEO. L. REV. 241 (1987).

<sup>28</sup> See Thomas W. Ross, *Store Wars: The Chain Tax Movement*, 29 J.L. & ECON. 125 (1986).

efficient or aggressive competitors, whether they be foreign producers or domestic producers of substitute products. In general collective lobbying of the government is protected from antitrust attack by the *Noerr-Pennington* doctrine.<sup>29</sup> But the economic effects are the same in a case where the group of competitors does not need help from government in order to exclude the efficient competitors or raise their costs, but may achieve the same result through collective actions that are not immune from antitrust challenge.

As a theoretical matter, therefore, even a joint venture with many members setting prices independently can exercise market power through collectively set rules regarding entry or other policies that affect price.<sup>30</sup> Thus, contrary to the Tenth Circuit's holding in *MountainWest*, when a credit card joint venture acts collectively in ways that can affect price (e.g., by excluding a firm or firms that would lower price), the antitrust inquiry should focus on the joint venture's collective market share and collective market power.<sup>31</sup> Otherwise, any joint venture that could find indirect methods to raise price through the use of nonprice rules, including exclusionary conduct, would enjoy immunity under the antitrust laws.

#### IV. INTERCHANGE FEES

In this section, we analyze the competitive effects of one type of collective action by credit card joint ventures: the collective setting of inter-

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<sup>29</sup> *United Mine Workers v. Pennington*, 381 U.S. 657 (1965); *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961).

<sup>30</sup> In *MountainWest*, Visa argued that Dean Witter had only been excluded from the Visa network, not from the relevant market. The relevant economic question, however, is not how to define the market, but whether the exclusion of Dean Witter caused prices to be higher than they otherwise would be. If the relevant market is defined as all general purpose credit cards, Dean Witter would not have been excluded from the market, but its costs would have been raised, causing an anticompetitive effect. Alternatively, if the relevant market is defined as Visa and MasterCard brands, Dean Witter would have been totally excluded from the relevant market, but the anticompetitive effect on consumers would be the same. No matter how the market is defined, consumers are harmed. See *Associated Gen. Contractors, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 528 (1983) ("An agreement to restrain trade may be unlawful even though it does not entirely exclude its victims from the market"); *Reazin v. Blue Cross & Blue Shield, Inc.*, 899 F.2d 951, 964-66 (10th Cir.), cert. denied, 497 U.S. 1005 (1990) (finding that it was anticompetitive to increase the plaintiff's costs and reduce consumer options).

<sup>31</sup> Because Visa's and MasterCard's memberships largely overlap one another, we treat the two organizations as having the ability to act in concert. Therefore, we look at the collective shares of Visa and MasterCard together to assess the collective market power of these members. Visa and MasterCard together account for about 72% of annual general purpose credit card sales volume in the United States. See *The Earnings Balloon*, CREDIT CARD MGMT., May 1994, at 32. We also note that a high collective share can raise issues of either unilateral power or oligopoly coordination with other firms.

change fees. This practice, as discussed above, was the focus of the *NaBanco* case. In *NaBanco*, the court upheld the Visa network's imposition of interchange fees, the fees paid by the merchant bank to the card-issuing bank, finding that such fees are reasonably necessary to compensate the card-issuing bank for certain costs (such as marketing or providing interest-free grace periods to the customer) and thus are essential to the operation of the joint venture.<sup>32</sup> This analysis of interchange fees, we will show, is wrong or at best misleading.<sup>33</sup> Assuming that there is free competition among credit card network members and that prices are free to adjust to cost changes, interchange fees will have absolutely no effect on ultimate prices or the ability to compensate the issuing bank for any costs.<sup>34</sup>

Suppose that John initially buys a pair of shoes for \$100. In order to simplify the analysis, assume that the only cost of processing this transaction throughout the entire system is that the card-issuing bank incurs \$1 worth of costs. In such a case, with an interchange fee of \$1, the merchant bank will charge \$1 to the merchant as the merchant discount. Therefore, John pays a total bill of \$100, the merchant ends up with \$99, and \$1 will end up with the card-issuing bank.

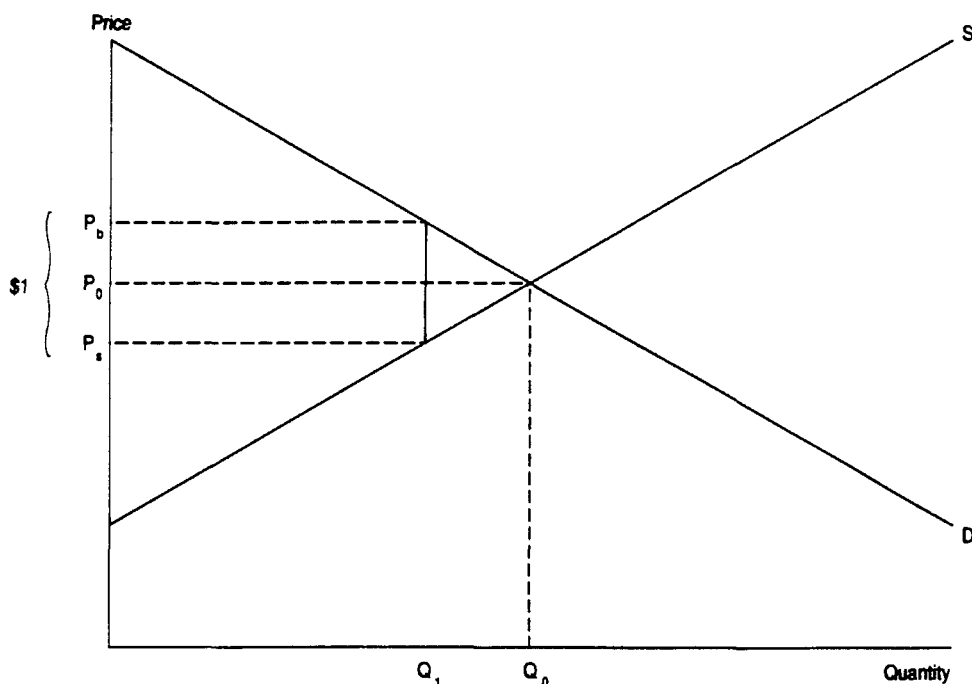
Now imagine a situation in which there is no interchange fee but all other costs are kept the same. In this situation, we can achieve exactly the same equilibrium that occurs with a \$1 interchange fee. If there is no interchange fee, then the merchant bank will not charge the merchant discount of \$1 and, therefore, the merchant's costs will be lowered by \$1. Under competition, the merchant will be forced to pass along this \$1 in savings to John; the price of shoes thus will drop to \$99. Of course, the card-issuing bank will recognize that it has incurred \$1 worth of costs when John buys his \$99 pair of shoes. Therefore, when the card-

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<sup>32</sup> *NaBanco*, 596 F. Supp. at 1259.

<sup>33</sup> A similar analysis applies to interchange fees in ATM systems. See Steven C. Salop, *Deregulating Self-Regulated Shared ATM Networks*, in *ECON. INNOVATION & NEW TECH.* 85 (1990). Interchange fees have been the focus of ATM network cases in Nevada and Texas. See *Valley Bank of Nev. v. Plus Sys.*, 749 F. Supp. 223 (D. Nev. 1989), *aff'd*, 914 F.2d 1186 (9th Cir. 1990); *First Tex. Sav. Ass'n v. Financial Interchange, Inc.*, 55 *Antitrust & Trade Reg. Rep. (BNA) No. 1380*, at 340 (Aug. 19, 1988) (Kaufer, Arb.); Karen L. Grimm & David A. Balto, *Consumer Pricing for ATM Services: Antitrust Constraints and Legislative Alternatives*, 9 *GA. ST. U. L. REV.* 839 (1993).

<sup>34</sup> The *NaBanco* decisions appear to agree with an article by then Assistant Attorney General for Antitrust William Baxter, which assumes that credit card issuers and merchant banks cannot recover their respective costs without a collectively set interchange fee. See William F. Baxter, *Bank Interchange of Transactional Paper: Legal and Economic Perspectives*, 26 *J.L. & ECON.* 541 (1983). But Baxter's analysis assumes that the alternative to a collectively set interchange fee is a situation in which each issuer dictates the interchange fee applicable to its own transactions, not the abolition of the interchange fee altogether.



**Figure 2.** Effect of a \$1 transaction cost

issuing bank sends John a bill on behalf of this transaction, it will separately charge John \$1 as the cost of dealing with this transaction and will also charge him \$99, reflecting the price of the shoes. That is, the card-issuing bank that has a direct relationship with John will charge John for the cost it incurs on his behalf. John ends up paying exactly the same amount as before, \$100; the merchant ends up receiving exactly the same amount as before, \$99. The only difference is that now there are two items on John's bill—one that says "shoes \$99" and another that says "credit card costs \$1," whereas before the bill contained a single charge for \$100 and it was up to the merchant bank and the card-issuing bank to sort out who received what amount of that \$100.

To understand how transaction costs affect the usual supply and demand analysis, picture the equilibrium, depicted in Figure 2 (at price  $P_0$  and output  $Q_0$ ), for the case of no transaction cost. Now suppose there is a transaction cost of \$1 per item, then the new equilibrium will occur at output  $Q_1$ . The buyer will pay  $P_b$ ; the seller will receive  $P_s$ ; and the \$1 difference between  $P_b$  and  $P_s$  will cover transaction costs. There can be only one equilibrium, and determining who pays what costs is simply a matter of flow of funds accounting. Ultimately, the seller receives  $P_s$  after transaction costs and the buyer pays  $P_b$ , whether or not there is an interchange fee.

One implication of this example is that, as the interchange fee continues to rise so that more funds flow to the card-issuing bank, the card-issuing bank will be forced by competition to return any high interchange fee to the customer by offering a rebate so as to keep the price paid by consumers at  $P_b$ . Thus, if interchange fees rose by 5 percent of the purchase amount, and merchants pass this along to consumers, then retail prices would be 5 percent higher and all issuing banks would earn additional revenue equal to 5 percent of retail sales. However, in competition for the now more profitable credit card customers, the banks would have an incentive to rebate these revenues back to consumers. We believe that the growing use of rebates is a direct function not only of intensified competition among credit card issuers (especially since AT&T's entry), but also of high interchange fees.<sup>35</sup>

There is a close analogy between interchange fees and vertical restrictions. The issue of whether payments from the merchant banks to the card-issuing banks are necessary in order to encourage promotion by card-issuing banks is very similar to the issue of how a manufacturer can induce its competing distributors to engage in promotional activity. It is well known that, under standard economic assumptions, merely altering the wholesale price will have no effect on the distributors' incentive to promote a product.<sup>36</sup> As long as there is competition among distributors, promotional effort cannot be induced through price discounts at wholesale, because distributors simply will pass on the savings to customers, leaving the incentive to promote unchanged. To influence promotional activity at the distributor level, one must employ additional policies such as resale price maintenance, to prevent the lowered wholesale price from being completely passed along to consumers. Without such policies, promotional incentives are unaffected. This holds true for interchange fees, which can be viewed as a subsidy at wholesale to the card-issuing bank.

This analysis is similar to a standard result regarding tax incidence. It is well accepted that the identity of the party on whom a tax is levied, whether it is the buyer or the seller, the employer or employee, is immaterial to the final equilibrium.<sup>37</sup> Regardless of who has to pay, the final

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<sup>35</sup> One would predict that if interchange fees were "too high" competition would force issuers to use rebates. Direct discounts from the purchase amounts on credit card bills mailed to consumers (instead of frequent flier miles, discounts on automobiles and phone calls, etc.) may be the most efficient form of rebate. In fact, some issuers are moving in this direction by offering cash rebates on all bank card purchases. See Linda Punch, *Who's Afraid of Cobranding*, CREDIT CARD MGMT., Nov. 1993, at 39-44.

<sup>36</sup> See Carlton & Perloff, *supra* note 23, at 499.

<sup>37</sup> See, e.g., ROBERT H. FRANK, MICROECONOMICS AND BEHAVIOR 50-51 (1991).

price paid and received (after taxes) by buyers or sellers will remain unchanged. For example, suppose there is a \$1 tax on the seller; thus, the buyer pays \$10 while the seller (after taxes) receives \$9. In order to see why the technical payment of the tax is irrelevant, imagine that the buyer has to pay the tax. In this situation, the price marked in the store will be \$9, which is the amount the seller will receive, but the buyer then has to pay an additional \$1 to the government in taxes, so the buyer pays a total of \$10. In contrast, if the seller has to pay the \$1 tax, the seller sells the product in the store for \$10, the buyer pays the \$10, and the seller, after sending \$1 to the government, keeps \$9. In either case, the buyer pays \$10 and the seller receives \$9 after taxes. Indeed, the usual diagram used to determine the equilibrium from the imposition of a \$1 tax is one exactly like Figure 2.

Despite the foregoing analysis, there are circumstances under which the use of an interchange fee can have a real effect on market performance.<sup>38</sup> (These circumstances were not the focus of the *NaBanco* case, though perhaps they should have been.) For example, suppose that there are restrictions on competition among banks so that banks have agreed not to compete either for consumers or merchants, or have agreed not to give rebates or merchant discounts above a certain amount. As interchange rates rise, one would expect consumer rebates to occur. If rebating is not allowed, however, interchange fees will have allocative effects and could stimulate promotion.

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<sup>38</sup> Although interchange fees were not the focus of the *MountainWest* trial, some commentators have suggested that Dean Witter's entry into Visa would reduce its incentive to lower Discover Card's merchant discount rates, and thus would inhibit intersystem competition between Discover Card and Visa. See David A. Balto, *Antitrust and Credit Card Joint Ventures*, 47 CONS. FIN. L.Q. REP. 266 (1993). Discover Card transactions typically have a lower merchant discount rate than Visa transactions, at least in part because Discover Card needed to provide merchants with an incentive to accept another credit card brand. (Discover Card cardholders generally also hold a Visa card or MasterCard, so the merchant would not be forgoing large numbers of transactions if it only accepted Visa and MasterCard brands.) If Discover Card's lower merchant discount rate forced Visa to reduce its interchange fees (to allow Visa merchant banks to themselves offer their existing merchants lower discount rates) in order to keep Discover Card out of the market, then Balto's suggestion might have merit. However, then Discover Card would have failed to create an incentive for merchants to accept its card, so we are skeptical that this concern is grounded in reality. In fact, to our knowledge Visa has cut its interchange fee in response to Discover Card only in situations in which Discover Card was able to target particular industries, such as supermarkets, that have low profit margins and in the past had generally not accepted credit cards. Visa would appear to have no incremental incentive to reduce its standard interchange fee unless it expects a significant number of merchants to discontinue accepting Visa cards as a result of Discover Card's lower merchant discount rate, which we regard as unlikely in the current environment. This is because acceptance or nonacceptance is the only option available to merchants to influence the customer's choice of card at retail. See note 40, *infra*. Moreover, as discussed below, the net effect of Dean Witter's entry on consumers, according to Visa members, is that price would fall. This indicates that any

Interchange fees also can have allocative effects where banks are not perfectly competitive with each other but instead are engaged in some sort of oligopolistic or monopolistic competition. In oligopolistic markets, changing the wholesale price generally will affect the margin between the wholesale and retail price, depending upon the price elasticity of demand, and thus will influence incentives to engage in promotional expenditures. There can be an effect from the imposition of interchange fees but the effect will depend upon the elasticity of demand with respect to marketing efforts, as well as the elasticity of demand with respect to price.<sup>39</sup>

Perhaps the most interesting reason why interchange fees can have allocative effects is because most merchants, presumably due to the high cost of distinguishing between payment methods, do not charge different prices to consumers depending upon whether they pay with cash or with credit cards.<sup>40</sup> Interchange fees can be viewed as a way to raise costs to

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anticompetitive effects on intersystem competition are dwarfed by the procompetitive inter- and intrasystem effects.

<sup>39</sup> For a similar analysis relating to ATM networks, see Steven C. Salop, *Evaluating Network Pricing Self-Regulation*, in ELECTRONIC SERVICES NETWORKS, *supra* note 3.

<sup>40</sup> Federal law once prevented price distinctions between cash and credit card transactions. See 15 U.S.C. § 1666f(9)(2) (1982). In the early 1980s Congress (against the efforts of credit card issuers) amended the Truth in Lending Act to allow "discounts" for cash transactions, but—in accord with the position taken by the card issuers—still banned "surcharges" for credit transactions. For some of this history, see BOARD OF GOVERNORS OF THE FEDERAL RESERVE, CREDIT CARDS IN THE U.S. ECONOMY: THEIR IMPACT ON COSTS, PRICES, AND RETAIL SALES (1983); *The Cash Discount Act: Hearings on the Cash Discount Act and Proposals to Extend the Ban on Credit Card Surcharges Before the Subcomm. on Consumer Affairs of the Senate Comm. on Banking, Housing, and Urban Affairs*, 98th Cong., 2d Sess. (1984); *The Cash Discount Act: Hearings on H.R. 31 Before the Subcomm. on Consumer Affairs and Coinage of the House Comm. on Banking Finance and Urban Affairs*, 97th Cong., 1st Sess. (1981); *The Cash Discount Act: Hearings on S. 414 Before the Subcomm. of Consumer Affairs of the Senate Comm. on Banking, Housing, and Urban Affairs*, 97th Cong., 1st Sess. (1981); *Credit Card Surcharge Ban: Hearings on H.R. 5026 and S. 2336 Before the Subcomm. on Consumer Affairs and Coinage of the House Comm. on Banking, Finance and Urban Affairs*, 98th Cong., 2d Sess. (1984); *Credit Card Surcharges* (Bankcard Holders of Am., McLean, Va., Mar. 8, 1993). One reason that surcharge and discount policies might not be equivalent is that credit card surcharges permit different consumer fees for different credit cards—i.e., direct interbrand price (i.e., merchant discount) competition between American Express, Visa, MasterCard, Discover Card, and proprietary retailer credit cards—while cash discounts only permit a uniform difference between the cash price and the price charged for any credit card transaction. Although all federal restrictions lapsed several years ago, many states still forbid credit card surcharges. See, e.g., CAL. CIV. CODE § 1748.1 (West 1991 Supp.); COLO. REV. STAT. ANN. § 5-3-110 (West 1989); CONN. GEN. STAT. § 42-133ff (West 1987). The credit card companies themselves often prohibit surcharges or any actions by retailers that "discriminate" against users of their credit card brand relative to users of other credit cards. For example, in some celebrated cases American Express has terminated retailers that encouraged (through nonprice means) consumers to use a different credit card. See, e.g., *American Express Keeps the Heat on Its Merchants*, CREDIT CARD NEWS, Feb. 1, 1992; *Escalating: American Express Company*, CARDFAX (Faulkner & Gray, Inc., Jan. 24, 1992); *The Other Check: American Express Co.*, CARDFAX (Faulkner & Gray, Inc., Jan. 28, 1992). The existence of such restrictions likely reduces competition on merchant discounts.

merchants who then pass those costs on to cash and credit customers alike by charging the same higher price to both. Cash customers are essentially being taxed to finance credit customers because the interchange fees eventually flow back to the card-issuing banks that will be forced by competition to give back at least part of the interchange fees in the form of rebates or lower fees to their credit card customers. Therefore, interchange fees allow credit customers to impose a tax on cash customers. In such a setting, banks issue more credit cards and consumers use credit cards for more transactions than they would with no interchange fee. As retailing technology advances, and our economy incurs lower transactions costs, reluctance on the part of merchants to distinguish in price between cash and credit customers is likely to diminish and, barring legal or contractual barriers, this effect of interchange fees could therefore also diminish.

Even though there are many circumstances under which an interchange fee can have an effect on price, the important insight is that the standard justification for interchange fees—that they are an essential means of covering the costs of a card-issuing bank—is simply wrong under the assumptions commonly used in antitrust analysis. Competition will guarantee that costs are covered even without interchange fees.<sup>41</sup> Therefore, the underlying reasoning in *NaBanco* is flawed.

Our analysis leaves open the possibility of an antitrust challenge to interchange fees, *NaBanco* notwithstanding. Our analysis also suggests that if there are anticompetitive effects of interchange fees, they are likely linked to restrictions on a merchant's pricing freedom at the point of sale.<sup>42</sup> Given our general predisposition against interfering with potentially efficient business practices, before reaching any conclusions regarding the need for intervention, we would require additional evidence that interchange fees and related practices actually harm consumers.

## V. ACCESS TO JOINT VENTURES

The second type of collective action that has raised antitrust concerns in the credit card industry are collectively set restrictions on membership in credit card joint ventures. Once it has been established that joint venture members can have collective market power, it makes sense to

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<sup>41</sup> Note that, under Visa's reasoning in *NaBanco*, one would not expect banks to be able to cover the costs of offering checking accounts to consumers absent some form of interchange fee. Yet checking accounts are offered by virtually all financial institutions without any such fee.

<sup>42</sup> If there are restrictions that lead to real *procompetitive* effects of interchange fees, these effects are likely linked to network externalities. However, for a sobering view of the importance of network externalities, see S.J. Liebowitz & Stephen E. Margolis, *Network Externality: An Uncommon Tragedy*, 8 J. ECON. PERSP. 133 (1994).

examine whether compelling access to the joint venture by a rebuffed entrant is socially desirable. This requires a careful balancing of the likely costs and benefits of intervention. There are really two arguments that could weigh heavily against intervention. First, intervention that forces a successful, ongoing joint venture to accept a new member could harm the functioning of the joint venture and possibly result in its demise, leaving consumers worse off than they were before. Second, antitrust intervention in any activity could be argued to deprive future innovators of the expectation of rewards needed to create the incentives to invest.<sup>43</sup>

There will always be a greater incentive to form a joint venture if the venturers are allowed to collude and exercise market power, in the same way that patent laws are used to spur product innovation. But it cannot logically follow that every joint venture should have the unlimited right to earn profits from market power by imposing any rules or restrictions that it chooses. As a general principle, antitrust is wary of collective action among competitors. So, for example, it should raise antitrust scrutiny if a joint venture like Visa altered its structure and replaced the current competition among its banks in annual fees and finance charges with collectively set consumer fees. While there is a theoretical possibility that some valuable joint ventures will not form unless their prospective members can be assured of the right to exercise their collective market power under the venture, antitrust generally places the burden on such ventures to prove that the collective activity is essential to the success of the venture.

#### A. COMPETITIVE BENEFITS OF COMPELLING VISA TO ADMIT DEAN WITTER

In *MountainWest*, there was evidence that Dean Witter's entry into the Visa network would significantly benefit consumers by lowering prices.<sup>44</sup> Dean Witter intended to charge a zero annual fee on its Prime Option Visa card, instead of the average \$15 to \$20 fee then prevailing,<sup>45</sup> to maintain this zero annual fee for at least seven years, and to attract several million card holders. Moreover, Dean Witter intended to charge interest according to an innovative schedule that could have substantially

<sup>43</sup> See, e.g., CARLTON & PERLOFF, *supra* note 23, at 684–85.

<sup>44</sup> AT&T entered in March 1990 with a "free-for-life" offer that expired one year later. Sears planned to enter in March 1991 with its no-fee card. The next large-scale entry, General Motors, did not occur until roughly one and one-half years later. Further study is warranted to determine how technology and industry conditions have changed in recent years to induce some firms to enter with large-scale, heavily promoted card programs that cause industrywide price effects.

<sup>45</sup> See *Card Industry Directory: The Blue Book of the Credit and Debit Card Industry in the United States* (Faulkner & Gray, Inc. 1992).

lowered interest rates paid by many consumers. Evidence was also introduced that Visa members themselves recognized that, by obtaining entry into the Visa network, Dean Witter would have a much greater effect on overall credit card pricing than it could through proprietary cards only. The Visa members themselves expected that Dean Witter's entry into the Visa system would lead to lower prices and therefore would have a detrimental effect on their profits. Finally, there was evidence to indicate that allowing Dean Witter to join Visa would lead to increased competition by encouraging other firms to introduce new proprietary cards.<sup>46</sup>

### B. POSSIBLE COSTS OF COMPULSORY ACCESS

In analyzing the possible costs of allowing Dean Witter to enter the Visa network, there seem to be at least three reasonable concerns. The first concern is whether Dean Witter's entry would deprive Visa's early members of the expected level of return that induced their entry. While this is a reasonable concern for many joint ventures, the facts are that for many years the Visa network has thrived as an open membership joint venture. For most of its history, the Visa network allowed access to any bank that wished to join and compete in the issuing of Visa cards. A rule excluding one or two entrants could not possibly protect property rights that induced the entry of the early investors, because all other banks still have the right to enter and "share" that "property."<sup>47</sup> The bottom line is that there is no connection between the exclusion of Dean Witter and the desire to ensure that there are enough rewards so that the innovators and prior entrants will have earned an adequate return.<sup>48</sup> The actual history of how Visa has operated thus belies its need to be able to exclude entrants in order to succeed or to reward the initial investors.

Another concern is whether Dean Witter's entry would enable it to steal secrets and free ride. This also seems like a reasonable concern if in fact Dean Witter could, by issuing Prime Option cards as a member of the Visa network, obtain valuable proprietary information, such as lists of other members' customers, and then pass that information along

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<sup>46</sup> The district court concluded that all of this evidence, taken together, provided a reasonable basis for the jury's finding that Visa's exclusion of Dean Witter resulted in substantial competitive harm. *MountainWest*, 891 F. Supp. at 977 n.22, 984-87, 988-90, 999-1000.

<sup>47</sup> It is interesting to observe that out of the ten top current Visa issuers, six were not founding members.

<sup>48</sup> Several commentators have argued that profits in credit cards have been unusually and inexplicably high. See, e.g., Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 50 (1991).

to Discover Card to use in competition with Visa's members. Again, however, the history of how Visa has operated shows that this reason is not persuasive. Visa's largest member, Citibank, has issued its own proprietary cards (Diners Club, Carte Blanche, and, for a time, Choice) for many years without complaints by Visa of free riding or stealing of trade secrets.<sup>49</sup> Moreover, when Sears owned both Dean Witter and Sears Savings Bank, and issued Visa cards through Sears Savings Bank at the same time that it was issuing the Discover Card, there were no complaints of free riding or stealing of trade secrets. Furthermore, most banks issue MasterCard and Visa simultaneously, yet there apparently has never been a concern of trade secret theft or free riding between MasterCard and Visa. Visa members already share information with each other and have had to deal routinely with the "secrecy" of valuable information. For example, Visa members are forbidden from using transaction information from a particular merchant to identify cardholders of another member to target for solicitations. We are unaware of any problems related to the theft of proprietary information by one Visa member from another. Therefore, the bottom line is that the actual history of Visa shows that the concern about theft of secrets and free riding is baseless.

The third and final concern is whether Dean Witter's entry into Visa would make the Visa joint venture overly inclusive and significantly diminish intersystem competition between Visa and Discover Card. There are several important issues to note in assessing this concern. To begin, Dean Witter had not proposed a merger of Discover Card and Visa, which probably would raise different (and more difficult) antitrust issues than those analyzed here. Instead, Dean Witter had proposed to become a member of Visa, with a share of no more than 5 to 10 percent of Visa transactions even after several years. Such a small share obviously does not raise the specter of Dean Witter being able to control simultaneously both Discover Card and the Visa system. If someone were seriously worried that Dean Witter would control Visa, that concern could be easily addressed by limiting Dean Witter's participation on the Visa board of directors. Were Dean Witter to become a Visa member, Visa's other members of course would gain no control whatsoever of Discover Card. Thus, any diminution in the incentive of Discover Card to compete against Visa seems slight. For every Visa customer that Discover Card captures, the likelihood that it is a Dean Witter Visa customer seems too low to raise serious concerns about diminishing intersystem competition.

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<sup>49</sup> Citibank is even guaranteed a voting seat on the Visa Board under Visa rules, based on its volume of Visa card business, suggesting that Visa members are not overly concerned about this type of free riding.

motives cannot explain the widespread move to dual membership by individual members because an individual member, especially a small member, cannot significantly reduce rivalry between the Visa and MasterCard organizations through its own decision to become a member of both. Therefore, near-universal dual membership suggests that there are real efficiencies associated with multibrand card issuing that benefit both consumers and merchants.<sup>54</sup> One such efficiency is the ability of bank card association members to shift their card-issuing efforts from one brand to another as relative costs change; duality thus can promote competition between the associations by creating an incentive for each of them to provide better service at a lower cost than the other. We do not claim that duality was desirable, for we have seen insufficient evidence to reach such a conclusion. For the same reason, however, we cannot accept the claims that duality was harmful. A more thorough study of the actual effects of the change in duality policy in the 1970s is required before any conclusions can be drawn.

The concern that consumers could be harmed by a diminution in intersystem competition can be assessed only when one understands the magnitude of the collective activity involved in credit and networks—specifically, the relative significance of total costs from collective activities as compared to the private costs of individual banks. Many of the functions in a credit card transaction are carried out by the individual banks that bear the costs of their actions. It is the collective network costs that are most affected by intersystem competition. How important are the collective costs of the network as compared to the costs individually borne by the banks? Publicly available data show the following: In 1993 bank card issuers in the United States received \$36.1 billion in revenues.<sup>55</sup> Only a very small fraction (roughly 2 percent) of that amount goes for collective costs such as operation of the network and other collective functions.<sup>56</sup> The rest goes to covering those independently incurred costs

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<sup>54</sup> Dean Witter could presumably take advantage of such efficiencies derived from issuing its own brand in combination with Visa and MasterCard (which it also sought to enter). Indeed, noting this possibility, Visa complained that Dean Witter stood to gain an "unfair" advantage over other Visa issuers and thus was engaging in unfair competition. However, as is so often repeated, antitrust law is concerned with competition, *not* competitors.

<sup>55</sup> This excludes merchant discount revenue not reflected in interchange fees, so it underestimates the total. See *The Earnings Balloon*, *supra* note 31.

<sup>56</sup> Collective costs are represented by the budgets of the U.S. operations of Visa and MasterCard. We approximate MasterCard's U.S. budget using its global budget multiplied by the share of its global charge volume originating in the United States. We assume that Visa's U.S. budget is equal to MasterCard's multiplied by the ratio of their respective U.S. charge volumes. The result is a rough estimate of \$600 million in collective expenditures by the bank card associations, which is less than 2% of the costs and profits of the bank card issuers. See *MASTERCARD INTERNATIONAL, 1993 ANNUAL REPORT*.

that the banks themselves are competing with each other on, such as promotion costs, costs of processing credit applications, and the like. Therefore, even if the collective component could be eliminated entirely, only about 2 percent of total revenues could be saved. That may not be insignificant, but it represents the maximum cost of a reduction in intersystem competition that has to be compared against possible benefits from admitting Dean Witter, such as lower prices.<sup>57</sup>

Finally, a rule that penalizes members (and potential members) of Visa that wish to form new networks or issue their own proprietary cards has a negative effect on intersystem competition. The ability of members of a joint venture like Visa to issue their own proprietary cards in competition with Visa cards places a restraint on the pricing of Visa cards. Both Visa and its members could eliminate intersystem competition by adopting rules that make it undesirable for members of Visa to issue their own proprietary cards. In the *BMI* case<sup>58</sup> and in *NaBanco*, the organizations in each case (BMI and Visa, respectively) were able to escape antitrust liability in part by showing that their members had the ability to remain members of the joint venture and also compete with the joint venture as separate firms. The same principle was cited by the Department of Justice when it recently sued Electronic Payment Services, Inc., in part because the ATM network did not allow its members to compete outside of the EPS system.<sup>59</sup> Therefore, Visa could diminish competition by excluding members that wish to compete outside of Visa.

### C. BALANCING COSTS AND BENEFITS

Dean Witter's large-scale, heavily promoted introduction of the Prime Option Visa card would have allowed it to provide millions of card members with relatively low cost credit cards. Based on Visa's own operating history, there is no reason to believe that the ability to exclude certain members was essential to induce the creation of the joint venture, or is essential for its continuation. Although the effects on intersystem competition are ambiguous, quantitative calculations show that to the extent there are any negative effects, they are small. Visa members predicted that Dean Witter's entry would have the net effect of lowering prices for consumers. Therefore, any negative intersystem effects are

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<sup>57</sup> The effect of intersystem competition on new product development likewise should be kept in perspective. Significant innovation can occur not only at the network level, but at the individual issuer and processor levels as well.

<sup>58</sup> *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979).

<sup>59</sup> See *United States v. Electronic Payment Sys., Inc.*, Civ. No. 94-208 (D. Del. filed Apr. 21, 1994); U.S. DEP'T OF JUSTICE PRESS RELEASE, Justice Department Files Antitrust Suit Against the Largest Regional ATM Network in the U.S., Apr. 21, 1994.

swamped by other procompetitive intersystem and intrasystem effects. For these reasons, compelling Dean Witter's entry into the Visa network was justified.

## VI. CONCLUSION

Joint ventures, and credit card networks in particular, raise thorny issues under the antitrust laws. The collective setting of interchange fees and membership rules have drawn close antitrust scrutiny, but as we have shown, the analyses in the two key antitrust decisions involving these issues—*NaBanco* and *MountainWest*—are wrong. Contrary to the holdings of these cases, credit card joint ventures can have and exercise market power through the collective actions of their members. Intervention in joint ventures should be done only when clear and convincing evidence demonstrates that the intervention will benefit society. Even with such a strong presumption against intervention, we have shown that intervention is justified in some situations.