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FEATURE ARTICLES

Antitrust Implications of the Credit Card Interchange Fee and an International Survey

By Avril McKean Dieser*

I. Introduction

Although credit cards are ubiquitous and simple for consumers to use, the operation of a credit card network is complex and contains few network competitors. From the issuing of cards to the network processing of a purchase, a credit card transaction goes through many stages, and while some only take a couple of seconds, others involve intricate accounting details and arrangements for fee exchanges.¹

The initiation of a credit card system requires substantial resources to build a viable network; for example, there must be an abundance of card users and banks, technology for clearing transactions is required, and sharing of fees helps ensure everyone benefits.² Once the system is established, additional resources are needed to maintain and improve upon its security and operation. However, one may expect that marginal operating costs would

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¹ See generally William F. Baxter, *Bank Interchange of Transactional Paper: Legal and Economic Perspectives*, 26 J.L. & ECON. 556 (1983) (discussing in detail the function and operation of the interchange fee).

² David A. Balto, *The Problem of Interchange Fees: Costs Without Benefits?*, 2000 EUR. COMPETITION L. REV. 215, 223 (2000) [hereinafter Balto, *The Problem of Interchange Fees*].

decrease as the operation expands and becomes more efficient.³ MasterCard and Visa have created enormous webs of cardholders, merchants and bank issuers for their credit cards. Discover, American Express, and other international credit cards have also built substantial networks for their cards. Although operating costs have decreased over the years, the credit card industry, contrary to market logic, has continually increased its charges.⁴ The MasterCard and Visa associations have been at the forefront of increasing fees and their resulting revenues, and have run into legal problems across the globe.⁵

Visa and MasterCard hold dominant positions in the credit card industry, and they strive to ensure that they retain such dominance by doing things such as increasing interchange fees, which are paid to issuing banks, in order to entice issuing banks away from wanting to offer other competing credit cards. Litigation has grown against these companies over the past decade, and the antitrust enforcement agencies, the courts and enforcement authorities in other countries recognize the towering position that Visa and MasterCard hold.⁶

As will be explained throughout this article, the size and the non-transparent pricing practices of Visa and MasterCard have caused concerns about monopoly power, anticompetitive practices, and harm to consumers. Because of these concerns, Visa and MasterCard will continue to face legal challenges across the globe. While regulating the interchange fee may not be the most appropriate solution, monitoring a cost-based interchange by requiring transparent accountability may be the friendliest solution to all parties. This article will discuss the antitrust implications of the credit card interchange fee—the fee that acquiring banks pay to issuing banks⁷—focusing predominantly on the Visa and MasterCard associations.

This article will first give a brief history of the credit card industry, explaining the creation of the Visa and MasterCard

³ Balto, *The Problem of Interchange Fees*, *supra* note 2, at 223.

⁴ *Id.* at 216.

⁵ *See generally id.* (discussing legal issues facing the credit card associations across the world).

⁶ This is apparent with the mounting litigation in the United States, the regulation in Australia and the United Kingdom, and the recent European Commission decisions, all to be discussed in this paper.

⁷ *See infra* Part IV (discussing the interchange fee).

associations and the roles of American Express and Discover in the credit card industry. Next, it will introduce the network and issuing markets to set the stage for the discussion of the interchange fee. This article will then explain in detail the function of the credit card interchange fee, and the controversial role it plays with regard to the Visa and MasterCard networks. Next this article will provide a comparative perspective of the interchange fee and the manner in which it is treated and regarded under various international competition laws. Finally, this article will discuss the application of U.S. antitrust laws to the interchange fee and how they may differ from the competition laws of other nations. This article will conclude with an analysis of Visa and MasterCard's control over the interchange fee, how such control has placed the associations in monopolistic positions, and suggest that antitrust authorities review and monitor the harmful effects of the interchange fee.

II. History of the Credit Card Industry

A. A Brief Introduction to the Credit Card Industry

Since 1970, when credit cards began to increase dramatically in popularity, the number of credit cards in personal households grew from sixteen percent to sixty-eight percent by 1998.⁸ Two types of credit cards available to consumers are proprietary general purpose cards and general purpose bank cards.⁹ Proprietary general purpose cards, such as Discover Card, Diners Club and Carte Blanche, are issued by single firms and can be used at many different and unaffiliated merchants to make purchases.¹⁰ There are generally three

⁸ *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 334 (S.D.N.Y. 2001), *aff'd*, 344 F.3d. 229 (2d Cir. 2003), *cert. denied*, 125 S.Ct. 45 (2004) (providing a comprehensive discussion of the Visa and MasterCard association, which came under attack by American Express for the association's practice of dual governance, in addition to Visa and MasterCard's requirements of their members to exclusively issue Visa and MasterCard's cards). These issues will not be discussed in detail in this paper, but may be introduced to show Visa and MasterCard's power in the market.

⁹ Dennis W. Carlton & Alan S. Frankel, *The Antitrust Economics of Credit Card Networks*, 63 ANTITRUST L.J. 643, 645-46 (stating that these cards are distinguished by the way in which they are issued).

¹⁰ *Id.* It should be noted, however, that with the *Visa U.S.A.* decision, those cards presently considered proprietary in nature may begin to convert to a four-party system as they entice banks to issue their cards. This has already occurred

parties involved in a proprietary general purpose card transaction—issuer, cardholder, and merchant.¹¹ In this type of transaction, the issuer both issues the cards and processes the purchases.¹² The future of proprietary cards will likely begin to change with the recent decision against Visa and MasterCard and the issuing of American Express cards by MBNA, Corp.¹³ The recent court decision will be discussed throughout this paper and its effect will be noted in Section V below, which discusses the antitrust issues facing the interchange fees in the United States.

In contrast, general purpose bank cards are issued by financial institutions that connect to the Visa and MasterCard bank associations' operating network.¹⁴ With general purpose bank cards, merchants use their own banks to obtain access to the network, rather than having direct access to the network.¹⁵ This bank credit card system generally involves four parties—issuers, cardholders, merchants and merchant banks.¹⁶ A simple bank credit card transaction involves a card-carrying customer who makes a purchase from a merchant. Since the verification is completed electronically, the merchant's clerk will determine immediately if the sale can be processed.¹⁷ The merchant then goes to her bank to collect the money promised by the credit card, minus a merchant's fee.¹⁸ The merchant's bank will submit the transaction papers to the issuing

with American Express' partnership with MBNA Corp. *MBNA Debuts American Express-Branded Cards*, FORBES.COM, at <http://www.forbes.com/associatedpress/feeds/ap/2004/11/05/ap1636085.html> (Nov. 5, 2004) [hereinafter FORBES.COM].

¹¹ David S. Evans & Richard Schmalensee, *Economic Aspects of Payment Card Systems and Antitrust Policy Toward Joint Ventures*, 63 ANTITRUST L.J. 861, 888 (1995).

¹² *Id.*

¹³ FORBES.COM, *supra* note 10.

¹⁴ Carlton & Frankel, *supra* note 9, at 646.

¹⁵ *Id.*

¹⁶ *Id.* at 647-48 (noting that merchants banks are also know as "merchant acquiring members"); Evans & Schmalensee, *supra* note 11, at 888; Nat'l Bancard Corp. v. Visa U.S.A., Inc., 596 F. Supp. 1231, 1237 (S.D. Fla. 1984), *aff'd by*, 779 F.2d 592 (11th Cir. 1986), *cert. denied*, 479 U.S. 923 (1986) [hereinafter *NaBANCO*].

¹⁷ See *infra* Part III (discussing the network market).

¹⁸ Carlton & Frankel, *supra* note 9, at 647-48 (noting that this merchant fee is otherwise known as a "merchant discount rate").

bank which will pay the merchant's bank for the amount provided to the merchant, minus an interchange fee.¹⁹ The issuing bank will bill the customer for the amount of the purchase.²⁰

B. The Union of Visa and MasterCard

Credit cards, as they are known today, evolved from the established store credit and Travel and Entertainment cards ("T & E Cards").²¹ T & E Cards appeared during World War II with the mobilization of society.²² American Express and Diners Club were at the forefront, signing up a few retail facilities and nation-wide merchants who offered such travel amenities as hotels and restaurants.²³ The annual fee on these cards was generally high.²⁴

When a card requires full payment with the receipt of the billing statement, it is called a charge card.²⁵ A credit card allows a customer to pay only a portion of the bill upon receipt of the billing statement, and carry over the remaining portion of the balance.²⁶ All four major networks—American Express, Discover, MasterCard and Visa—issue both credit cards and charge cards.²⁷

Visa began in the late 1950s with the introduction of the BankAmericard issued by the Bank of America through a franchise of seventy banks located in California.²⁸ Bank of America granted a

¹⁹ *Id.*

²⁰ *Id.* at 648 (noting that this example supplies a very simplified example of the functioning of the bank credit card, it does not take into consideration other factors such as annual card fees, finance charges and interest periods).

²¹ See Baxter, *supra* note 1, at 572 (explaining store credit as granting an interest free credit period to customers who frequent the store and whose patronage is highly valued).

²² *Id.* at 572-73.

²³ *Id.*

²⁴ *Id.* at 573.

²⁵ United States v. Visa U.S.A., Inc., 163 F. Supp. 2d 322, 331 (S.D.N.Y. 2001), *aff'd*, 344 F.3d 229 (2d Cir. 2003), *cert. denied*, 125 S. Ct. 45 (2004).

²⁶ Visa U.S.A., 163 F. Supp. 2d at 331.

²⁷ *Id.*

²⁸ SCFC ILC, Inc. v. Visa U.S.A., Inc., 819 F. Supp. 956, 962 (D. Utah 1993), *aff'd in part, rev'd in part*, 36 F.3d 958 (10th Cir. 1994), *cert. denied*, 515 U.S. 1152 (1995); NaBANCO, 596 F. Supp. at 1238.

license to these banks to issue the BankAmericard credit card.²⁹ Through increases in technology and communications, by 1966 the Bank of America embarked upon a national credit card program.³⁰ The banks that held licenses owned the credit cards they issued and signed up local merchants to accept the cards, thereby creating a BankAmericard network.³¹ As the Bank of America network grew, a for-profit, non-stock membership corporation called National BankAmericard, Inc. ("NBI") was created in 1970.³² In 1974, IBANCO, the international component of the BankAmericard, was chartered by the international licensees of the Bank of America network.³³ In 1976, NBI changed its name to Visa U.S.A., returning all rights in the BankAmericard name to the Bank of America, and IBANCO became Visa International.³⁴ As long as a bank met the requirements for federal deposit insurance, it was eligible to become a Visa member.³⁵ By 1983 there were approximately 13,400 Visa members.³⁶ Today there are over 21,000 national and international members.³⁷ While Visa began as a non-profit association, presently it operates as a non-stock, for profit membership organization.³⁸

MasterCard was established in 1966, several years after Visa,

²⁹ *NaBANCO*, 596 F. Supp. at 1238.

³⁰ *Id.*

³¹ *Id.* (noting that Bank of America encouraged their licensee banks throughout the nation to enlist non-issuing banks as agents in order to increase the merchant base).

³² *Id.* at 1238-39; VISA MEDIA CENTER, VISA HISTORY, at http://usa.visa.com/about_visa/about_visa_usa/history.html (last visited May 24, 2005) [hereinafter VISA HISTORY].

³³ VISA HISTORY, *supra* note 32.

³⁴ *Id.*; see also *NaBANCO*, 596 F. Supp. at 1239 (discussing that many of the changes during the early Visa card were regarding changes in the concept of interchange fees).

³⁵ *NaBANCO*, 596 F. Supp. at 1239; *Visa U.S.A.*, 163 F. Supp. 2d at 332.

³⁶ *NaBANCO*, 596 F. Supp. at 1239.

³⁷ VISA, ABOUT VISA USA, at http://www.usa.visa.com/about_visa/about_visa_usa/index.html?it=h3/about_visa/newsroom/statistics/index%2Ehtml/img/nav/personal/nav_cat_about_visa_usa%2Egif#anchor_5 (last visited June 3, 2005).

³⁸ Visa International—Multilateral Interchange Fee, Commission Decision, 2002 O.J. (L 318) 17, 18 [hereinafter Commission Decision 2002].

and it was initially called Interbank Card Association (“ICA”).³⁹ In 1969, ICA became known as Master Charge, and in 1979 the name changed to MasterCard.⁴⁰ ICA/Master Charge began as a membership corporation and the credit card was promoted by individual banks as well as regional banking associations.⁴¹ Currently, MasterCard has approximately 25,000 members worldwide and operates as a private share corporation.⁴²

The relationship between Visa and MasterCard dates back to 1973 when the Worthen bank, an issuing member of the Visa system, began to issue cards for MasterCard.⁴³ In response to Worthen’s actions, Visa instituted By-law 2.16, which essentially prohibited its issuing banks from issuing cards on any other network and also prohibited acquiring banks, those banks that sign on merchants and generally handle the merchants’ processing, from participating as issuing banks with other networks.⁴⁴ The Eighth Circuit stated that the By-law preventing issuing members from becoming issuing members of another credit card network is not a per se violation of the antitrust laws.⁴⁵

After the Department of Justice (“DOJ”) refused to get involved with supporting the notion that dual issuing is an antitrust violation, Visa settled with Worthen and allowed its members to become members of MasterCard.⁴⁶ Visa’s Board of Directors also permitted dual governance by allowing MasterCard members to

³⁹ MASTERCARD INTERNATIONAL, MASTERCARD INTERNATIONAL CORPORATE FACT SHEET 1, at http://www.mastercardintl.com/newsroom/company_fact.html (last visited June 3, 2005) [hereinafter MASTERCARD FACT SHEET].

⁴⁰ *Id.*

⁴¹ *Worthen Bank & Trust Co. v. Nat’l BankAmericard Inc.*, 485 F.2d 119, 121 (8th Cir. 1973), *cert. denied*, 415 U.S. 918 (1974).

⁴² MASTERCARD FACT SHEET, *supra* note 39; Press Release, MasterCard International, MasterCard Members Approve Conversion To A Private Shareholder Corporation (on file with the Loyola Consumer Law Review).

⁴³ *Worthen*, 485 F.2d at 121.

⁴⁴ *Id.* at 122-23 (noting that at this time Interbank/Master Charge did not have the same type of prohibition on issuing).

⁴⁵ *Id.* at 129-30.

⁴⁶ *SCFC ILC, Inc. v. Visa U.S.A., Inc.*, 819 F. Supp. 956, 963 (D. Utah 1993), *aff’d in part, rev’d in part*, 36 F.3d 958 (10th Cir. 1994), *cert. denied*, 515 U.S. 1152 (1995) (noting that when this occurred, many banks became members of both Visa and MasterCard).

participate in the governance of the Visa association, and permitting Visa members to participate in the governance of the MasterCard association.⁴⁷ Although both membership associations operate as a joint venture, Visa and MasterCard contend that they compete with each other, in addition to other credit cards in the market.⁴⁸

C. The Long-Lasting American Express Card and the Entry of Discover

In 1850 American Express made its debut as a joint stock association and in 1965 became a New York corporation.⁴⁹ American Express made its Initial Public Offering on the New York Stock Exchange on May 18, 1977.⁵⁰ In 1999, American Express issued the largest number of credit and charge cards and had a transaction volume of \$186 billion.⁵¹ The company is profitable and consistently meets its earning targets.⁵²

Unlike American Express, Discover is a relatively new proprietary general purpose card. The Discover Card dawned in Atlanta, Georgia in late 1985, and made its national issuing debut in 1986.⁵³ In 1999, based on a transaction volume of \$70.98 billion, Discover was the fifth largest issuer, and, with its forty-eight million cards outstanding, it ranked among the top three credit card issuers.⁵⁴ As will be discussed below, Discover unsuccessfully attempted to join the Visa association in 1988 and again in 1990.⁵⁵

⁴⁷ *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 346-47 (S.D.N.Y. 2001), *aff'd*, 344 F.3d. 229 (2d Cir. 2003), *cert. denied*, 125 S. Ct. 45 (2004). (explaining that this structure became known as "governance duality").

⁴⁸ *Visa U.S.A.*, 163 F. Supp. 2d at 346-47.

⁴⁹ AMERICAN EXPRESS COMPANY INVESTOR RELATIONS, FREQUENTLY ASKED QUESTIONS 1, *at* http://ir.americanexpress.com/ireye/ir_site.zhtml?ticker=axp&script=1801&layout=7 (last visited June 3, 2005) [hereinafter INVESTOR RELATIONS].

⁵⁰ *Id.*

⁵¹ *Visa U.S.A.*, 163 F. Supp. 2d at 333.

⁵² *Id.*

⁵³ *SCFC ILC, Inc.*, 819 F. Supp. at 963.

⁵⁴ *Visa U.S.A.*, 163 F. Supp. 2d at 333.

⁵⁵ *SCFC ILC, Inc.*, 819 F. Supp. at 963-65. This case was the result of Discover's attempt to join Visa, and the holding prevented Discover from becoming a member of the MasterCard or Visa association.

III. The Credit Card Markets and Operations

A. The Network Systems Market

Four credit card networks dominate in the United States: Visa, MasterCard, American Express and Discover.⁵⁶ In order to create a functional and thriving credit card network, there must be an adequate number of cardholders and merchants willing to use and accept the cards.⁵⁷ A credit card company attracts a merchant by providing a substantial customer base, favorable merchant discount rates, and reliable and efficient means of processing transactions.⁵⁸ Customers are attracted to credit cards when there is a substantial merchant base that will accept their cards, when there is a low or no annual fee and when the credit card company offers other royalties such as sky miles.⁵⁹

Because of the elevated costs required to establish a network, it is difficult for a new network to enter and compete directly with those that are well-established.⁶⁰ Network costs usually include branding the cards, advertising, advancing technology, and other activities of the business that increase merchants and cardholders.⁶¹ The first-established network has advantages because customers are already comfortable using its cards and many banks and retailers already have the necessary processing equipment.⁶² In order for a new network to effectively compete, it must entice customers to want to use its card and it must attempt to duplicate equipment used by retailers and banks, or somehow gain access to the technology

⁵⁶ David A. Balto, *The VISA-MasterCard Decision and its Implications for High Tech Markets*, 1290 P.L.I. CORP. 69, 88 (2002) [hereinafter Balto, *VISA-MasterCard Decision*].

⁵⁷ David A. Balto, *Antitrust and Credit Card Joint Ventures*, 47 CONSUMER FIN. L.Q. REP. 266, 266-67 (1993) [hereinafter Balto, *Credit Card Joint Ventures*].

⁵⁸ *Id.* at 267. The merchant discount rate is the amount paid by the merchant to its bank (the acquiring bank) for the processing of the merchant's transactional paper. Carlton & Frankel, *supra* note 9, at 647.

⁵⁹ Balto, *Credit Card Joint Ventures*, *supra* note 57, at 267.

⁶⁰ Don Cruickshank, COMPETITION IN U.K. BANKING: A REPORT TO THE CHANCELLOR OF THE EXCHEQUER 3.44 (March 2000).

⁶¹ Evans & Schmalensee, *supra* note 11, at 865.

⁶² Cruickshank, *supra* note 60, at 3.44.

already in use.⁶³ Because of the strength exhibited by these types of networks, the number of competitors remains small and entry barriers are generally high.⁶⁴ With the introduction of duality between the Visa and MasterCard associations, the level of intersystem competition was stunted until the introduction of the Discover Card.⁶⁵ When Discover entered the market, it offered its credit card to consumers with no annual fee and a one percent rebate on purchases.⁶⁶ For its merchants, Discover imposed a small merchant discount relative to that charged by Visa and MasterCard.⁶⁷ Introduction of the Discover Card, thereafter, ignited a fire under Visa and MasterCard forcing them to become more competitive in the market.⁶⁸

B. Operating the Networks

Under the four-party network, a central network system must be established to process inter-member transactions, including approval, consolidation, and settlement of member transactions.⁶⁹ In order for the network system to properly function, members must accept and adhere to common rules of costs and risks that involve different parties, for example cardholders, merchants, acquirers, and issuers, who are necessary for a successful transaction.⁷⁰ These common rules enable all the players to understand their roles in the

⁶³ See *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 341-42 (S.D.N.Y. 2001), *aff'd*, 344 F.3d. 229 (2d Cir. 2003), *cert. denied*, 125 S.Ct. 45 (2004) (noting that Visa's CEO described establishing a new network as a "'monumental' task").

⁶⁴ *Visa U.S.A.*, 163 F. Supp 2d at 341-42.

⁶⁵ Balto, *Credit Card Joint Ventures*, *supra* note 57, at 267 (noting that little competition ensued between Visa and MasterCard during the 1970s and early 1980s, and the products offered by each association were highly similar).

⁶⁶ *Id.* (explaining that rebates were practically unheard of until Discover introduced them).

⁶⁷ *Id.*

⁶⁸ *Id.* (stating that Visa and MasterCard were forced to lower their interchange fees enabling the issuing banks to lower merchant discounts to compete with Discover).

⁶⁹ Evans & Schmalensee, *supra* note 11, at 888.

⁷⁰ *Id.*; David A. Balto, *Creating a Payment System Network: The Tie that Binds or an Honorable Peace?*, 55 BUS. LAW 1391, 1391 (2000) [hereinafter Balto, *Creating a Payment System Network*].

use of the credit card; for instance, the rules may describe what steps will be taken if a cardholder does not pay the issuer for the charges made.⁷¹ Unfortunately, when a network acquires a position of power, the benefits of accepting common rules begin to diminish and then those rules begin to act as barriers to new and possibly more efficient networks.⁷² For example, the rule that was declared anti-competitive in Visa, U.S.A., which required all Visa members to refrain from issuing cards on any other network, excluded other credit cards from prospering or entering the market.⁷³

In addition to requiring network members to follow rules and participate in common activities for its optimal performance, the network must also have the technological capacity to operate on a functional level. Until 1996, American Express, like Discover, had a single-issuer network whereby one firm issued cards for the whole of the network.⁷⁴ In processing transactions for single-firm issuers, the network connects the merchant directly with the issuer.⁷⁵ In 1996, however, American Express began inviting banking members of the Visa and MasterCard associations to issue American Express Cards in an attempt to move toward a four-party system.⁷⁶ Since the finality of the Visa, U.S.A. lawsuit, Visa and MasterCard members may now issue competing credit cards.⁷⁷ Following the suit, in November 2004, American Express introduced its first bank-partnership card issued in the United States by MBNA, Corp.⁷⁸ Because this deviates substantially from the way the credit card industry, as described above, has operated over the past several decades, it is inevitable that these industry changes will alter the dynamics of both the network and issuing sides of the credit card industry.

⁷¹ Evans & Schmalensee, *supra* note 11, at 888 (noting that another example is a rule that specifies the responsible party in the case of charges placed on a stolen credit card).

⁷² Balto, *Creating a Payment System Network*, *supra* note 70, at 1391.

⁷³ *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 329, 406 (S.D.N.Y. 2001), *aff'd*, 344 F.3d 229 (2d Cir. 2003), *cert. denied*, 125 S. Ct. 45 (2004).

⁷⁴ *Visa U.S.A.*, 163, F. Supp. 2d at 380.

⁷⁵ *See* Carlton & Frankel, *supra* note 9, at 646.

⁷⁶ *See Visa U.S.A.*, 163 F. Supp. 2d at 380-82 (noting that when American Express attempted to enlist MasterCard and Visa associations members, both Visa and MasterCard created By-laws stopping American Express).

⁷⁷ *Visa U.S.A.*, 163 F. Supp. 2d at 334.

⁷⁸ FORBES.COM, *supra* note 10.

In the four-party card system, the network provides the technology for the authorization and clearing of transactions among the parties.⁷⁹ When a cardholder makes a purchase at a merchant's store, the transaction is verified and either approved or denied through the use of the electronic services provided by the networks.⁸⁰ The transaction that occurs between the merchant and its bank, and then the merchant's bank and the issuing bank, also lies under the shield of the network because the network provides protection against fraud and the guarantee of funds owed.⁸¹ In situations where the merchant's bank and the issuing bank are the same, the transaction that occurs is called an "on us" transaction.⁸² With an "on us" transaction, no transactional paper is exchanged and, therefore, no interchange fee is involved.⁸³ However the transactions are structured, either "on us" or through the use of an interchange, the network allows the entire system to function.

C. The Issuing Market

In addition to the network market, there is also a market for the issuing of cards.⁸⁴ In the Visa and MasterCard associations, neither association actually issues card.⁸⁵ Member banks issue cards while the association provides services such as advertising and technologically advanced processing to members.⁸⁶ At the issuing market level of competition, the Visa and MasterCard association members compete with the proprietary card firms such as American Express and Discover.⁸⁷ While the networks cover the costs of advertising and processing credit card transactions, the issuing banks or firms are responsible for circulating their credit cards and

⁷⁹ Carlton & Frankel, *supra* note 9, at 646; Evans & Schmalensee, *supra* note 11, at 888-89.

⁸⁰ Carlton & Frankel, *supra* note 9, at 646-47.

⁸¹ Evans & Schmalensee, *supra* note 11, at 889-90.

⁸² *NaBANCO*, 596 F. Supp. at 1240.

⁸³ *Id.*

⁸⁴ In *SCFC ILC, Inc.*, both Visa and Discover agreed that the issuing market was the relevant market for the purposes of the case. *SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 966 (10th Cir. 1994).

⁸⁵ *SCFC ILC, Inc.*, 36 F. 3d at 966.

⁸⁶ *Id.*

⁸⁷ *Id.* at 966-69.

promoting cardholder use and satisfaction.

IV. The Credit Card Interchange Fee

The interchange fee is the fee paid by the acquiring bank to the issuing bank for the exchange of the transactional paper.⁸⁸ The role of the interchange fee in the United States, and in some countries abroad, has changed over time. Some changes reflect costs, while others are simply revenue raising tools. Lack of transparency poses one of the greatest problems that most countries have with the interchange fee.

A. The Interchange Fee, as an Economic Tool, was Established to Cover the Costs of Building the Credit Card Network

1. The Initial Purpose of the Interchange Fee

The credit card interchange began with NBI, the predecessor to Visa through which the merchant's bank would "interchange" its transactional paper with the issuing bank.⁸⁹ The fee that accompanied this interchange was presented to potential issuing and merchant banks as the costs for participating in and establishing the network.⁹⁰ In the early stages of the interchange fee, only banks performed the functions of card issuing and processing merchant's transactions so that the fee appeared to be nothing more than a cost-based transfer of funds.⁹¹ This theory of cost-based transfer remains true with three-party systems where the interchange fee, if charged, would act as an internal transfer of funds within the same firm.⁹²

In the late 1970s and early 1980s, non-financial institutions began to participate in the Visa scheme by contracting with either

⁸⁸ Baxter, *supra* note 1, at 575-76.

⁸⁹ See *Worthen Bank & Trust Co. v. Nat'l BankAmericard Inc.*, 485 F.2d 119, 121 (8th Cir. 1973), *cert. denied*, 415 U.S. 918 (1974) (finding that this transactional paper was derived from the sales draft collected from the customer by the merchant, and the merchant would sell the sales draft to its bank creating the transactional paper).

⁹⁰ Balto, *The Problem of Interchange Fees*, *supra* note 2, at 217.

⁹¹ *Id.*

⁹² Cruickshank, *supra* note 60, at 3.34.

merchant banks or issuing banks as processors.⁹³ One of these early non-financial institutions questioned payment of the interchange fee and the issue landed in court.⁹⁴

2. NaBANCO

NaBANCO v. Visa, U.S.A. has been the only case to directly challenge the credit card interchange fee in the federal courts.⁹⁵ In the case, NaBANCO complained that the requirement to pay the interchange fee did not allow them to equally compete for merchant business with other Visa members that were able to both issue and acquire utilizing “on us” transactions, thereby avoiding the interchange fee.⁹⁶ NaBANCO claimed that because it was not a Visa member and was required to route through the Visa system for any interchange transaction, it was *required* to pay the interchange fee.⁹⁷ The antitrust apex of NaBANCO’s claim was that the interchange fee constituted horizontal price fixing.⁹⁸

The court, under a rule of reason analysis, held that the interchange fee was not horizontal price fixing, but rather a means for cost and risk sharing between Visa acquiring and issuing members.⁹⁹ This fee was necessary to cover costs such as the risk of fraud, loss, floating funds, and issuing the cards.¹⁰⁰ The court also found that the relevant market was the market for all payment services, rather than the general purpose credit card market.¹⁰¹

In response to NaBANCO’s questioning of Visa’s intent in setting its interchange fee, the court revealed that while the method for calculating the fee was “not perfect . . . ,” it was “within the

⁹³ *NaBANCO*, 596 F. Supp. at 1239.

⁹⁴ *Id.* at 1231.

⁹⁵ *Id.*

⁹⁶ *Id.* at 1240.

⁹⁷ *Id.* at 1240-41.

⁹⁸ *NaBANCO*, 596 F. Supp. at 1240-41 (noting that both “on us” and interchange fee transaction involved the same costs for processing, Nat’l Bancard Corp. questioned Visa’s intent and reasoning for setting the interchange fee).

⁹⁹ *See id.* at 1261 (stating that to prohibit the use of the interchange fee would harm interbrand competition and thus violate the antitrust laws).

¹⁰⁰ Balto, *The Problem of Interchange Fees*, *supra* note 2, at 217.

¹⁰¹ *See NaBANCO*, 596 F. Supp. at 1259 (including in its payment services cash, checks, travelers cheques, ATM cards, and etc.).

bounds of sound business judgment.”¹⁰² The method used had been in place since 1973 and was designed by the accounting firm of Arthur Andersen.¹⁰³ The best methodology decided upon by Visa and Arthur Andersen was a cost-based method which calculated average costs across the entire system.¹⁰⁴ This methodology was reviewed again in 1980 and remained cost-based including average costs across the system.¹⁰⁵ To date, the actual calculating of the interchange fee remains a business secret for the Visa and MasterCard associations, and therefore, acquiring banks, merchants and consumers have no fair assessment of whether the interchange fee is based upon the operating costs of the system.¹⁰⁶

The court brushed aside NaBANCO’s claim of horizontal price fixing, stating that whether or not Visa was literally fixing prices, it was not doing so “in any meaningful sense of the word.”¹⁰⁷ The court went on to state that market forces could not have set the interchange fee for several reasons, but specifically named only free riding.¹⁰⁸ The court ultimately held, and the Eleventh Circuit agreed, that Visa may fix a system-wide transfer price in order to efficiently operate its network.¹⁰⁹

Today it is unlikely that a court would define the relevant market as broadly as the court in *NaBANCO*.¹¹⁰ The industry has moved from a predominantly paper based system with higher risks of fraud and loss, to an electronic processing system where the

¹⁰² *Id.* at 1262.

¹⁰³ *Id.* (noting that Arthur Andersen was given a carte blanche to design the method to be used to calculate the interchange fee).

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ Balto, *The Problem of Interchange Fees*, *supra* note 2, at 216.

¹⁰⁷ *NaBANCO*, 596 F. Supp. at 1264.

¹⁰⁸ *Id.* Free riding is the opportunistic behavior on the belabored product of another. *Id.*

¹⁰⁹ *Id.*

¹¹⁰ See *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 335-38 (S.D.N.Y. 2001), *aff’d*, 344 F.3d 229 (2d Cir. 2003), *cert. denied*, 125 S.Ct. 45 (2004)(defining the relevant markets as the markets for general purpose cards and general purpose network services); Balto, *The Problem of Interchange Fees*, *supra* note 2, at 220 (noting that a higher interchange fee will not easily send consumers and merchants to other forms of payments); see also Commission Decision 2001, 2001 O.J. (L 293) 31, 32. [hereinafter Commission Decision 2001] (including in the relevant market all types of payment cards and excluding cash and checks).

transactional risk has been substantially lowered.¹¹¹ While scholars differ on the analysis and outcome of *NaBANCO*, all would probably agree that the role of the interchange fee in the United States has transformed.¹¹²

3. The Function of Interchange Fees Today

When companies are engaged in a joint venture, as Visa and MasterCard, the antitrust laws recognize that collective price setting may be necessary for the efficient functioning of the venture.¹¹³ The interchange fees set by Visa and MasterCard can take three different theoretical forms.¹¹⁴ A positive interchange fee is a transfer of funds from the acquiring bank to the issuing bank, a negative interchange fee causes funds to transfer from the issuing bank to the acquiring bank, and in the case where no funds are transferred, then there is a zero interchange fee.¹¹⁵ Presently, the Visa and MasterCard joint venture operates with a positive interchange fee whereby the acquiring bank pays the issuing bank the fee.¹¹⁶

While *NaBANCO* found, and some scholars agree, that the interchange fee is necessary to offset the costs of operating the credit card system, other scholars argue that in a competitive market the interchange fee is unnecessary to compensate issuing banks for costs.¹¹⁷ Some scholars argue that in a market of free competition, prices will adjust with costs and the interchange fee is not necessary to compensate an issuing bank for incurred costs.¹¹⁸ Issuers would

¹¹¹ Balto, *The Problem of Interchange Fees*, *supra* note 2, at 218-19.

¹¹² David A. Balto, Dennis W. Carlton, & Alan S. Frankel have written with skepticism toward the decision in *NaBANCO*, while David S. Evans and Richard Schmalensee, who received financial support from Visa to compose their joint article, ardently support the decision in *NaBANCO*. Balto, *The Problem of Interchange Fees*, *supra* note 2, at 223; Carlton & Frankel, *supra* note 9, at 646; Evans & Schmalensee, *supra* note 11, at 888.

¹¹³ Balto, *The Problem of Interchange Fees*, *supra* note 2, at 216.

¹¹⁴ Evans & Schmalensee, *supra* note 11, at 890.

¹¹⁵ *Id.*

¹¹⁶ *Id.* (noting that the interchange fee is automatically charged when processing is performed through Visa Base II clearinghouse system).

¹¹⁷ Carlton & Frankel, *supra* note 9, at 656.

¹¹⁸ *Id.*

then recoup their expenses from card users.¹¹⁹

Several scholars have presented different theories regarding the setting of the interchange fee. Although the economic literature available to policy makers seeking to understand the function of the interchange fee is evolving, more economists are realizing a need to study and prepare models to define the socially and privately optimal interchange fee.¹²⁰ Visa and MasterCard may use several different methods to set their interchange fees. One method used by Visa is to assess the costs incurred by the issuing and acquiring banks, and to set the interchange fee so that issuing banks (which are considered the high-cost component of the system) receive revenues from the acquiring banks (which are considered the low-cost component of the system).¹²¹ MasterCard, on the other hand, uses methodologies that allow the issuers to recover servicing costs from the acquirers and merchants.¹²² In other words, acquirers, merchants and consumers are subsidizing the cost of the network services and providing profits to MasterCard's member banks.

William F. Baxter, former Assistant Attorney General of the Antitrust Division of the Department of Justice, wrote an influential analysis regarding the setting of interchange fees in credit card systems.¹²³ Baxter points out that the income merchants receive from cardholder purchases will more than cover the merchants' costs, while income received by card issuers from card holders is not sufficient to cover issuing costs.¹²⁴ Therefore, in order to achieve equilibrium in credit card interchange, the surplus gained by the

¹¹⁹ *Id.*

¹²⁰ Baxter, *supra* note 1; Julian Wright, *The Determinants of Optimal Interchange Fees in Payment Systems*, LII J. OF INDUS. ECON. 1 (2002); Richard Schmalensee, *Payment Systems and Interchange Fees*, L. J. OF INDUS. ECON. 103 (2002); Jean-Charles Rochet & Jean Tirole, *Platform Competition in Two-Sided Markets*, Working Paper (2001); Sujit Chakravorti & Ted To, *A Theory of Credit Card*, Working Paper (2002); Joshua S. Gans & Stephen P. King, *The Neutrality of Interchange Fees in Payment Systems*, 3 TOPICS IN ECON. ANALYSIS & POLICY 1 (2002) [hereinafter Gans & King, *Neutrality of Interchange Fees*] (unpublished sources on file with author).

¹²¹ Wright, *supra* note 120, at n.2 (citing H. Chang & David S. Evans, *The Competitive Effects of the Collective Setting of Interchange Fees by Payment Card Systems*, THE ANTITRUST BULLETIN 641-677 (2000)).

¹²² Joshua S. Gans & Stephen P. King, *Approaches to Regulating Interchange Fees in Payment Systems*, REVIEW OF NETWORK ECONOMICS 125, 126-27 (2003).

¹²³ Baxter, *supra* note 1, at 558.

¹²⁴ *Id.* at 575.

merchant should be passed on to make up the deficit incurred by the issuer.¹²⁵ This would, in Baxter's opinion, create an "optimum transfer fee."¹²⁶ His model, however, assumes perfect competition.¹²⁷

Several other scholars have devised models to determine the optimal interchange fee by taking into consideration such conditions as imperfect competition, demand elasticities, relationships between consumers and merchants, optimizing output for profit and consumer welfare, and finding a neutral fee.¹²⁸ The commonality between these scholars is the attempt to define an interchange fee that in some way benefits each party without harming competition or consumers.

B. The Interchange Fee in the United States Has Gone Above and Beyond the Cost of Duty

The current Visa interchange fee in the United States ranges from .95% to just over 2.63%.¹²⁹ In addition to the interchange fee, acquirers also pay an assessment fee per transaction to the card associations.¹³⁰ When setting their interchange rates Visa and MasterCard consider each other's interchange rates first, then they analyze the merchant discount rates collected by American Express and Discover.¹³¹ The MasterCard and Visa associations will generally review their interchange rates in the spring and the fall to determine whether the rates need adjusting.¹³²

Just recently, MasterCard and Visa raised their interchange

¹²⁵ Baxter, *supra* note 1, at 575.

¹²⁶ *Id.* at 576 (implying that a transfer should bring the two parties back to equilibrium).

¹²⁷ Gans & King, *Neutrality of Interchange Fees*, *supra* note 120, at 8.

¹²⁸ Wright, *supra* note 120; Schmalensee, *supra* note 120; Rochet & Tirole, *supra* note 120; Chakravorti & To, *supra* note 120; Gans & King, *Neutrality of Interchange Fees*, *supra* note 120.

¹²⁹ SHIFT 4, CURRENT VISA INTERCHANGE FEES, at http://www.shift4.com/CCC_interchange.cfm (last visited June 3, 2005); CAPITAL Q NEWS PAGE at <http://www.capitalq.com/qtips/news.html> (last modified Dec. 31, 2004) [hereinafter CAPITAL Q].

¹³⁰ NOVA NETWORK, INTERCHANGE Q & A, at <http://www.merchantconnect.com> (2002) [hereinafter NOVA NETWORK]; CAPITAL Q, *supra* note 129.

¹³¹ *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 337 (S.D.N.Y. 2001), *aff'd*, 344 F.3d 229 (2d Cir. 2003), *cert. denied*, 125 S. Ct. 45 (2004).

¹³² NOVA NETWORK, *supra* note 130.

fees for consumer and corporate credit cards in the United States.¹³³ MasterCard stated that the increased rates are intended to balance acquiring and issuing in this complicated payment market.¹³⁴ Visa stated that its increased fee is intended to match MasterCard's increase and to compete with the newly joined partnership between American Express and MBNA Bank.¹³⁵ In 1999, the average interchange fee charged by American Express was 2.73% while Visa and MasterCard were offering approximately 2.0%.¹³⁶

In 2002, a similar scenario occurred when MasterCard increased its rate in the spring and then Visa increased its rate in the fall, creating for merchants a double rate increase for that year.¹³⁷ A rate increase also occurred in 2000, and the associations defended that increase by stating that they incurred increased costs; however, specific information relating to the reason of the increase was kept secret by the associations.¹³⁸ These rate increases have puzzled merchant acquirers, merchants and some scholars because of the economic assumption that as the costs of processing and data communications decreases, the interchange fees should also decrease.¹³⁹ However, the opposite continues to occur without explanation.

As the interchange fee continues to increase, so do the prices consumers pay for goods.¹⁴⁰ Because the interchange fee is paid by acquiring banks, the fee itself is passed to the merchants via the merchant discount, and then the merchant passes the fee on to customers in higher prices.¹⁴¹ Therefore, cash customers are subsidizing credit card customers, and credit card customers are reaping the benefits of higher interchange fees through rebates and

¹³³ CAPITAL Q, *supra* note 129.

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ See BTN ONLINE.COM, *Amex Signs First U.S. Issuer* (Feb. 9, 2004) (on file with author).

¹³⁷ NOVA NETWORK, *supra* note 130.

¹³⁸ Balto, *Creating a Payment System Network*, *supra* note 70, at 1395.

¹³⁹ See *id.* (noting that Visa and MasterCard claim that fees have increased because of increased costs; however, as Balto points out, processing fees have continually fallen).

¹⁴⁰ Gans & King, *Neutrality of Interchange Fees*, *supra* note 120, at 3-4.

¹⁴¹ Carlton & Frankel, *supra* note 9, at 660-61.

other incentives presented to them by issuing banks.¹⁴²

Ideally, if merchants were allowed to place a surcharge on credit card purchases, then the interchange fee would find a neutral ground. In such a situation the merchant would be collecting from credit card users the charge that the merchant pays in the form of the merchant discount and only credit customers would pay to take advantage of the credit card network.¹⁴³ This is another version of showing how the interchange fee may have no effect if it is eliminated in a well-established network. In this case, the cardholder pays the merchant a surcharge amount that equals the interchange fee that the merchant ultimately pays to the issuer. The seemingly more practical route would require the cardholder to simply pay a fee to the issuer for services the cardholder receives.

Presently, in the United States, Visa and MasterCard impose a "no-surcharge" rule, which prohibits merchants from charging credit card customers an additional fee for using credit cards.¹⁴⁴ While this rule is permissible in the United States, other countries prohibit such a restriction on merchants.¹⁴⁵ If merchants collectively apply a surcharge to credit card purchases, competition by other forms of payments would heat up.¹⁴⁶ If other payment options make a strong come-back and enter into the payment systems market that Visa and MasterCard have created, the associations would be forced to lower interchange fees, which would in turn lower merchant fees and encourage merchants to stop passing their fee onto to credit card

¹⁴² Carlton & Frankel, *supra* note 9, at 660-61.

¹⁴³ Gans & King, *Neutrality of Interchange Fees*, *supra* note 120, at 5, 10.

¹⁴⁴ Balto, *Creating a Payment System Network*, *supra* note 70, at 1396 (noting that the fee charged to customers is called a surcharge).

¹⁴⁵ For example, presently the Netherlands and Sweden do not allow the credit card associations to impose no-surcharge rules. Chakravorti & To, *supra* note 120, at n.4. Likewise, the United Kingdom prohibited the no-surcharge rule in 1990. EUROPA, THE EUROPEAN COMMISSION, EU ANTITRUST LAW AND THEIR POTENTIAL IMPACT ON THE BANKING SECTOR OF THE CZECH 5, at http://europa.eu.int/comm/competition/speeches/text/sp1998_016_en.html (Apr. 28, 1998). Just recently in 2002, the Reserve Bank of Australia ended the no-surcharge policy. AUSTRALIAN COMPETITION AND CONSUMER COMMISSION—MEDIA RELEASES, ACCC WELCOMES RESERVE BANK CREDIT CARD REFORMS (2002) [hereinafter ACCC Study]. However, the Commission of the European Communities has ruled that the no-surcharge rule does not harm competition and may be enforced. Commission Decision 2002, *supra* note 38, at 34-35.

¹⁴⁶ See Balto, *Creating a Payment System Network*, *supra* note 70, at 1396.

customers.¹⁴⁷

In the year 2000, the top ten issuers of credit cards managed about eighty percent of receivables on bank cards.¹⁴⁸ In that same year Visa held 47% of the U.S. market share, MasterCard held 28.4%, American Express held 17.5%, and Discover held 7.1%.¹⁴⁹ The interchange fees in 2000 were figured to be on average 1.7% of \$768.2 billion in purchase volume as compared with the 1999 figure of 1.6% on \$681.6 billion.¹⁵⁰ In 2000, the interchange fee accounted for 14.4% of the revenues earned by credit cards.¹⁵¹ While credit card expenses in 2000 were \$75.8 billion, revenues exceeded \$90.9 billion, meaning that the interchange fee does more than simply cover expenses.¹⁵² In 2004 it was estimated that interchange fees accounted for \$24 billion in annual revenues for credit card issuing banks.¹⁵³

C. International Perspective of the Interchange Fee

Since credit card use has swept across the world, the interchange fee has become a debated issue in many countries where credit cards proliferate. In the United Kingdom, the Office of Fair Trading has been given regulatory authority to oversee the setting of

¹⁴⁷ This statement assumes that if there were no no-surcharge rule, then merchants would pass their merchant fees on to credit card customer via a surcharge, although it is uncertain whether merchants would actually pass their fee along in this manner. Gans and King suggest that an alteration, regulation for example, of the interchange fee will not in any way affect competition or the operation of the credit card system unless the domino effect described here actually occurs—every player must adjust her prices. Gans & King, *Neutrality of Interchange Fees*, *supra* note 120, at 12. Gans and King conclude in their study that the only way in which banks may profit from the interchange is when both imperfect merchant competition exists, and when a no-surcharge applies. *Id.* at 25.

¹⁴⁸ James J. Daly, *CCM's Annual Report: Tenuous Gains in Card Profitability*, CREDIT CARD MANAGEMENT, CARD FORUM & EXPO (May 2001) (on file with author).

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Id.* (noting that these 2000 figures led to a 2.1% tax return on assets in that year, making it a very profitable year for credit cards).

¹⁵³ Kenneth Posner & Athina Meehan, *Attacking the Death Star*, Morgan Stanley Equity Research, at 2 (Apr. 15, 2004) [hereinafter *Attacking the Death Star*].

the interchange fee.¹⁵⁴ The European Commission still allows the credit card associations to set their interchange fees in Europe so long as there is a cap on the multilateral interchange levels.¹⁵⁵ In Australia, the Reserve Bank of Australia has recently begun regulating the interchange fee.¹⁵⁶ The interchange fee in other countries such as Canada, Israel, Poland and South Africa are also being scrutinized by policy makers.¹⁵⁷ This section will explore the experience of interchange fees in selected countries.

1. England

In March 2000, a banking study (the "Cruickshank Report" or "Report") in the United Kingdom was submitted to the Chancellor of the Exchequer calling for a revision in the interchange fee.¹⁵⁸ The Report revealed many faults with the interchange payment for credit card schemes.¹⁵⁹ Among the problems identified were the ability of issuing banks to increase interchange fees above actual costs and the use of interchange fees to inhibit new entry into the credit card networks.¹⁶⁰ The Report determined that Visa, MasterCard, and Switch collectively maintained market power over retailers and consumers.¹⁶¹

The credit card schemes in the U.K. are similar to the U.S. in that they are member associations made up of, and controlled by, their member banks.¹⁶² The associations are non-profit organizations that may own, control and share certain capital infrastructures such as telecommunication networks and clearing house systems.¹⁶³ Also,

¹⁵⁴ Wright, *supra* note 120, at 2.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*; AUSTRALIAN COMPETITION AND CONSUMER COMMISSION, MEDIA RELEASES (Aug. 27, 2002) (on filed with author).

¹⁵⁷ Wright, *supra* note 120, at 2.

¹⁵⁸ Cruickshank, *supra* note 60, at 3.44.

¹⁵⁹ The report uses the term "scheme" to represent the credit card "network;" these terms will be interchangeable for this Part.

¹⁶⁰ Cruickshank, *supra* note 60, at 3.97.

¹⁶¹ *Id.* at 3.100. Switch is one of two debit card schemes in the U.K.; the other scheme is Visa Debit. *Id.* at 3.8.

¹⁶² *Id.* at 3.53 (showing that these schemes resemble the schemes for Visa and MasterCard in the U.S., but not necessarily American Express and Discover).

¹⁶³ *Id.* at 3.54.

like the U.S., the U.K. credit card schemes participate in what is known as dual governance, or mutual governance as it is called in the U.K.¹⁶⁴ With mutual governance, most of the large banks in England sit on the boards of most of the credit card payment schemes.¹⁶⁵ The Cruickshank Report concluded that intense competition between the credit cards schemes is unlikely since all banks have a stake in what each credit cards association is reaping, to include increased interchange fees.¹⁶⁶

The interchange fees in the U.K. work the same as in the U.S. where the acquiring bank pays a fee to the issuing bank.¹⁶⁷ The acquiring bank, therefore, collects the fee paid to the issuing bank from the retailer, who essentially pays the interchange fee.¹⁶⁸ The fees are determined by cost studies and decided upon by the association members.¹⁶⁹ At the time of the Cruickshank Report, interchange fees in the U.K. were most problematic with the Visa and MasterCard associations.¹⁷⁰ These fees, however, remained secret and were not provided to Mr. Cruickshank during his review.¹⁷¹ Based on the credit card costs and other information provided to Cruickshank, the Report revealed that more than costs are involved in setting the interchange default rate.¹⁷² This information lead the Report to conclude that the interchange fees set by the credit card schemes were higher than justified by the associations' cost recoveries.¹⁷³

The Report explains several anti-competitive consequences of setting high interchange fees. First, a higher interchange fee raises

¹⁶⁴ See generally *id.* at 3.53-3.66 (describing mutual governance).

¹⁶⁵ Cruickshank, *supra* note 60, at 3.64, tbl. 3.1 (noting that four of the largest banks in the U.K. own 84.1% of the shares of MasterCard/Europay UK Ltd.).

¹⁶⁶ See *id.* at 3.65 (noting that common governance and ownership inhibits each association from promoting themselves at the expense of the other).

¹⁶⁷ *Id.* at 3.102.

¹⁶⁸ *Id.* at 3.103. Of course, the retailer will then pass these fees onto customers through higher retail prices.

¹⁶⁹ *Id.* at 3.102.

¹⁷⁰ Cruickshank, *supra* note 60, at 3.98.

¹⁷¹ *Id.* at 3.102.

¹⁷² *Id.* at 3.113. The default rate is the rate decided upon by the association members. If retailers and association members decided to by-pass the default rate they may do so and set their own rate of interchange, although 90% of interchange fees that are paid are done so according to the default rate. *Id.* at 3.102.

¹⁷³ *Id.* at 3.114.

costs to retailers, precluding smaller retailers from accepting credit cards.¹⁷⁴ This, in turn, makes them unable to compete with larger retailers that can afford to pay the interchange fees.¹⁷⁵ Second, by allowing inflated interchange fees, there is no incentive for issuers to cut costs by increasing efficiency.¹⁷⁶ Additionally, higher interchange fees increase card usage at the expense of other payment methods.¹⁷⁷ Because the interchange fee is collected by the issuing bank, it provides benefits to its customer, the cardholder, by creating incentives such as bonus points or rebates.¹⁷⁸ In light of such inducements, the cardholder has an incentive to use the card.

Meanwhile, a cash customer receives no such incentive, except in the unlikely event that discounting cash purchases or surcharging credit purchases is permitted or exercised.¹⁷⁹ The cash-paying customer, therefore, is placed in the position of subsidizing the card user by paying the collectively higher retail prices.¹⁸⁰ This argument, which was accepted by the Chancellor of the Exchequer, can be made with equal force in the United States where, in recent years, credit card customers have received numerous perks and incentives, such as spending rebates and frequent flier miles, to use credit cards.

The Cruickshank Report called for an increase in transparency. Consumers, the Report concluded, should know exactly what they are paying for, including the interchange rates.¹⁸¹ The Report also called for a revision in the way the credit card schemes are governed in order to increase innovative competition and inhibit anti-competitive activities.¹⁸² The proposal would, in essence, require an end to the practice of mutual governance as it has been known.

The U.K. Treasury was pleased with Cruickshank's review of the banking industry and assigned implementation of Cruickshank's

¹⁷⁴ Cruickshank, *supra* note 60, at 3.115.

¹⁷⁵ *Id.*

¹⁷⁶ *Id.* at 3.97, 3.116 (noting that, in essence, inefficient suppliers are protected from what would happen to them in the condition of full competition).

¹⁷⁷ *Id.* at 3.117.

¹⁷⁸ *Id.*

¹⁷⁹ Cruickshank, *supra* note 60, at 3.117.

¹⁸⁰ *Id.*

¹⁸¹ *Id.* at 3.191.

¹⁸² *Id.* at 3.192.

suggestions to the Office of Fair Trading (“OFT”).¹⁸³ The OFT has the task of requiring banks to open the market to competition, ensure that the credit card networks are not hindering new competition, and also require that interchange fees be based on, *inter alia*, costs.¹⁸⁴

In February 2003, the OFT issued a Preliminary Conclusion regarding MasterCard’s interchange fees.¹⁸⁵ In its report, the OFT concluded that the agreement to set common interchange fees among MasterCard’s members simply led to higher fees being paid to issuing banks, which in turn acted as a tax on retail transactions, and therefore, violated the anti-competition laws.¹⁸⁶ The OFT did not find that the interchange fee itself was anti-competitive, but that MasterCard’s lack of disclosure regarding the purpose for setting the fee at such a high level was unacceptable.¹⁸⁷ In its conclusion, the OFT provided guidance on what MasterCard could include in the calculation of the interchange fee.¹⁸⁸ The OFT stated that the interchange fee could be based on costs, and should only include those costs that relate to processing transactions¹⁸⁹ and that bestow a benefit to consumers.¹⁹⁰ The OFT demanded that MasterCard justify whether its current interchange fees comply with anti-competitive laws or make adjustments to come into compliance.¹⁹¹

¹⁸³ HM-TREASURY, NEWSROOM & SPEECHES, REGULATOR TO ENSURE A BETTER DEAL FOR BANK CUSTOMERS, at http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2000/press_148_00.cfm (Dec. 21, 2000); *see also* HM-TREASURY, NEWSROOM & SPEECHES, BANKING COMPETITION TO DELIVER BENEFITS TO CONSUMERS: GOVERNMENT RESPONDS TO CRUICKSHANK REPORT (Aug. 4, 2000) (on file with author).

¹⁸⁴ *Id.* (noting that interchange fees may also include in its costs the offering of better and cheaper services).

¹⁸⁵ OFFICE OF FAIR TRADING, *MASTERCARD INTERCHANGE FEES: PRELIMINARY CONCLUSIONS* (2003).

¹⁸⁶ *Id.* at Summary.

¹⁸⁷ *Id.* at 6-8.

¹⁸⁸ *Id.* at 7.

¹⁸⁹ *Id.* at 7. The Office of Fair Trading (“OFT”) included in its test for allowing processing costs those costs associated with improving the proliferation of cards and advancing economical and technological progress. *Id.* at 5.

¹⁹⁰ OFFICE OF FAIR TRADING, *supra* note 185, at 7.

¹⁹¹ *Id.* at 13.

2. Australia

The United Kingdom is not the only country to begin regulating the interchange fees. Australia has also begun a regiment of regulation, and their model of regulating the interchange fee is such that it may translate well in other countries' credit card markets.¹⁹² In 2000, the same year that the Cruickshank Report came out in the United Kingdom, the Australian Competition and Consumer Commission ("ACCC") and the Reserve Bank of Australia ("RBA") published a study on debit and credit card interchange fees.¹⁹³ The report called for a substantial reform of the setting of interchange fees.¹⁹⁴ In its executive summary, the report describes the interchange fee as a means "to encourage growth of payment networks by redistributing revenues between participants to induce them to join."¹⁹⁵

In 2000, the average credit card per transaction interchange fee in Australia was .95%.¹⁹⁶ In the same year credit cards accounted for twenty-four percent of all non-cash retail payments.¹⁹⁷ Of the total revenue earned by issuing banks, one-third constituted revenues from the interchange fee, while about one-half came from credit card interest on borrowed funds.¹⁹⁸ The interchange fees are set by an agreement among the member financial institutions and apply to all credit card transactions.¹⁹⁹

Like in the U.K. and the U.S., setting of the interchange fee in Australia was a business secret, which made it difficult to assess the

¹⁹² See Gans & King, *Approaches to Regulating Interchange Fees in Payment Systems*, *supra* note 120, at 126.

¹⁹³ AUSTRALIAN COMPETITION AND CONSUMER COMMISSION & RESERVE BANK OF AUSTRALIA, DEBIT AND CREDIT CARD SCHEMES IN AUSTRALIA: A STUDY OF INTERCHANGE FEES AND ACCESS (2000).

¹⁹⁴ See generally *id.* (describing the issues and concerns facing the credit card industry in Australia).

¹⁹⁵ *Id.* at ii.

¹⁹⁶ *Id.* at iii.

¹⁹⁷ *Id.* At tbl. 2.1 (showing that only checks were higher at 27%).

¹⁹⁸ AUSTRALIAN COMPETITION AND CONSUMER COMMISSION & RESERVE BANK OF AUSTRALIA, DEBIT AND CREDIT CARD SCHEMES IN AUSTRALIA: A STUDY OF INTERCHANGE FEES AND ACCESS iii (2000).

¹⁹⁹ *Id.* at 1.

reasonableness of the fees.²⁰⁰ In 1992, a study was conducted by the Prices Surveillance Authority and it concluded that credit card interchange fees had not gone down even though technology had improved, credit card operations were proliferating, and on-line clearance capability had reduced credit card fraud.²⁰¹

Credit cards were first introduced in Australia in 1974 with the Bankcard, which was a collective effort of Australian banks.²⁰² MasterCard and Visa made their Australian debut in the mid 1980s.²⁰³ American Express has recently arrived in Australia, but only commands a small percentage of the credit card market.²⁰⁴ In 2000, Visa held 51.4% of credit cards on issue, while MasterCard and Bankcard had 22.7% and 19.2% respectively.²⁰⁵ The credit card network works essentially the same in Australia as in the U.S. and the U.K.²⁰⁶

As a network start-up tool, the interchange fee is effective.²⁰⁷ Because issuers bear a large burden of the set-up costs of the network, from providing the technological means needed to operate the system to enticing merchants and potential cardholders to join the network, merchants will shift some of their profits made from accepting the credit cards to the issuing banks in attempt to balance the market.²⁰⁸ The acquiring institution will only participate and pay the interchange fee so long as its costs, to include payment of the interchange fee, are less than the revenues it makes from merchant service fees.²⁰⁹

In Australia, at the time of the ACCC and RBA study, issuing

²⁰⁰ *Id.*

²⁰¹ *Id.* at 2.

²⁰² *Id.* at 15.

²⁰³ AUSTRALIAN COMPETITION AND CONSUMER COMMISSION & RESERVE BANK OF AUSTRALIA, DEBIT AND CREDIT CARD SCHEMES IN AUSTRALIA: A STUDY OF INTERCHANGE FEES AND ACCESS 15 (2000).

²⁰⁴ *Id.* at 15, tbl. 2.3.

²⁰⁵ *Id.* at tbl. 2.3 (noting that the remaining percentage was held by American Express credit and charge card, and Diners Club).

²⁰⁶ *See id.* at 18.

²⁰⁷ *See id.* at 25-27.

²⁰⁸ AUSTRALIAN COMPETITION AND CONSUMER COMMISSION & RESERVE BANK OF AUSTRALIA, DEBIT AND CREDIT CARD SCHEMES IN AUSTRALIA: A STUDY OF INTERCHANGE FEES AND ACCESS 25-27 (2000).

²⁰⁹ *Id.* at 26.

and acquiring of credit cards earned revenues well above the costs of the network.²¹⁰ One-third of the revenues earned came from interchange fees.²¹¹ Not only was there no transparency in the setting of interchange fees in Australia, but there were also no formal methods established for reviewing interchange fees once set.²¹² The study suggested two ways in which an interchange fee could be determined.²¹³ The first approach would allow the financial institution that is providing the service to recover costs from the beneficiaries of the service, generally the merchants.²¹⁴ Applied to credit card schemes, acquirers and issuers would first collect whatever costs are permissible directly from merchants and cardholders; then those costs that still remain between the acquirers and issuers should be shared.²¹⁵ Three costs should be included in the calculation: costs for funding the interest-free period, costs associated with guaranteeing funds, and costs incurred during processing.²¹⁶

The second approach looks at revenues earned by issuers and acquirers to determine if their respective revenues may cover the costs for both.²¹⁷ This type of mechanism would take into consideration the total revenues and costs, as opposed to the individual revenues and costs of the issuers and acquirers, and would distribute revenues to cover all costs associated with the operation of the network as a whole.²¹⁸ In practice, whichever party earns excess revenues will pay an interchange fee to the party that does not meet

²¹⁰ AUSTRALIAN COMPETITION AND CONSUMER COMMISSION & RESERVE BANK OF AUSTRALIA, DEBIT AND CREDIT CARD SCHEMES IN AUSTRALIA: A STUDY OF INTERCHANGE FEES AND ACCESS, at 44 (explaining that average costs were \$1.93 per transaction, while revenues averaged \$2.69 per transaction—leaving an over cost amount of \$0.76, which equates to 39% of the transaction cost).

²¹¹ *Id.*

²¹² *Id.* at 46.

²¹³ *Id.* at 29 (qualifying that the actual setting of an interchange fee would depend on the set-up of the actual payment network). These possibilities are not exhaustive and do not take into consideration the capital committed by the parties of the network. *Id.* at 30.

²¹⁴ *Id.*

²¹⁵ AUSTRALIAN COMPETITION AND CONSUMER COMMISSION & RESERVE BANK OF AUSTRALIA, DEBIT AND CREDIT CARD SCHEMES IN AUSTRALIA: A STUDY OF INTERCHANGE FEES AND ACCESS, at 29-30.

²¹⁶ *Id.* at 46-47.

²¹⁷ *Id.* at 30.

²¹⁸ *Id.*

costs, and the interchange fee will be determined by the shortfall of the latter party.²¹⁹ Applying either of these two methods would have had the effect of a lower interchange fee in 2000.

Upon publication of the Australian study, the RBA announced three reform measures that should occur with the credit card payment systems.²²⁰ First, the RBA should introduce a system that would force open the market to new entrants interested in issuing cards or servicing merchants.²²¹ Second, and similar to the outcome of the Cruickshank Report, the RBA should require a cost-based method for calculating the interchange fees.²²² Finally, the RBA should require elimination of the no-surcharge rule so that merchants may recover directly from cardholders their costs for accepting the cards, rather than penalizing all paying customers.²²³

After receiving scholarly suggestions on how the credit card interchange fee should be calculated, the RBA ultimately created its own model that the credit card companies should use to calculate the fee.²²⁴ In its approach to regulating the interchange fee, the RBA decided that only costs incurred by issuers and that relate to payment processing should be included in the fee.²²⁵ These costs would include authorizing and processing the credit card transactions, eliminating and preventing fraud, and funding for the interest free

²¹⁹ *Id.*

²²⁰ AUSTRALIAN COMPETITION AND CONSUMER COMMISSION, MEDIA RELEASES, ACCC WELCOMES RESERVE BANK CREDIT CARD REFORMS, at <http://www.accc.gov.au/content/index.phtml/itemId/88157> (last visited June 3, 2005).

²²¹ *Id.*

²²² *Id.*

²²³ *Id.* This allows intended beneficiaries to benefit from card usage, and releases cash paying customers from their obligation to subsidize card users by paying the same retail prices as those card users. *Id.*

²²⁴ See RESERVE BANK OF AUSTRALIA, REFORM OF CREDIT CARD SCHEMES IN AUSTRALIA IV: FINAL REFORMS AND REGULATION IMPACT STATEMENT (2002), at <http://www.rba.gov.au/PaymentsSystem/PaymentsPolicy/Reforms/CreditCardSchemes/FinalReforms/index.html> (last visited June 3, 2005) [hereinafter REFORM OF CREDIT CARD SCHEMES]; See Gans & King, *Approaches to Regulating Interchange Fees in Payment Systems*, *supra* note 120, at 128. Gans and King's article provides a summary of the approaches the RBA considered in regulating the Interchange Fee. *Id.*

²²⁵ Gans & King, *Approaches to Regulating Interchange Fees in Payment Systems*, *supra* note 120, at 128; REFORM OF CREDIT CARD SCHEMES, *supra* note 224, at 37.

period.²²⁶ These regulations will have the effect of increasing transparency in the credit card schemes so that merchants and consumers are aware of the costs associated with the efficient operation of the credit card networks as opposed to trying to guess whether the credit card banking members are simply running away with excessive profits.

Since the reforms imposed by the RBA went into effect in 2003 and 2004, the interchange fee for credit cards has fallen thirty-five basis points and this has been reflected in fees passed onto merchants.²²⁷ The average merchant service fee in 1999 was approximately 1.8% of the transaction value; however, by July of 2004 that fee had fallen to approximately 1.05% of transaction value.²²⁸ Additionally, in questioning merchants, the RBA has learned that much competition has erupted between merchants and their banks and offers received by other bank to lower merchant fees.²²⁹ Although still early to tell, it seems as though regulating the interchange fee in Australia has produced a positive outcome.

3. Israel

Presently, there are three large credit card companies in Israel: Isracard, Israel Credit Cards ("ICC"), and Leumi card.²³⁰ All three companies issue Visa and MasterCard credit cards, while Isracard is the only issuer and acquirer of the Isracard and American Express,

²²⁶ Gans & King, *Approaches to Regulating Interchange Fees in Payment Systems*, *supra* note 120, at 128; REFORM OF CREDIT CARD SCHEMES, *supra* note 224, at 37. There was much debate over whether the RBA would include the funding of the interest-free period because they concluded that it is not a direct benefit to all consumers of the credit card market, but an exclusive benefit to cardholders. Gans & King, *Approaches to Regulating Interchange Fees in Payment Systems*, *supra* note 120, at 128. The RBA ultimately decided that the interest-free period does benefit merchants by allowing customers to purchase items on credit if cash is not readily available, which allows merchant to make sales they otherwise may not have made. *Id.* at 141.

²²⁷ RESERVE BANK OF AUSTRALIA, RESERVE BANK OF AUSTRALIA BULLETIN, MERCHANT SERVICE FEES FOR CREDIT CARDS 10 (2004), at http://www.rba.gov.au/PublicationsAndResearch/Bulletin/bu_jul04/bu_0704_2.pdf.

²²⁸ *Id.* at 11.

²²⁹ *Id.* at 12.

²³⁰ Yossi Spiegel, *The Credit Card Industry in Israel*, Preliminary Note Written for a Panel Presentation, 1-2 (June 2002) (on file with author).

and ICC is the only issuer and acquirer of Diners Club.²³¹ In 2001, Isracard possessed 47% of the market share, ICC possessed 31.8% of the market, and Leumi card possessed 15.3% of the market, the remaining 5.9% was held by smaller credit card companies.²³²

Credit card use in Israel is different from most other countries in that credit cards are linked directly to bank accounts.²³³ Because cards are linked to bank accounts, most cardholders carry cards issued from their banking institution.²³⁴ With such credit card and bank account arrangements, Israelis are more likely to use credit cards for purchases.²³⁵ Credit cards are used in three separate ways.²³⁶ The default use of credit cards is to have the cardholder's bank account debited for the full amount of the card balance at the end of the month.²³⁷ Merchants may also allow cardholders to make interest free installments, in which case the merchant provides the credit.²³⁸ Finally, the cardholder may ask the merchant to qualify the purchase as a "credit transaction" so that the cardholder may make installment payments to the credit card company while paying interest on the carried-over unpaid portions.²³⁹ Because credit cards are so popular and commonly used in Israel, merchants generally will not surcharge for credit card transactions, even though they are legally permitted to do so.²⁴⁰

In establishing the structure of the current credit card industry in Israel, the Israeli Antitrust Authority ("IAA") plays two major

²³¹ *Id.* at 2.

²³² *Id.* at tbl. 1.

²³³ *See id.* at 3. (noting that credit cards in Israel are tied to bank accounts; however, the Israel Antitrust Authority began prohibiting tying arrangements between bank accounts and credit cards in September 2001 although the industry hasn't appeared to change much).

²³⁴ *Id.* at 5-6.

²³⁵ Spiegel, *supra* note 230, at 4 (noting that one-quarter to one-third consumption spending is paid with credit cards).

²³⁶ *Id.* at 5.

²³⁷ *Id.*

²³⁸ *Id.* (stating that the total amount of these types of merchant provided credit card transactions account for nearly one-quarter of all credit card transactions).

²³⁹ *Id.* (qualifying that the installment is set by the cardholder and usually spans 3 to 36 installments).

²⁴⁰ *See* Spiegel, *supra* note 230, at 6 (stating merchants are reluctant to impose surcharges for fear of causing a decrease in sales).

roles.²⁴¹ First, the director of the IAA has the authority to label a firm or a concentrated group of firms as monopolists.²⁴² While the director has not declared this industry, or any one credit card company to be a monopolist, the threat of his doing so gives him great power over the structure of the industry.²⁴³ The second major role of the IAA is a result of the director declaring that the interchange fee is a "restrictive arrangement," in which case any interchange agreement requires approval by the Court for Trade Restrictions.²⁴⁴ As a general rule, the Court approves such fees including any restrictions proposed by the director.²⁴⁵ Interchange fees did not begin in Israel until 1998, when banks began to act as acquiring banks for merchants and an arrangement became necessary with issuing banks to clear transactions.²⁴⁶ Because the Court for Trade Restrictions is legally required to seek the opinion of the director of the IAA before making a decision on interchange fees, the IAA is quite involved in the setting of these fees.²⁴⁷

The interchange fee causes controversy in Israel.²⁴⁸ It lacks

²⁴¹ See Spiegel, *supra* note 230, at 2.

²⁴² *Id.*

²⁴³ *Id.* For example, this power retained by the director of the IAA allowed him to require Isracard to give up its exclusive right to issue MasterCard, and also caused Isracard to acquire and issue Visa cards. *Id.*

²⁴⁴ *Id.* See also, THE ANTITRUST AUTHORITY, ANNUAL REPORT ON COMPETITION POLICY 2001 at http://80.70.129.121/aboutus/aboutus_english.asp?subid=+Annual+Report+on+Competition+Policy+2001. By declaring the interchange fee a restrictive arrangement, under Israeli law, restrictive arrangements must be approved by the Court in order to proceed. *Id.* In practice, the credit card participants would come up with an arranged fee and present it to the Court, the Court would then ask the director of the IAA for his position regarding the set fee, and would then render a decision on whether the fee is legal and satisfactory or restrictive and anti-competitive. *Id.* at 2,6. This, therefore, gives the IAA director great power over the setting of the interchange fee.

²⁴⁵ Spiegel, *supra* note 230, at 2 (explaining that one condition imposed by the director required that Leumi card and ICC issue and acquire MasterCard in order for approval of their interchange agreement).

²⁴⁶ *Id.* at 7. Prior to this time, banks issued their credit cards and also signed up merchants in a market where credit cards were concentrated in few banks and nearly all transactions were "on us" transactions. *Id.*

²⁴⁷ *Id.*

²⁴⁸ Lawsuits have been brought against credit card companies claiming that they are abusing their powers in charging exorbitant fees. See Assaf Bergerfreund

neutrality in Israel for two reasons:²⁴⁹ (1) because merchants do not charge surcharges to credit card users they are not necessarily reimbursed for the merchant fees that they pay;²⁵⁰ and (2) because issuers essentially have a captured market it is not necessary for them to provide rebates and other deals to cardholders, and as a result there is no justification for a large interchange fee.²⁵¹ Therefore, Israel does not support a market regulation of interchange fee, but allows the director of the IAA to regulate the fee that is being charged to acquiring banks and ensure that it is justified and warranted in the Israeli economy.²⁵²

The credit card system used in Israel would probably not work in the U.S. for a couple of reasons. First, the use of credit cards has increased in the U.S. likely due to the rebates and incentives offered by credit card issuers. If cardholders lacked the incentives, as is the case in Israel, then they may consider using debit cards or other forms of payments. Additionally, the majority of credit card users in the United States carry monthly balances, and in Israel this is the exception rather than the rule.

4. Italy

Unlike Israel where credit cards are commonly used, Italy is a predominantly cash-based economy.²⁵³ In 2001, Italy only had 20 million credit cards in circulation.²⁵⁴ Prior to the introduction of the interchange fee in Italy, most interchange arrangements were paper-based and negotiated bilaterally between issuing and acquiring

& Eli Daniel, *Tel Aviv Court Approves NIS 1 Billion Class Action Against Credit Card Firms*, HA'ARETZ (Jan. 30, 2003) (stating that a class action was approved against the credit card companies claiming that they are charging excessive fees) (on file with author).

²⁴⁹ *Id.*

²⁵⁰ Spiegel, *supra* note 230, at 9.

²⁵¹ *Id.*

²⁵² *Id.*

²⁵³ Guerino Ardizzi & G. Coppola, *The Italian Case Study: Interchange Fee, Market Structure and Cost Efficiency in the Retail Payment System*, paper read at conference on "The Economics of Payment Networks," IDEI Universite' de Toulouse 2 (June 2002).

²⁵⁴ *Id.* (noting that in Italy the cashless payments per-capita in 1999 were 45 in Italy, 370 in the United States, and 110 in Europe).

institutions, which generated high transaction costs.²⁵⁵ The interchange fee in Italy did not appear until 1986 when the Italian Bankers' Association ("ABI") was given the task of determining a multilateral interchange fee.²⁵⁶ The intent of the multilateral interchange fee was to lower transaction costs by moving away from bilaterally negotiated interchange situations to centralizing settlement.²⁵⁷

In setting the interchange fee for credit cards, the ABI set an *ad valorem* fee, in a percentage of each transaction amount, to cover items such as authorization, settlement, trademark, and credit disputes.²⁵⁸ The interchange fee is calculated on full cost basis, which combines direct and indirect costs per unit to generate the total.²⁵⁹ A mark-up is then added to account for return on capital invested.²⁶⁰ Like other economies, the interchange fee in Italy is passed on to the merchants.²⁶¹ Under the *ad valorem* setting of the interchange fee, the higher the volume of sales obtained by the merchant, the more that will be paid in interchange fees and the more revenues earned for acquiring and issuing institutions.²⁶² Time will tell whether Italy will require a formal regulation of the interchange fee as cards become more commonplace.

5. The European Union

In addition to the interchange issues faced by the countries described above, the European Union has also been required to consider the ill-effects of the credit card interchange fee.²⁶³ In 2002, the Commission of the European Communities had to determine whether the multilateral interchange fee for intra-regional

²⁵⁵ Ardizzi & Coppola, *supra* note 253, at 3.

²⁵⁶ *Id.*

²⁵⁷ *Id.* (explaining, however, that there is still no real-time settlement in the retail payment system for credit card transactions in Italy).

²⁵⁸ *Id.* (noting that the rate is the same across the board for merchants, there is no differential for supermarkets versus retailers, for example).

²⁵⁹ *Id.*

²⁶⁰ Ardizzi & Coppola, *supra* note 253, at 3.

²⁶¹ *Id.*

²⁶² *Id.* at 4.

²⁶³ Commission Decision 2002, *supra* note 38, at 25.

transactions was harmful to consumers.²⁶⁴ In its assessment of the multilateral interchange fee, the Commission determined that the fee was excessive and should be recalculated so that the fees are based on costs incurred by issuers.²⁶⁵ In requiring increased transparency, the Commission stated that Visa must base the calculation of its interchange fee on processing costs, the cost of the interest free period, and the cost of guaranteeing payment.²⁶⁶ Additionally, Visa must provide this information to merchants if requested.²⁶⁷ Therefore, Visa may no longer keep this cost information hidden as a business secret, but must disclose such information for the benefit of competition.

V. Antitrust Issues Facing Interchange Fees in the United States

This section will revisit the *NaBANCO* case to determine whether the market definitions used in 1984 still make sense, and whether the interchange fee in the United States, after all of these years, can still be considered “pro-competitive in nature.”²⁶⁸

The behavior exhibited by Visa and MasterCard in the raising of interchange fees and maintaining control of the credit card industry, provides evidence that Visa and MasterCard are monopolists in the credit card market. The two associations have created an enormous credit card industry where they have maintained their positions as leaders and giants. In order to establish the monopolistic position held by Visa and MasterCard, a two part test must be met.²⁶⁹ First, monopoly power must be held by Visa and

²⁶⁴ *Id.* at 18. This case was brought by EuroCommerce, an organization in the European Union that retails, wholesales and acts as an international trade representative. *Id.* EuroCommerce claimed that the elevated multilateral interchange fees did nothing more than cause merchants and consumers to pay for benefits received by cardholders, and that the price fixing scheme amounted to no more than a price-fixing cartel. *Id.* at (L 318) 21. Intra-regional transactions include those transactions where a cardholder from one EEA country makes a purchase in another EEA country. *Id.*

²⁶⁵ *Id.* at 20.

²⁶⁶ *Id.*

²⁶⁷ *Id.*

²⁶⁸ *NaBANCO*, 596 F. Supp. at 1259-61.

²⁶⁹ *United States v. Microsoft Corp.*, 253 F.3d 34, 50 (2001), *cert. denied* 534 U.S. 952 (2001), *aff’d* 373 F.3d 1199 (D.C. Cir. 2004).

MasterCard in the relevant market.²⁷⁰ In making this determination, the relevant market must first be defined; then it must be determined whether Visa and MasterCard have power in that market.²⁷¹ The second part of the monopolization test is the “willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.”²⁷² In proving the second element, the plaintiff must show that Visa and MasterCard engaged in exclusionary conduct that harmed the competitive process, which in turn harmed consumers.²⁷³ However, Visa and MasterCard would have the opportunity to proffer pro-competitive reasons for their actions that may be used to offset any anti-competitive effects.²⁷⁴

A. Visa and MasterCard Have Power in the Relevant Market

1. The Relevant Product and Geographic Markets

Most antitrust analyses under Section 2 of the Sherman Act begin by defining the relevant product and geographic markets.²⁷⁵ The relevant product market will contain those products that are reasonably interchangeable,²⁷⁶ and include the range of substitutes that are significant enough to determine if the potential offender has market power.²⁷⁷ For example, the relevant market defined in the *NaBANCO* case included all types of payments used in retail sales because at that time it was believed that any type of payment was substitutable for any other type of payment.²⁷⁸ In other words, cash could be easily and conveniently substituted for a credit card. This ease and convenience of customer substitutability is critical to the

²⁷⁰ *Microsoft Corp.*, 253 F.3d at 50.

²⁷¹ *Id.* at 50-56.

²⁷² *Id.* at 50.

²⁷³ *Id.* at 58-59.

²⁷⁴ *Id.* at 59.

²⁷⁵ Sherman Antitrust Act, 15 U.S.C. § 2 (2004).

²⁷⁶ *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 404 (1956).

²⁷⁷ *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 218-19 (D.C. Cir. 1986).

²⁷⁸ *NaBANCO*, 596 F. Supp. at 1259.

determination of the relevant market.²⁷⁹

Another test employed to determine the relevant market is contained in the Department of Justice (“DOJ”) and Federal Trade Commission’s (“FTC”) Horizontal Merger Guidelines. The Guidelines basically include within the market any firm that could, if a monopolist, impose a “small but significant and nontransitory” price increase—generally five percent.²⁸⁰ In other words, a profit-maximizer selling all the products within a market can impose a price higher than what is competitive without losing sales to make the price increase unprofitable.²⁸¹

In such an illustration, if Visa and MasterCard increase their interchange pricing for credit cards to levels that are higher than what may be considered competitive, and lose no consumers or merchants in the process, then the market would be defined as the credit card market. If, however, Visa and MasterCard increase their interchange levels, and the use of cash increases enough to force the fee back down, then cash would be included in the relevant market.²⁸² As will be noted below, since the *NaBANCO* decision, the use of other retail payments in lieu of credit cards has not been significant even with the interchange increases.

In *NaBANCO*, the defined market included all retail payment methods, such as cash, checks, store cards, charge cards, traveler’s cheques, and credit cards.²⁸³ In defining the market in this manner, Visa had less than five percent of the market share.²⁸⁴ The markets defined in *Visa U.S.A.*, which are the market for general purpose card network services and the market for general purpose credit cards, represent a more realistic view of the current situation.²⁸⁵ Because the interchange fee is paid by the merchant, via the acquiring bank, it is

²⁷⁹ *E.I. du Pont de Nemours & Co.*, 351 U.S. at 394-96, 404.

²⁸⁰ United States Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, 57 Fed.Reg. 41552, 41557 (Sept. 10, 1992).

²⁸¹ *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 335 (S.D.N.Y. 2001), *aff’d*, 344 F.3d. 229 (2d Cir. 2003), *cert. denied*, 125 S. Ct. 45 (2004).

²⁸² The use of cash may increase, for example, if merchants offer discounts for using cash or if they discontinue credit acceptance.

²⁸³ *NaBANCO*, 596 F. Supp. at 1259 (adding other types of payment options not listed here).

²⁸⁴ *Id.*

²⁸⁵ *Visa U.S.A.*, 163 F. Supp. 2d at 335.

centralized in the credit card market.²⁸⁶ In *Visa U.S.A.*, the court found that consumers did not find store cards, debit cards, cash, check, or other types of payment mechanisms to be substitutes for credit cards.²⁸⁷

A similar decision was reached by the European Commission in 2002.²⁸⁸ The Commission determined that the relevant markets for analyzing the multilateral interchange fee included the network market and the market for all types of payment cards.²⁸⁹ Because so many retail shops accept credit cards, and have made it easy for consumers to use them by providing credit card swipe machines at the register, consumers are no longer compelled to carry a checkbook or cash. They may simply use their credit cards and opt to pay the balance upon receipt of their statement, or pay the balance over time—these options are not available with a check or cash. Therefore, the relevant markets are the general purpose credit card market and the market for credit card network systems.

After defining the relevant product market, the geographic market must be defined.²⁹⁰ Although the interchange fee is used worldwide, each country has control over whether or not to monitor the interchange fees that are charged.²⁹¹ As previously discussed, fees should be based on costs and would depend on the network effects established in each individual country. For example, credit cards in a country such as Poland are not as common as in the U.S., and interchange fees may be higher in Poland to offset the costs of establishing a healthy network of users. Because the need for

²⁸⁶ Although an interchange fee is usually paid with debit card transactions, and countries that have begun to regulate the credit card interchange fees are also regulating debit interchange fees, I am confining the scope of this paper to credit card interchange fees because interchange fees paid for debit transactions are generally paid differently and involve different economic analysis. Balto, *The Problem of Interchange Fees*, *supra* note 2; Balto, *Creating a Payment System Network*, *supra* note 70; Jocelyn Donze and Isabelle Dubec, *Access Pricing in Shared ATM Networks*, Working Paper—Preliminary Version (May 20, 2002); Rochet & Tirole, *supra* note 120.

²⁸⁷ *Visa U.S.A.*, 163 F. Supp. 2d at 336-37 (using testimony of Professor Katz, an expert witness of the government and Professor of Economics and Business Administration at the University of California at Berkeley, the court accepted that consumers prefer credit and charge cards to other forms of payment).

²⁸⁸ Commission Decision 2002, *supra* note 38, at 25.

²⁸⁹ *Id.* at 25-26.

²⁹⁰ *Visa U.S.A.*, 163 F. Supp. 2d at 339-340.

²⁹¹ See *supra* Part IV.C. (discussing interchange fees in different countries).

interchange fees is greater in some countries over others, each country must be responsible for the monitoring of such fees. In the U.S., one interchange fee is set for the entire nation, not localized by state. Therefore, in this analysis the geographic market is the United States.

2. Market Power

A firm has market power if it is able to control prices or eliminate competition without losing business.²⁹² Evidence of this power must be displayed through specific actions proving the firm's ability to control prices or eliminate competition.²⁹³ However, even if there is no direct evidence that a firm can control prices, market power may be assumed if the firm has a substantial share of a concentrated market and there are excessive barriers to entry into the market.²⁹⁴

In *NaBANCO*, the court determined that neither Visa nor MasterCard possessed market power, due mainly to the fact that the relevant market included all payment systems such as cash, checks and other forms of payment.²⁹⁵ *NaBANCO* also determined that there was ease of entry into the marketplace.²⁹⁶ *NaBANCO* contrasts greatly with the more recent *Visa, U.S.A.* decision. The relevant market was narrowed to include only general purpose credit cards and the credit card network systems.²⁹⁷ With a more narrow market, the court accurately determined that MasterCard and Visa have market power.²⁹⁸

In the past seven years, MasterCard and Visa have each been on an interchange fee raising spree, thus creating many double raises in rates to acquirers. When Visa or MasterCard raise interchange fees, they generally do not lose merchant customers because

²⁹² *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956); *K.M.B. Warehouse Distributions v. Walker Mfg. Co.*, 61 F.3d 123, 129 (2d Cir. 1995).

²⁹³ *K.M.B. Warehouse Distributions*, 61 F.3d at 129.

²⁹⁴ *Eastman Kodak Co. v. Image Tech'l Servs.*, 504 U.S. 451, 464 (1992).

²⁹⁵ *NaBANCO*, 596 F. Supp. at 1259.

²⁹⁶ *Id.* (noting that entry was possible and was demonstrated by the entrance of ATM networks into the market).

²⁹⁷ *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 342 (S.D.N.Y. 2001), *aff'd*, 344 F.3d 229 (2d Cir. 2003), *cert. denied*, 125 S. Ct. 45 (2004).

²⁹⁸ *Visa U.S.A.*, 163 F. Supp. 2d at 342.

merchants cannot afford to lose customers that pay with credit cards.²⁹⁹ Because both the United Kingdom and Australia have decided to regulate the interchange fee, this may suggest that the purpose of the fee is not to offset costs, as MasterCard and Visa would have the market accept, but instead the fee is to increase revenues and profits for the association members.

In 1999, Visa possessed about forty-seven percent of credit and charge card transactions based on dollar volume, MasterCard possessed about twenty-six percent.³⁰⁰ Together Visa and MasterCard accounted for about seventy-three percent of the credit card sales volume.³⁰¹ As measured by cards issued, Visa and MasterCard together controlled approximately eighty-five percent of the market.³⁰² For credit and charge card volume, American Express and Discover controlled twenty percent and six percent respectively.³⁰³ The court in *Visa U.S.A.* determined that market share controlled by Visa and MasterCard allowed them to charge excessive interchange fees since merchants are essentially obligated to accept the cards because their customers insist on using them.³⁰⁴

Not only do Visa and MasterCard hold a substantial share of the credit and charge card markets, but there are also high barriers to market entry. Under the DOJ and FTC Merger Guidelines, ease of entry into the market place is defined as having potential entrants likely to enter the market in a timely fashion, and the entry will be profitable.³⁰⁵ Evidence presented in the *Visa U.S.A.* case disclosed that for a new entrant to enter the credit card market it must be willing to invest over \$1 billion.³⁰⁶ New entrants would also have to convince merchants and cardholders to accept and use the new credit card in order to create appropriate network effects.³⁰⁷ A new entrant

²⁹⁹ *Visa U.S.A.*, 163 F. Supp. 2d at 340.

³⁰⁰ *Id.* at 341.

³⁰¹ *Id.*

³⁰² *Id.*

³⁰³ *Id.*

³⁰⁴ *Visa U.S.A.*, 163 F. Supp. 2d at 341.

³⁰⁵ United States Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, 57 Fed.Reg. 41552, 41561 (Sept. 10, 1992).

³⁰⁶ *Visa U.S.A.*, 163 F. Supp. 2d at 341-42 (stating that other sources said that entering the credit card network would cost between \$2 billion and \$5 billion (citing *Dahar* [*Visa U.S.A.*] Dep. at 200-01)).

³⁰⁷ *Id.* at 342.

would have to obtain twenty to twenty-five percent of the market share in order to succeed.³⁰⁸

With the significant MasterCard and Visa market shares, and the high barriers to entry, both associations have market power in both the general purpose card market and in the credit card network systems market.³⁰⁹ Both have raised the interchange fee without losing a significant number of merchants and have created a credit card network making entry by other potentially new credit card companies nearly impossible.

B. MasterCard and Visa Willfully Acquired and Maintained Their Market Power

To violate the Sherman Act, market power must be accompanied by some form of abusive, exclusionary or anti-competitive conduct.³¹⁰ This paper does not claim that the interchange fee is per se illegal. Rather, the interchange fee has been used to “harm the competitive *process*, and thereby harm consumers.”³¹¹ If prima facie evidence of anti-competitive harm is established, then Visa and MasterCard may introduce pro-competitive justifications to explain their behavior.³¹² If the associations provide sufficient evidence that their actions are pro-competitive, then the burden would return to the plaintiff to rebut any efficiencies claimed by the associations.³¹³ If the pro-competitive justifications stand against the plaintiff’s rebuttal, then the plaintiff may attempt to show that the anti-competitive harm actually outweighs the pro-competitive claims.³¹⁴

When introduced, the interchange fee served the purpose of offsetting the costs of establishing a credit card network by providing issuing banks with revenues to expand their card base. It also helped the Visa and MasterCard associations establish technologically savvy settlement mechanisms—computerized clearing house systems, for

³⁰⁸ *Id.*

³⁰⁹ *Id.*

³¹⁰ *Id.*

³¹¹ *United States v. Microsoft Corp.*, 253 F.3d 34, 58 (2001) (emphasis in the original).

³¹² *Microsoft*, 253 F. 3d at 59.

³¹³ *Id.* at 58-59.

³¹⁴ *Id.* at 59.

example. The revenues earned by interchange fees to establish a credit card network can be justified. This justification is not very convincing once the network is up-and-running, and the costs of its operation are down, particularly when the interchange fee has continued to rise.³¹⁵ In 1999, credit card interchange fees exceeded \$10 billion.³¹⁶ The raise in interchange fees by Visa and MasterCard in 1998 and 1999 resulted in a collective raise to merchants of over \$300 million a year.³¹⁷ While Visa and MasterCard argued that their interchange fees increased because of costs, no information was revealed to explain the increased costs.³¹⁸

When the interchange fee increases, issuers receive more revenues. Acquiring banks must pay more to issuing banks, causing merchants to pay more to acquiring banks, and ultimately raise retail prices. Consumers are generally harmed by a rise in retail prices. When issuing banks receive profits that exceed their costs, they generally pass this excess on to their card-carrying customers via special rebates and royalties, such as zero percent financing and airline miles.³¹⁹ If indeed Visa and MasterCard based their interchange fees on costs, issuing banks could not likely afford to offer substantial rebates, frequent flyer miles, or attractive financing. Those essentially benefiting from increased interchange fees, therefore, are people who qualify for and use credit cards, and their issuing banks.

Those harmed by these fee hikes include cardholders by paying increased retail prices, non-cardholders who also pay increased retail prices, merchants who lose by either paying higher merchant discount fees or discontinuing acceptance of Visa and MasterCard (which is not a realistic option for most merchants), and acquiring banks who do not participate in "on us" transactions and therefore must pay a higher interchange fee. Although acquiring banks generally receive full reimbursement from merchants for the interchange fee, some acquiring banks may end up losing merchant customers if they go out of business because they can no longer afford the increased interchange fee. Also, although this increased fee is passed along to cardholders through rebates and incentives, many

³¹⁵ Balto, *Creating a Payment System Network*, *supra* note 70, at 1395-96.

³¹⁶ Balto, *The Problem of Interchange Fees*, *supra* note 2, at 215.

³¹⁷ *Id.* at 216.

³¹⁸ *Id.*

³¹⁹ See Carlton & Frankel, *supra* note 9, at 658 (noting that increased interchange fees are passed on to card customers).

consumers may prefer lower overall retail prices; however, cardholders were not asked which they prefer prior to the fee hikes.

In looking at the interchange fee from an international perspective, the United Kingdom found the fee to be anticompetitive and therefore regulated it.³²⁰ The same is true of Australia.³²¹ In practice, the interchange fee in Israel and Italy are regulated and monitored to ensure that they are based on costs and are not excessive.³²² Other still developing credit card systems such as Poland may need to have the credit card system unregulated and allow the interchange fee to adequately establish the network system before determining whether to regulate. However, in the United States, where the credit card interchange fee was introduced and has proliferated, it has also continued to increase, its calculation has remained a secret, and has gone unchecked by any sort of regulation or market basis.

The credit card interchange fee stifles competition. Competition is reduced among issuing banks since there is no incentive for them to experiment with other credit card networks because the elevated interchange fee offered by the Visa and MasterCard systems provide them generous profits. This may change as a result of the *Visa, U.S.A.* decision and as displayed with the partnership between MBNA, Corp. and American Express. Although banks that agree to issue cards other than Visa and MasterCard will likely look for an attractive interchange rate at the negotiating table. Why would issuers go elsewhere when Visa and MasterCard maintain the largest credit card system and offer the most attractive interchange fees?

Interchange fees harm merchants because unless a merchant wants to lose a large portion of its customers, accepting Visa and MasterCard remains a high cost of doing business and a convenience to customers not easily replaced. As a result of the network effects, merchants cannot afford to lose their credit card customers, and therefore, take the hit and pay the increased interchange fee.

Consumers are harmed because they must pay the larger interchange fees in higher prices; although non-cardholders are paying the most, cardholders also pay higher retail prices. Because

³²⁰ Cruickshank, *supra* note 60, at 3.44.

³²¹ See ACCC Study, *supra* note 145, (discussing throughout the study the anticompetitive effects of the interchange fee); Gans & King, *Approaches to Regulating Interchange Fees in Payment Systems*, *supra* note 120, at 125.

³²² *Supra* Parts IV.C.3 & IV.C.4.

merchants are not allowed to surcharge credit card purchases and they choose not to discount cash purchases, all consumers pay the inflated price for goods spurred by higher interchange rates.³²³

The justifications that Visa and MasterCard gave for their increased interchange fees are increases in costs and increases in incentives for issuers and merchants.³²⁴ Merchants do not seem to be aided or impressed by the interchange hikes.³²⁵ Therefore, because interchange fees are not based solely on costs, and since merchants are not being enhanced by the fees, the fees seem beneficial only to the pocketbooks of issuing banks and some cardholders. From this information it would appear that the pro-competitive effects of the credit card interchange fee are not outweighing the harm done to consumers, merchants and acquirers.

Visa and MasterCard have monopoly power in the credit card market. Their activities regarding the interchange fees, therefore, should be monitored and more transparent so that a more accurate determination can be made regarding whether the fee indeed has any purpose other than inflating profits. This article does not assume the position that the solution to the interchange fee problem is to declare it unlawful, yet the fee's transparency to its consumers and payers should be argued. This was the decision in the United Kingdom and Australia.³²⁶

Visa and MasterCard would put up an arduous fight if regulation to control the interchange fee was recommended in the United States, although, regulation may not be essential. If Visa and MasterCard displayed more transparency in the setting of the interchange fee, merchants would have more ammunition to decide whether to pay the entire interchange fee, and in lieu of government regulation, the credit card associations may continue to maintain some control over the setting the fee. This control may not remain the case if the interchange fee is forced into regulation because the networks are hiking fees out of control. Transparency would also give merchants and acquirers more leverage in determining whether the fee is justified. If merchants gain more leverage in this respect

³²³ If the no-surcharge rule was declared illegal, then non-card-paying customers would not be paying as much of the increased interchange fee—that is, of course, if the merchant decided to actually charge differing prices.

³²⁴ Balto, *Creating a Payment System Network*, *supra* note 70, at 1395-96.

³²⁵ *Interchange Fee Hikes Test Merchants' Muscle*, DEBIT CARD NEWS, available at 1998 WL 11240618 (June 25, 1998).

³²⁶ *Supra* Parts IV.C.1 & IV.C.2.

and the credit card associations choose not to lower fees, then merchants may come together to file lawsuits in situations where fees charged are excessive or frivolous.

A recently published study predicted that there is a twenty percent chance that litigation brought to combat the interchange fee in the next five years would be successful.³²⁷ Presently, merchants have no idea what they are paying for, except that they are paying to maintain their cardholding customers. Considering the recent Wal-Mart settlement, merchants are becoming dissatisfied with sitting around waiting for lower interchange fees.³²⁸

VI. Conclusion

The credit card interchange fee has been analyzed and questioned world-wide, and several suggestions have been made for its economical calculation. The problem is that calculation of the interchange fee has been a secret for Visa and MasterCard since their cards' inceptions. In some industries this may not be problematic; however, in the credit card industry where there are multiple players and all are affected, either negatively or positively, by the consistent increases in interchange fees, transparency is essential to avoid harm. Some countries have required disclosure by regulating the calculation of the interchange fee. In the United States, however, the interchange fee is still under the secret blanket of the Visa and MasterCard associations. This lack of transparency in the process of setting the interchange fee has caused many to question the fee's purpose, whether it is really a tool for covering costs and increasing cardholders or whether it is simply a profit maximizer at the cost of harming merchants and consumers. By requiring greater transparency in the setting of the interchange fee, merchants may have the information to determine whether or not the credit card associations are acting anti-competitively or unfairly. If this is the case more lawsuits by merchants may arise, and end up in settlement, ultimately lowering interchange fees. Transparency would certainly change the structure of the interchange fee, and candid justification to merchants and consumers would accompany each new increase.

As monopolists of the credit card market, Visa and MasterCard have controlled the setting of the interchange fee out of view of the parties that it affects. In order to place a check on the

³²⁷ *Attacking the Death Star*, *supra* note 153, at 3.

³²⁸ *Wal-Mart Stores, Inc. v. Visa U.S.A., Inc.*, 280 F.3d 124 (2001).

activities of Visa and MasterCard, the United States should move to something closer to that practiced in the United Kingdom, Australia, Italy, and Israel by requiring transparency in the setting of interchange fees; however, unlike these other countries the setting of the fee should remain market based and not necessarily regulated by the banking or antitrust authorities.

In requiring a more fair interchange rate in the United States that would benefit all parties, disclosure of the fee's calculation should be made to a governing body, such as the Department of Treasury or the Federal Trade Commission. If the calculation of the fee is disclosed, then the credit card networks are more accountable for the fees they are charging and the governing body can monitor the distribution of the interchange fee to ensure that its initial purpose of easing the burden to issuing institutions is fulfilled. To be fair to all parties, the calculation of the interchange fee should be made public annually so that the parties who are involved in paying the fee and who are affected by the assessment of the fee can determine whether the fees are excessive. After such determinations, retailers or consumer groups may legally attack the interchange fees and would have the numbers and justification to support such an attack.

While a proposed system of monitoring may seem like a pseudo-regulation, the market forces would still be responsible for the actual setting of the fee and the monitoring would simply keep the credit card companies accountable for the costs included in the fee calculation. In this case, the participants in the market keep the interchange fee competitive. While monitoring the interchange may seem acceptable to many involved in the network, a recent Morgan Stanley Report makes a seventy percent prediction that the interchange situation will continue on the status quo, but pressure from merchants, to include litigious threats, will level out the fee without requiring a decrease.³²⁹

While it may appear that the market presently determines the interchange fee, this ideology is inaccurate because in the market of issuers, cardholders, merchants and merchant acquirers, none of these groups as a whole determines the actual setting of the interchange fee in the Visa and MasterCard associations. Because cardholders, merchants and merchant acquirers are at the mercy of the associations, the only true market forces that determine the anti-competitive interchange fee are the credit card associations. And thus, some type of checks and balances may be necessary to create an interchange equilibrium.

³²⁹ *Attacking the Death Star*, *supra* note 153, at 4.