

# Research Report

## Multilateral Interchange Fees

Competition and regulation in light  
of recent legislative developments

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# Multilateral Interchange Fees: Competition and Regulation in light of Recent Legislative Developments

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## **Abstract**

Two-sided payment card markets generate costs that have to be distributed among the participating actors. For this purpose, payment card networks set an interchange fee, which is the fee paid by the merchant's bank to the cardholder's bank per transaction. While in recent years many antitrust authorities all over the world - including the European Commission - have opened proceedings against card brands in order to verify whether agreements to collectively establish the level of interchange fees are anticompetitive, the Reserve Bank of Australia - as a regulator - has directly tried to address market failures by lowering the level of interchange fees and changing some network rules. The US has followed with new legislation on financial consumer protection, which also intervenes on interchange fees. This has opened a strong debate not only on legitimacy of interchange fees, but also on the appropriateness of different public tools to address such issues. Drawing from economic and legal theories and a comparative analysis of recent case law in the EU and other jurisdictions, this work investigates whether a regulation rather than a purely competition policy approach would be more appropriate in this field, considering in particular, at EU level, all of the competition and regulatory concerns that have arisen from the operation of SEPA with multilateral interchange fees. The paper concludes that a wider regulation approach could address some of the shortcomings of a purely antitrust approach, proving to be highly beneficial to the development of an efficient European single payments area.

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# 1. Introduction

In November 2008, a study was released by the World Bank on cooperation and competition in retail payment systems (hereinafter, 2008 WB study).<sup>1</sup> This study addressed, among other issues, the extent to which efficiency, access and innovation are determined by cooperation and competition among market players, and what are the main drivers of these factors. As a first step, it stated that the key drivers of cooperation and competition are environmental, legal and legacy issues, as well as governance, access and pricing and that the focal point is the trade-off between cooperation and competition. Then, it illustrated guidelines for a policy response through the oversight function over payment systems and cooperation among authorities. In particular, it concluded that effective oversight of payment systems is the major tool at the authorities' disposal with which to address market and coordination failures in the national payment systems. Central banks are the natural overseers of these systems as the only authority able to ensure that all public policy goals are aligned, whereas other authorities – such as competition authorities – can play an important ancillary role.

The 2008 WB study was mainly undertaken because of the increasing awareness of the role of cooperation and competition in the overall efficiency of the (retail) payment systems, and because of the widely diverging opinions on how to address their shortcomings. Since then, the debate in this domain has grown fierce, attracting the attention of regulators, scholars and market operators. Among these shortcomings, that of multilateral interchange fees (hereinafter, MIFs)<sup>2</sup> in cards has especially attracted the interest of both competition and regulatory authorities, as well as spurred a strong reaction by the market against some of the measures adopted. Both economic and legal doctrines have contributed substantive arguments to the debate.

Recently, in the context of the European efforts to achieve a unified European payment system – the so-called Single Euro Payments Area (hereinafter, SEPA) – special attention was devoted by the European Commission to MIFs under antitrust principles. At the same time, the mentioned interest in these pricing schemes also raised the issue of the authority best suited to evaluate them.

Indeed, the introduction of the euro as a single currency in 1999-2002 was one of the most important steps in the integration process of the European financial market. Harmonisation of national payment systems of all the member states of the European Union (EU), in addition to Norway, Iceland, Liechtenstein and Switzerland, started in January 2008. SEPA is now the next key event in the development of an integrated European money market. The main aim of the migration from domestic systems to SEPA is both to make payments easier, faster and more convenient for European customers, and to enhance competition in the European retail market which is expected to lead to lower prices. By eliminating technical, legal and commercial barriers, SEPA is intended to make non-cash payments within the euro

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<sup>1</sup> G. Guadamillas (Coordinator) (2008), “Balancing Cooperation and Competition in Retail Payment Systems - Lessons from Latin America Case Studies”, Financial Infrastructures Series - Payment Systems Policy and Research, World Bank, Washington, D.C., November.

<sup>2</sup> The CPSS Glossary defines interchange fees as the fees applied for a network organisation, and paid by the card-issuing institution to the acquiring bank for the cost of deploying and maintaining ATMs and POS. Since this paper focuses on credit card networks, MIFs shall mean the fees that are paid by the merchant's bank to the cardholder's bank per transaction under the pricing conditions uniformly set by the network.

area as easy and efficient as it is within a single national payment system.<sup>3</sup> The creation of a pan-European playing field is likely to increase competition between financial institutions and to bring about increased compatibility and scale economies, thus resulting in lower costs for customers and merchants.<sup>4</sup>

Although one of the main declared goals of the process is indeed to enhance competition, the migration to SEPA still presents a number of challenges from an antitrust perspective. In order to identify possible weaknesses in the retail sector that could distort or restrict competition and to discover valuable information that could be used to inspire the future developments of the SEPA process, in 2007 the European Commission launched a sector inquiry on retail banking.<sup>5</sup> This inquiry concluded that a major competition issue could be the introduction of a higher level of MIFs in cards. According to the Commission, even if these default MIFs would be able to guarantee that transactions between all financial institutions in Europe participating in the SEPA process would be possible because agreements existed between members of the card network, they may have led to higher tariffs than those paid in some member states. This risk was considered to be real, given that there are countries in the European payments market where the level of interchange fee was (is) low or where card schemes would operate without an MIF.<sup>6</sup>

On the other side, the Commission is certainly not unaccustomed to evaluating MIFs under competition law. Back in 2002, when examining the consistency of cross-border MIFs of Visa with European law, it ascertained a violation of Article 101(1) of the Treaty on the Functioning of the European Union (hereinafter, TFEU) on anticompetitive agreements. However, it then granted an exemption according to Article 101(3) TFEU, allowing agreements that while anticompetitive in nature, may benefit the market under a number of conditions (hereinafter, VISA II decision)<sup>7</sup>. In that context, the Commission thus seemed to take the view that MIFs could in principle be anticompetitive but that the question of their anti-competitiveness could be concretely resolved only after an assessment of their level. In a more recent decision concerning *MasterCard* (hereinafter, MasterCard decision),<sup>8</sup> however, the Commission examined the effects of MIFs only on one side of the market, i.e. the acquiring one, thereby disregarding possible benefits in the organisation of the offer of the

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<sup>3</sup> W. Bolt and H. Schmiedel (2009), "SEPA, Efficiency and Payment Card Competition", ECB Working Paper series, ECB, Frankfurt, December, p. 9.

<sup>4</sup> On the analysis of the potential benefits from SEPA in the European payment market see C. Beijnen and W. Bolt (2009), "Size Matters: Economies of Scale in European Payments Processing", *Journal of Banking and Finance*, Vol. 33, No. 2, p. 203; W. Bolt and D. Humphrey (2007), "Payment Network Scale Economies, SEPA, and Cash Replacement", *Review of Network Economics*, Vol. 6, No. 4, p. 453; K. Kempainen (2008), "Integrating European Retail Payment Systems: Some Economics of SEPA", Bank of Finland Discussion Paper, No. 22, Bank of Finland, Helsinki; G. Schaefer (2008), "An Economic Analysis of the Single Euro Payments Area (SEPA)", FIW Working Paper, No. 11, FIW, Vienna; H. Schmiedel (2007), "The Economic Impact of the Single Euro Payments Area", ECB Occasional Paper Series, No. 71, ECB, Frankfurt.

<sup>5</sup> European Commission (2007), Sector Inquiry under Art. 17 of Regulation 1/2003 on Retail Banking, COM(2007)33 final, Brussels, 31.1.2007.

<sup>6</sup> European Commission (2007), Report on the Retail Banking Sector Inquiry, European Commission Staff Working Document accompanying the Communication from the Commission - Sector Inquiry under Art. 17 of Regulation 1/2003 on Retail Banking, SEC(2007) 106, Brussels, 31.1.2007, pp. 97-101.

<sup>7</sup> Commission Decision of 24.07.2002, *Visa International - Multilateral Interchange Fee*, [2002] O.J. L. 318, 22.11.2002.

<sup>8</sup> Commission Decision of 19.12.2007, *MasterCard*, [2007] COMP/34.579.



payment service and thus finding an infringement of Article 101(1) TFEU without granting any exemption.

Moreover, these recent developments of European law are not isolated cases. For the last few years, regulators and antitrust authorities around the world have increasingly intervened in the field of payment card systems. In Australia, for example, the Reserve Bank (RBA) eliminated the 'no discrimination' rule that had been in effect in card networks agreements and significantly reduced interchange fees. In this context, the Governor of the RBA expressly stated that, even if the best way to improve efficiency is to leave the market to free competition, retail payment systems "are constructed in such a way that competition increases costs and reduces efficiency".<sup>9</sup> As a consequence, retail payments regulation would be needed. In this case, it was the regulatory authority that intervened and it is thought that other central banks will be inclined to follow similar routes. Among these, the intervention most discussed is that of the US Federal Reserve Bank (Fed), under the so-called Durbin Amendment to the Dodd-Frank Act, imposing caps on interchange fees and limiting network exclusivity. These new provisions are part of the Electronic Fund Transfer Act (EFTA), which regulates consumer transactions. As a result, such amendments indeed were meant to be aimed at consumer protection.

One stance thus seems to be shared by authorities, i.e. the need for public intervention in this domain. Those who are in favour of a regulatory or antitrust intervention offer a number of arguments to support their claim, which can be briefly summarised as follows:

- First of all, MIFs would subsidise card holders, thus creating an incentive for customers to prefer card payment over other potentially less-expensive means of payment. From an economic point of view, the fact that card holders are not charged the marginal cost of using a card would lead to an excessive use of payment card systems.<sup>10</sup>
- Second, given that merchants are accustomed to passing the fees they have to pay onto users – regardless of the means of payment used by them – interchange fees would lead to generally higher prices for goods and services.<sup>11</sup>
- Finally, despite the general agreement that interchange fees play a beneficial role in addressing the externalities caused by the fact that the cards market is a two-sided market, member banks would have an incentive to set fees at the level that maximises their profits.<sup>12</sup>

Notwithstanding this perceived agreement among authorities, and the fierce opposition of the market and by some scholars, the issue has not been fully addressed whether such public intervention should take the form of antitrust intervention against anticompetitive behaviour or of regulation (or, more properly, oversight). The WB 2008 study did conclude that oversight of the retail payment systems is crucial to balancing cooperation and competition issues and ensuring adequate governance, access and pricing. This is because achieving

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<sup>9</sup> I.J. Macfarlane (2005), "Gresham's Law of Payments," speech to AIBF Industry Forum, Sydney, *RBA Bulletin*, Vol. 8, p. 13.

<sup>10</sup> D.D. Garcia Swartz, R.W. Hahn and A.L. Farrar (2006), "The Move Toward a Cashless Society: a Closer Look at Payment Instrument Economics", *Review of Network Economics*, Vol. 5, No. 2, pp. 183-188.

<sup>11</sup> J. Gans and S.P. King (2001), "The Role of Interchange Fees in Credit Card Associations: Competitive Analysis and Regulatory Options", *Australian Business Law Review*, Vol. 29, No. 2, pp. 121-123. See, *infra*, § 2.1.

<sup>12</sup> A. Frankel and A. Shampine (2006), "The Economic Effects of Interchange Fees", *Antitrust L.J.*, Vol. 73, No. 3, p. 649. See, *infra*, § 2.2.

multiple public policy objectives to maximise social welfare, in the context of retail payments, requires certain trade-offs. In particular, the lack of an overarching objective means that there is a greater need to reconcile multiple public-policy goals relating to safety and efficiency, reliability, competition, access and consumer/data protection.<sup>13</sup> Yet, it also mentioned the need for cooperation among authorities, as each is tasked with ensuring the attainment of specific objectives, including freedom of competition. Moreover, considerations in the 2008 WB study stress the role of the overseer of the national payment systems as that of reconciling multiple public policy goals, whereas MIFs as such would seem at a first glance only to relate to competition principles, although efficiency is also at stake.

In light of the above, the 2008 WB study, together with the recent EU experience, sheds light on pros and cons of antitrust or regulatory intervention in this field.

To answer these questions, this paper starts by briefly explaining the economics of interchange fees, acknowledging some of the major conclusions reached in the still highly controversial debate on externalities of MIFs. Then, we will consider, in particular, the SEPA initiative and the main consequences of the introduction of a unified MIF in Europe, also according to existing case law and comparing this experience with that of other countries where central banks intervened instead of the antitrust authorities. Finally, we will try to investigate the most appropriate approach to the issue, comparing advantages and drawbacks of regulatory and competition policy, in the hope of reaching some guiding principles of a more general nature, or at least stimulating a new debate.

## 2. Payment Systems as a Two-Sided Market

### 2.1 The Economics of Four-Party Credit Card Transactions and Interchange Fees

Video game consoles, the newspaper industry, auction houses and shopping malls are all examples of 'two-sided markets'. According to the definition given by J. C. Rochet and J. Tirole, these are "*markets in which platforms offer interaction services to two (or several) categories of end-users*".<sup>14</sup> Shopping malls, for example, link retailers and shoppers.

Generally speaking, three conditions must be fulfilled in order to have a two-sided market. First of all, there must be two different groups of customers. Secondly, because of the membership externality,<sup>15</sup> the value one group of end-users obtains increases in parallel with the number of people on the other side of the market. Finally, a common platform created by an intermediary is necessary in order to allow interaction between the two sides and to have

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<sup>13</sup> See in particular pp. 25-26 of the study. See also B. Bossone and M. Cirasino (2001), "The Oversight of Payments Systems: A Framework for the Development and Governance of Payment Systems in Emerging Economies", *Payment and Securities Clearance and Settlement Systems Research Series*, CEMLA-World Bank, Washington, D.C., July.

<sup>14</sup> J. C. Rochet and J. Tirole (2008), "Competition Policy in Two-Sided Markets, with a Special Emphasis on Payment Cards" in P. Buccirossi (eds), *Handbook of Antitrust Economics*, Cambridge: MIT Press, p. 543.

<sup>15</sup> *Ibid.*, p. 554.

the two groups “on board”.<sup>16</sup> This means that both sides of the market are essential in order to have the product.<sup>17</sup>

Also payment cards (and, in general, payment systems) can be considered an example of a two-sided market. As a matter of fact, in order to carry out the transaction, the participation of the two involved customer groups (cardholders and merchants) is needed. If, for example, the consumer does not carry a payment card or the merchant does not accept it, the payment does not take place.<sup>18</sup>

In case of card payments, a joint venture allows getting both sides of the market “on board”, by defining pricing conditions and offering a wide range of services. However, these conditions differ according to the specific type of card payment, three- party or four- party.<sup>19</sup>

More precisely, in the case of three-party systems (usually only for credit) there are three parties participating in the transaction: the consumer, the merchant and the card company. This implies that the platform has, at the same time, the role of acquirer and issuer, considering that it receives the information on the amount of the transaction and the one related to the consumer card. Therefore, the funds flow directly into the merchant account as soon as the transaction is authorised. Nevertheless, in order to receive the service, the merchant has to pay a fee which is set by the payment platform and which is a certain percentage of the purchase amount.<sup>20</sup>

On the other hand, in four-party systems (both for credit and for debit), there are four parties involved in a card transaction: the consumer, the bank that issued the card (the issuer), the merchant and the bank that deals with the merchant (the acquirer).

The first author who described how the card payment system works was W.F. Baxter in 1983,<sup>21</sup> who based his analysis on the assumption that there is perfect competition between banks and homogeneity of customers and merchants: assuming that the price of the good that the cardholder wishes to buy is  $p$ , usually he pays, in addition to  $p$ , a fraction of the card fee,  $f$ . However, in many cases, he pays a fixed fee annually or quarterly which could be considered a small fee per transaction. The function of this  $f$  is to ensure that the issuer can cover its transaction costs. Subsequently, the issuing bank pays the bank of the merchant the retail price minus an amount  $a$  of the transaction value. This amount constitutes the interchange fee.

The merchant receives from his bank the price  $p$  minus a transaction amount,  $m$ , which is the merchant fee (also called merchant service charge) which usually encompasses the

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<sup>16</sup> T. J. Muris (2005), “Payment Card Regulation and the (Mis)Application of the Economics of Two-Sided Markets”, *Columbia Business Law Review*, Vol. 3, p. 517.

<sup>17</sup> D.S. Evans and R. Schmalensee (2005), *Paying with Plastic: the Digital Revolution in Buying and Borrowing*, 2<sup>nd</sup> ed., Cambridge: MIT Press, p. 133.

<sup>18</sup> D.S. Evans (2003), “The Antitrust Economics of Two-Sided Markets”, *Yale Journal on Regulation*, Vol. 20, II, p. 359.

<sup>19</sup> A. Heimler (2010), “Payment Cards Pricing Patterns: the Role of Antitrust and Regulatory Authorities”, ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1574292](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1574292)).

<sup>20</sup> B. Klein, A.V. Lerner, K.M. Murphy and L.L. Plache (2006), “Competition in Two-Sided Markets: the Antitrust Economics of Payment Card Interchange Fees”, *Antitrust L.J.*, Vol. 73, III, p. 572.

<sup>21</sup> W.F. Baxter (1983), “Bank Interchange of Transactional Paper: Legal and Economic Perspectives”, *Journal of Law and Economics*, Vol. 26, III, p. 541. See also A. Frankel and A. Shampine (2006), “The Economic Effects of Interchange Fees”, *Antitrust L.J.*, Vol. 73, III, p. 630; J.S. Gans and S.P. King (2003), “The Neutrality of Interchange Fees in Payment Systems”, *Topics in Economic Analysis and Policy*, Vol. 3, I.

interchange fee paid to the issuer. Through the merchant fee, the acquirer covers also its part of transaction costs. Should the acquirer pass through the interchange fee, the merchant service charges will be higher. However the merchant also has the opportunity to pass through his fee to consumers. As a result, he will ask for higher prices when the payment is made by card rather than by cash or cheque. Another option available to the merchant is to set higher prices for all the products he sells. In this case, all the consumers, not only those who pay by card, will contribute to covering the costs incurred by the merchant because of card transactions.

In most cases, the interchange fee is set not by banks individually but by payment brands. As regards the two-sidedness of the market, these payment brands, in setting the interchange fee, face a trade-off between promoting the use of the cards and merchants' acceptance.<sup>22</sup> A low interchange fee tends to favour the acquiring side of the payment system. In contrast, a high interchange fee encourages consumers to hold and use cards for their transactions, especially when it is associated with a low annual or quarterly card fee.

## 2.2 In Favour and Against Interchange Fees as Regards the Economic Debate

There are two main arguments in favour of interchange fees in the payment card system. The first one relates to the role of the interchange fee in ensuring compensation for the costs incurred by the issuer when offering the service. The second one focuses on the two-sided aspect of the market.

As for the first argument, there are three different kinds of services that are offered by the issuer, which generate three kinds of costs: "general service costs", which cover costs such as that of processing transactions; "costs for a payment guarantee", under which the issuing bank agrees to honour all payments which derive from a "fraudulent use of credit cards" or "from bad debt write-off"; and "costs for an interest-free funding period", coming from the fact that the price is debited to the cardholder's account after a certain period of time and not immediately after the authorisation of the transaction.<sup>23</sup> Since it is the merchant who must initiate the electronic payment, the issuer needs to be compensated for its costs and the interchange fee would be the best instrument to produce such compensation.<sup>24</sup>

The second main argument in favour of interchange fee concerns the two-sidedness of the market. As already said in the previous paragraph, the credit card market is an example of a two-sided market given that in order to carry out a transaction both sides of the market (the consumers on the one side and the merchants on the other) have to be involved. This characteristic of the market means that, in addition to the problem of the "price level", the main difficulty is to determine the 'optimal price structure' of the two sides and, therefore, which part of the transaction cost should be paid by consumers or merchants. The interchange fee is claimed to be an unavoidable tool to influence this allocation and to affect

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<sup>22</sup> J. Wright (2004), "The Determinants of Optimal Interchange Fees in Payment Systems", *Journal of Industrial Economics*, Vol. 52, No. 1, p. 3.

<sup>23</sup> J. Freigang and A. Grün (2005), "The Assessment of Domestic Credit Card Interchange Fees Under EC Competition Law", *European Business Law Review*, Vol. 16, p. 153.

<sup>24</sup> Muris, *op. cit.*, p. 523. Against this argument, it has been argued that it is the cardholder who initiates the transaction and so he should pay the costs related to it. This could be done through higher transaction fees or annual card fees: A.S. Frankel (2007), "Towards a Competitive Card Payments Marketplace", *Proceedings of Payments System Review Conference*, RBA, Sydney, November, p. 33.

the cardholder fee and the merchant service charge, and consequently the volume of transactions.<sup>25</sup>

Network effects play a central role in two-sided markets. As a matter of fact, if there are numerous merchants who accept a card brand, then consequently this card brand becomes more valuable to consumers. At the same time, the more consumers hold the card, the larger the benefits to the merchants.<sup>26</sup> Due to the existence of these network effects, the interchange fee shifts the costs of the transaction from cardholders to merchants and makes the card payment more attractive, thus contributing to an expansion of the network which is beneficial to both sides.<sup>27</sup>

Three main arguments have been raised against interchange fees.

First of all, it is maintained that the main reason why interchange fees are not passed through cardholders is because of the market power of the issuing banks.<sup>28</sup> This is because issuing banks and acquiring banks are not perfectly competitive. Given these imperfections, the effective economic role of interchange fees depends on whether the acquirer passes through the interchange fee to the merchant (and the latter to cardholders) and, more importantly, whether the issuer transfers the benefits related to the collection of interchange fees to the consumers through a lower annual card fee. The point is that, on the one hand, merchants do not usually demand a higher price only from those consumers which prefer card payment. As a result, when the level of interchange fee increases, the higher costs of the card transaction are transferred to all the consumers without taking into account the

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<sup>25</sup> Guadamillas, *op. cit.*, p. 194. In this study it is clearly stated that, because of the asymmetry between the two sides of the market, it may be socially efficient to have a balancing act that reallocates the costs between merchants and customers, even if this implies that one side of the market - in this case retailers - pays more than the other. This is mainly because banks have to recoup fixed costs needed to maintain safe and efficient infrastructures. However, as discussed *infra*, empirical findings in the European retail banking sector demonstrate that, even without an interchange fee, banks would still make profits and that there is not a negative relationship between the average fee per card and the level of interchange fee, that is to say that an increase in interchange fees is not fully offset by reductions in cardholder fees. This finding may raise doubts about the two-sided market argument. *See, also*, D.S. Evans and R. Schmalensee (2005), "The Economics of Interchange Fees and Their Regulation: An Overview", 4548-05 MIT Sloan Working Paper, MIT, Cambridge, May, p. 12; Evans and Schmalensee, *op. cit.*, pp. 300-310.

<sup>26</sup> R. Schmalensee (2002), "Payment Systems and Interchange Fees", *Journal of Industrial Economics*, Vol. 50, II, pp. 103-105.

<sup>27</sup> In respect to this second argument, it has been argued that whilst having a temporary interchange fee would lead to the expansion of a new network, this function of the interchange fee might not be needed in a developed network. *See* M. Katz (2001), "Network Effects, Interchange Fees and no Surcharge Rules in the Australian Credit and Charge Cards Industry", RBA, Sydney, p. 27; S. Semeraro (2007), "Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty", Thomas Jefferson School of Law - Legal Research Paper Series, March, p. 36.

<sup>28</sup> A.S. Frankel (1998), "Monopoly and Competition in the Supply and Exchange of Money", *Antitrust L.J.*, Vol. 66, II, pp. 341-346; D.W. Carlton and A.S. Frankel (2005), "Transaction Costs, Externalities, and "Two-Sided" Payment Markets", *Columbia Business Law Review*, Vol. 3, pp. 633-638; M. Katz (2005), "What Do We Know About Interchange Fees and What Does It Mean for Public Policy?: Commentary on Evans and Schmalensee", *Proceedings - Payments System Research Conferences*, Federal Reserve Bank of Kansas City, Kansas City, p. 127. *Contra* Klein, Lerner, Murphy and Plache, *op. cit.*, pp. 594-609; H. Chang and D.S. Evans (2000), "The Competitive Effects of the Collective Setting of Interchange Fees by Payment Card Systems", *Antitrust Bull.*, N. 45, p. 664.

payment system they chose.<sup>29</sup> On the other hand, the issuing banks “do not fully rebate each increment in interchange fee revenue back to their cardholders”.<sup>30</sup> From this perspective, the interchange fee can be considered a means to make profits for the issuers.

Related to this issue is the fact that interchange fees are collectively set by banks, so that they can be considered an example of horizontal agreements. Considering the fact that a high level of interchange fee is attractive for both issuing and acquiring banks, they are induced to agree on excessively high interchange fees.<sup>31</sup> Moreover, most banks are both issuers and acquirers: in acquiring transactions they do not make losses, while as issuing banks they make profits.

Another risk lies in the fact that, because of the intensified competition for issuers, when there is a rise in the level of interchange fees the issuing banks tend to offer the cardholders a series of advantages and rebates that make the use of such instrument of payment more attractive than other forms of payment. At the same time, payment brands tend to increase the level of interchange fee with the aim to attract more and more banks, whereas banks do not have any interest in encouraging the use of the lower fee cards, despite of the efficiencies associated with them.<sup>32</sup>

Because of ‘price coherence’ and market power exercised by banks, some payment methods (namely, card payment) drive out others (namely, cash and cheques). This is known as the ‘Gresham’s law’.<sup>33</sup>

### 2.3 A socially optimal determination of MIF? And what about ancillary restraints?

To complete the analysis, and within the framework of the self-regulatory initiative leading to the creation of SEPA, it could be useful to investigate some possible alternatives to a high fall-back MIF.

Three options are usually mentioned in economic literature.<sup>34</sup>

A possible solution, known as “par collection”, would be to set MIF equal to zero.<sup>35</sup> In this scenario, there is no need for negotiations between the parties because the transactions are processed automatically and “the clearing and settlement of interbank payment claims” occurs “at the face amount of the claim”.<sup>36</sup> Instead of reaching an agreement on the level of the fee that has to be paid from one side of the transaction to the other, issuing and acquiring

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<sup>29</sup> J.C. Rochet and J. Tirole (2006), “Externalities and Regulation in Card Payment Systems”, *Review of Network Economics*, Vol. 5, I, p. 4; Frankel, op. cit., p. 346. In response to all the criticisms to interchange fees made by A. Frankel, see Chang and Evans, op. cit., pp. 662-677.

<sup>30</sup> Frankel and Shampine, op. cit., p. 634.

<sup>31</sup> D.A. Balto (2000), “The Problem of Interchange Fees: Costs Without Benefits?”, *ECLR*, Vol. 21, p. 216.

<sup>32</sup> Frankel and Shampine, op. cit., p. 637.

<sup>33</sup> Sir Thomas Gresham was the financial adviser of Queen Elisabeth I. Gresham’s source of concern was the recognition of the same value to different coins irrespective of the preciousness of the metals contained. See Frankel, op. cit., pp. 317-318. *Contra* Chang and Evans, op. cit., pp. 669-677.

<sup>34</sup> R. Schmalensee (2003), “Interchange Fees: a Review of the Literature”, *Payment Card Economics Review*, Vol. 1, p. 43.

<sup>35</sup> *Contra* Klein, Lerner, Murphy and Plache, op. cit., pp. 576-577; Chang and Evans, op. cit., pp. 665-666.

<sup>36</sup> Frankel and Shampine, op. cit., p. 637.

banks would just impose on their respective customers the charges which reflect the costs borne for the services they offer.

The second option would be to make the bilateral negotiations between banks on the level of interchange fee as mandatory. In such a situation, there would be again a contract between acquiring and issuing banks and an interchange fee ensuring that the transaction occurs. The main criticism against this system has been that it would lead to a “web of millions of contracts connecting each bank with every other bank”<sup>37</sup> thus resulting in an extremely costly system. However, in other circumstances, banks have shown that they are able to find some alternatives to bilateral agreements, for example allowing the transactions’ data of small banks to be processed through larger ones. In this case, only roughly one hundred contracts should be concluded rather than millions.<sup>38</sup> Another criticism to this second option is that the issuing banks are likely to have considerable bargaining power by worsening the alternatives of the other party. This is because of the honour all cards rule, according to which a merchant that accepts to carry a payment brand is obliged to accept all cards issued by the banks which are in the same association.

Another possibility would be to give the banks in the network discretion to decide whether they wish to sign contracts with each other. Nonetheless, it could be argued that some payments would become impossible since there is no contract between the issuing and the acquiring banks.<sup>39</sup>

In addition, MIF are often combined with ancillary clauses, such as the no surcharge rule, the no steering rule and the honour all cards rule. These further price restraints imposed on merchants by network rules are considered to be also anti-competitive because they reduce the retailers’ freedom to price discriminate. They also need to be considered together with MIF because their combined application might reinforce anti-competitive effects.

In order to maximise the use of cards by customers, card networks have prohibited merchants from price discriminating on the basis of the chosen means of payment (no discrimination rule) and from surcharging customers who use cards or offering discounts to customers using low-cost payment systems such as cash or cheque. As a result, prices usually do not vary according to the payment instrument customers choose even if actually the costs that merchants (and other customers) have to bear are much higher in case of cards.

According to some scholars, the no discrimination rule leads customers to have “*inappropriate incentives*”<sup>40</sup> to choose the costliest payment system. As a matter of fact, the lack of differentiation between prices according to the payment instrument means that customers consider only their own benefits associated with card spending (such as the interest-free funding period or the frequent flyer miles). Given that these rewards are earned almost for free by card holders (because the retailers and partly all other final customers pay for them), they have an incentive to choose this costly system. Consequently, the elimination of this network rule would reduce free riding: merchants would pass through the merchant fees to cardholders; cardholders would become more aware of the interchange fees charged by card

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<sup>37</sup> Baxter, op. cit., p. 556.

<sup>38</sup> Frankel and Shampine, op. cit., pp. 640-641.

<sup>39</sup> Ibid., p. 642.

<sup>40</sup> A. Heimler and S.F. Ennis (2008), “Competition and Efficiency in Payment Cards Which Options for SEPA?”, *W. Comp.*, Vol. 31, I, p. 20.

brands; customers would choose less costly means of payment or they would opt for card schemes setting low interchange fees.<sup>41</sup>

Price coherence has been challenged by many competition authorities and regulators. However, even after the elimination of the no surcharge rule in some countries, only a very small percentage of merchants have started to offer different prices reflecting the relative costs of the payment instrument used by customers.<sup>42</sup> This does not mean that the elimination of this anticompetitive network rule is without effect,<sup>43</sup> as the Australian case that we will discuss below shows: the number of Australian merchants surcharging credit card transactions has risen over recent years, possibly as an effect of such prohibition.<sup>44</sup>

Merchants are also not allowed to induce customers to use certain types of payment instruments rather than others (no steering rule). This rule, in addition to the no surcharge rule, ensures that there is price coherence among payment instruments/systems.<sup>45</sup> In light of the lack of any efficiency justifications for these rules, many believe that they should be eliminated.

Finally, another network rule is the honour all cards rule, which requires retailers to accept all cards - both credit and debit - issued by a payment card network once they have decided to join that network. While at the beginning, this rule applied only to credit cards, when credit cards brands started issuing debit cards, this was extended to debit cards.<sup>46</sup> The overall consequence of this situation is that banks tend to direct customers towards card programs with high interchange fees. On the other hand, merchants can decide either to accept all the cards issued by the brand or not accept them at all - so they must make an "all or nothing choice".<sup>47</sup>

## 2.4 Empirical Findings in the European Retail Banking Sector

As mentioned, according to Baxter's analysis, banks in retail payment services do not have market power against customers and merchants.<sup>48</sup> As a result, interchange fees are passed through without generating any kind of profit for banks. However, Baxter's theory assumes a perfect competition exists between banks and homogeneity of customers and merchants, has been rejected in the mentioned 2007 sector inquiry into retail banking by the European Commission.<sup>49</sup>

One of the most interesting findings of the Commission is indeed that in Europe the acquiring side of the market is much more concentrated than the issuing one.<sup>50</sup> In some Member States, it emerges that there is only one acquiring party which has strong market power and, therefore, is able to pass on the interchange fees to merchants.<sup>51</sup> Moreover, in

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<sup>41</sup> Ibid., pp. 27-28.

<sup>42</sup> Chang, Evans and Garcia Swartz, op. cit., p. 19; Evans and Schmalensee, op. cit., p. 27.

<sup>43</sup> Heimler and Ennis, op. cit., p. 25.

<sup>44</sup> RBA (2007), *Reform of Australia's Payments System: Issues for the 2007/08 Review*, Sydney, p. 14.

<sup>45</sup> Frankel, op. cit., pp. 52-54.

<sup>46</sup> Heimler and Ennis, op. cit., p. 26.

<sup>47</sup> Frankel, op. cit., p. 55.

<sup>48</sup> Baxter, op. cit., p. 542.

<sup>49</sup> European Commission, op. cit., p. 87.

<sup>50</sup> Ibid., pp. 88-90.

<sup>51</sup> See also NMa (2005), *Monitor Financiële Sector*, The Hague, p. 34.



these countries, the only acquirer in the market is likely to carry out negotiations and reach agreements on behalf of the banks. This high market concentration on the acquiring side of the industry, together with a high level of profitability and the existence of entry barriers, raise many concerns because of the ability of banks to exercise market power.

Furthermore, according to economic theory, the level of card fees should be lower and the merchant service charges higher when interchange fees increase. This would happen because of the interchange fee mechanism itself: in case no interchange fee is paid by the acquirer to the issuer, the latter would have to recoup all the costs from cardholders, thus increasing the card fees when the interchange fee is higher and lowering them when the interchange fee decreases. This hypothesis is confirmed by the existence of a negative relationship between the average fee per card and the level of interchange fee in a given country or network. However, contrary to what economic theory suggests, the Commission sector inquiry reveals that there is no negative relationship between the level of interchange fees and the fees paid by cardholders. From an econometric estimation in the inquiry, it emerges that approximately only 25% of the interchange fee is passed onto cardholders. The remaining 75% is retained by banks as a profit.

This striking finding may indeed cast some doubts on the relevance of the two-sided market argument as regards the role played by the interchange fee in this industry: challenging the hypothesis advanced by some industry participants and the economic literature that an increase in interchange fees is fully offset by reductions in cardholder fees, the results of the econometric estimation by the Commission rather suggest that “if issuers do not pass return the additional interchange fee revenues back to cardholders this implies that interchange fees are a way to transfer profits to the side of the scheme where they are least likely to be competed away”.<sup>52</sup>

The report gives also empirical evidence of a relationship between the interchange fees for credit card payment and the level of profitability of the issuing banks. In particular, comparing the total income including the interchange fee revenues and the total income in the absence of the interchange fee revenues, the Commission concludes that even without the interchange fee revenues - so, even in the case of ‘par’ clearing - the institutions considered in the inquiry would still realise profits.<sup>53</sup> This would seem to weaken the argument put forward by the operators in the market, according to whom, interchange fees are a necessary condition to recover the costs borne by the issuing banks.

Thus, from the Commission sector inquiry, it would appear that, even if there could be some reasons for implementing an interchange fee, in practice the main effect is that it leads to extremely high profits for banks, especially the issuers. The Commission explicitly mentions that the aim of the report is not to take a position in favour of an interchange fee equal to zero for all networks, but that the levels in Europe are probably not optimal. Nevertheless, a zero interchange fee seems to be the solution that would better correspond to the Commission’s conclusions, as this would be likely to increase competition not only between the issuers but also between the acquirers. Given that each issuer and acquirer would charge its customers according to the costs they bear, the issuer had a strong incentive to offer cards which are attractive for customers and which would not involve the payment of high fees. On the acquiring side, banks would face much lower fees as they would not have to pay an interchange fee for every transaction.<sup>54</sup>

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<sup>52</sup> European Commission, *op. cit.*, p. 100.

<sup>53</sup> *Ibid.*, pp. 121-122.

<sup>54</sup> Heimler, *op. cit.*

These various – and sometimes conflicting – findings on and evaluations of MIF, have to be analysed from a competition case law standpoint.

### 3. Competition Policy and Interchange Fees

#### 3.1 At the EU Level

All over the world, competition authorities and competition tribunals have scrutinised the use of MIF. The main competition concern is that, by collectively and centrally<sup>55</sup> setting MIF, the involved banks set a floor on the merchant fee that makes it difficult to agree bilaterally on a lower fee. In the European Union, these agreements may conflict with Article 101(1) TFEU because a minimum price would be fixed indirectly.

As already briefly mentioned in the introduction, there are in particular two streams of decisions taken by the European Commission in relation to MIF in the payment card industry: addressing the schemes of VISA, on the one side, and MasterCard, on the other.<sup>56</sup>

In the *Visa II* decision, the Commission took the view that MIF is an agreement on price which is caught by Article 101(1) TFEU and which restricts competition by effect, but it granted an exemption under Article 101(3) TFEU, provided that Visa reduced the level of MIF.

In the first place, as regards the relevant market the Commission considered that both sides of the market (the acquiring and the issuing side) have to be taken into consideration.<sup>57</sup>

In the second place, two main anti-competitive concerns were identified. Firstly, MIF agreements, by restricting the freedom of member banks to set the level of MIF which best suits their own commercial or pricing strategy, restrict competition by effect. The agreement therefore fixes a *de facto* floor and affects price competition in the market for card issuing and merchant acquiring. Secondly, the Commission found that there was an upward pressure on the level of MIF, and the chance for merchants to cease accepting Visa if the MIF were too high was not found to be sufficiently strong to constrain this upward pressure. As a matter of fact, when the level of MIF goes up, it would appear that merchants prefer to recover this increase in their costs by raising the price for all goods.

At the same time, the Commission accepted a number of efficiency justifications for MIF.<sup>58</sup> Generally speaking, in order to benefit from the exemption under Article 101(1) TFEU, an agreement must satisfy four conditions: it must improve the production or distribution of goods or promote technical or economic progress; consumers must receive a fair share of the resulting benefit; the agreement does not have to contain restrictions which are dispensable;

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<sup>55</sup> L. Repa, A. Malczewska, A. C. Teixeira and E. Martinez Rivero (2008), “Commission Prohibits MasterCard’s Multilateral Interchange Fees for Cross-Border Card Payments in the EEA”, *Competition Policy Newsletter*, Vol. 1, p. 1.

<sup>56</sup> On the policy developed by the Commission on MIF see also S. Ryan, E. Martinez Rivero, A. Nijenhuis (2007), “Financial Services”, in J. Faull and A. Nikpay, *The EC Law of Competition*, 2<sup>nd</sup> edition, Oxford: Oxford University Press, p. 1305.

<sup>57</sup> For an explanation of the anticompetitive effects of MIF agreements, see J. Freigang and A. Grün (2005), “The Assessment of Domestic Credit Card Interchange Fees under EC Competition Law”, *European Business Law Review*, Vol. 16, p. 158.

<sup>58</sup> J.C. Rochet (2009), “Interchange Fees in Payment Card Systems: Price Remedies in a Two-Sided Market” in B. Lyons (ed.), *Cases in European Competition Policy: the Economic Analysis*, Cambridge: Cambridge University Press.

and it does not have to substantially eliminate competition.<sup>59</sup> The Commission identified two efficiency justifications in respect of MIF applied by VISA. On the one hand, it was accepted that a MIF could lead to efficiency gains, compared to bilateral agreements, due to lower negotiation and transaction costs. On the other, the Commission acknowledged that, because of the existence of network externalities in a payment card system, interchange fees could provide greater utility for both merchants and cardholders. The consequent balancing between the efficiencies and consumer benefits that an agreement may generate against the restrictions of competition that such agreement may cause,<sup>60</sup> led to the conclusion that the former outweighed the latter. As a result, the agreement was exempted.<sup>61</sup>

In the following *MasterCard* decision, almost all efficiency claims accepted in *Visa II* were rejected.<sup>62</sup> First of all, the Commission did not accept the argument that MIF *per se* enhance efficiency of the payment card system, arguing that “there is no presumption that MIF in general enhance the efficiency of card schemes just as there is no presumption that they do not fulfil the conditions of art. 81(3) of the Treaty and are therefore illegal”,<sup>63</sup> since MasterCard had failed to prove that the efficiencies outweighed the negative effects of the restrictions of competition. More specifically, as to the condition of a fair share of benefit to consumers, the Commission held that not all customers benefited from MIF and the efficiencies on the issuing side of the market that receives the interchange fee do not offset the negative effects on merchants. Regarding the indispensability condition, the Commission considered that MasterCard “had not proven that its current MIF is indeed indispensable to maximise system output and to achieve any related objective efficiencies”,<sup>64</sup> citing the ECB statistics on payment card schemes in the European Payment Area that have been operating without MIF.<sup>65</sup>

These conclusions were partly the result of the fact that in *MasterCard*, the Commission considered that the relevant market for the assessment of the effects of MIF was only the acquiring one. Focusing the antitrust scrutiny on the merchant side, the Commission found

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<sup>59</sup> P. Nicolaides (2005), “The Balancing Myth: the Economics of Article 81(1) & (3)”, *Legal Issues of Economic Integration*, Vol. 32, No. 2, p. 134.

<sup>60</sup> According to Nicolaides, Article 101(3) implies the application of “*successive filters*” more than a real balancing. In Nicolaides, *op. cit.*, pp. 142-143.

<sup>61</sup> Freigang and Grün, *op. cit.*, p. 163.

<sup>62</sup> L. Vitzilaiou (2008), “MIF: The Root of Evil or Just a Scapegoat?”, *GCP*, Vol. 2, p. 5.

<sup>63</sup> Commission Decision of 19.12.2007, *MasterCard*, *cit.*, § 730.

<sup>64</sup> *Ibid.*, § 751.

<sup>65</sup> Another interesting, although more technical aspect of the Commission’s analysis is that it did not accept MasterCard’s argument pursuant to which, after the Initial Public Offering (IPO) of the holding company MasterCard Incorporated, MIF could no longer be considered a decision taken by an association of undertakings within the meaning of Article 101(1). As a matter of fact, the Commission found that, despite the changes brought about by the IPO, MasterCard remained an association of undertakings whose members were banks that still had to comply with network rules and were bound to follow MIF as set by the brand. That is to say that, after the restructuring, MasterCard Incorporated vertically obliges directly each member bank to apply the default interchange fee it decided, whereas horizontal agreements between participating banks are removed. In the end, according to the Commission, nothing changes substantially and Article 101(1) still applies. See V. Fleischer (2007), “The MasterCard IPO: Protecting the Priceless Brand”, *Harvard Negotiation Law Review*, Vol. 12, pp. 144-154. In 2008, Visa had the largest IPO of equity in U.S. history. In J.D. Wright (2006), “MasterCard’s Single Entity Strategy”, *Harvard Negotiation Law Review*, Vol. 12, p. 227; W. Bolt and S. Chakravorti (2008), “Economics of Payment Cards: A Status Report”, *DNB Working Papers*, The Hague, p. 1.

little difficulty in concluding that the efficiencies that MIF could generate did not counterbalance the restrictions on competition. Finally, the decision seems to leave open the possibility that agreements on MIF could be deemed anti-competitive by object. This is another evidence of a more formalistic approach adopted by the Commission in its most recent decisions.<sup>66</sup>

On 1 March 2008, MasterCard appealed the decision to the General Court which issued its judgement on the case on 24 May 2012.<sup>67</sup> The Court dismissed the action brought by the card brand and fully upheld the Commission's decision.

First of all, the Court stated that MIF are not necessary to the working of the network: "the requirement for objective necessity cannot be interpreted as implying a need to weigh the pro and anti-competitive effects of an agreement. Such an analysis can take place only in the specific framework of Article [101](3) EC".<sup>68</sup> It then added that MIF are not objectively necessary for the operation of four-party payment schemes for two reasons. On the one hand, there are other default settlement mechanisms less restrictive of competition than the MIF, such as the prohibition on "ex-post pricing".<sup>69</sup> On the other hand, MIF are not a necessary mechanism for transferring funds to the issuing banks, which already receive significant revenues from cards. It is thus unlikely that if the MIF did not exist, issuers would stop their business. This conclusion was reinforced by the Australian case we will discuss below, where a significant reduction in MIF levels did not impact the system's viability.

In the second place, the Court seemed to point to the existence of a restriction of competition by object given that "Article [101](1)(a) EC expressly provides that measures which directly or indirectly fix purchase or selling prices constitute restrictions of competition, and that, according to the case-law, the purpose of Article [101](1)(a) EC is to prohibit undertakings from distorting the normal formation of prices on the markets".<sup>70</sup> However, it based its analysis on the MIF restrictive effects and acknowledged that MIF set a *de facto* floor for the merchant service fees and that they limit the pressure which merchants can exert on acquirers by reducing their possibility to negotiate a price which is below a certain threshold.

In the third place, the Court considered that MasterCard had not proven the existence of efficiencies brought by MIF and that could offset the harm of the restriction. Precisely, after having confirmed the Commission's analysis, focused only on those efficiencies arising specifically from the MIF and not from the MasterCard payment system as a whole, the Court held that the fact that the MIF could contribute to increasing the system output is not

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<sup>66</sup> Repa, Malczewska, Teixeira and Martinez Rivero, *op. cit.*, p. 2.

<sup>67</sup> General Court, judgment of 24.5.2012, case T-111/08, *MasterCard, Inc. and Others v. European Commission*, not yet reported. For comments related to the judgement, see E. Chiti and S. Screpanti (2012), "Osservatorio della Corte e del Tribunale dell'Unione Europea", *Giornale di diritto amministrativo*, Vol. VIII-IX; M. Debroux and F. De Bakker (2012), "Commissions Multilatérales d'Interchange: Le Tribunal de l'UE Confirme la Condamnation d'une Organisation Internationale de Paiement par la Commission Européenne [Multilateral Interchange Fees: The General Court Upholds the European Commission's Decision against an International Payment Organization]", *Concurrences: revue des droits de la concurrence*, Vol. 3; A. Gee (2012), "Mastercard: Illegality Confirmed for Multilateral Interchange Fees for Payment Card Transactions", *Journal of European Competition Law & Practice*, Vol. 3, VI.

<sup>68</sup> General Court, judgment of 24.5.2012, case T-111/08, *cit.*, § 80.

<sup>69</sup> *Ibid.*, §§ 95-95. If ex-post pricing is prohibited, any interchange fee must be agreed between the issuing and the acquiring banks before the transaction takes place.

<sup>70</sup> *Ibid.*, § 140. See also General Court, judgment of 10.3.1992, case T-13/89, *Imperial Chemical Industries plc v. Commission*, [1992] ECR II-01021, § 311.

sufficient to conclude that the first condition set out in Article 101(3) is satisfied. This is because, while the primary beneficiaries of a greater use of MasterCard system are the participating banks, the second condition of Article 101(3) requires the existence of appreciable objective advantages in regard to merchants, as one of the two user groups affected by payment cards. Moreover, in the Court's view, MasterCard did not provide empirical evidence to support its argument that the MIF give rise to efficiencies. From this point of view, it interestingly clarified that, in light of Article 2 of Regulation No. 1/2003, it is the Commission's burden to prove that the agreement restricts competition, and on the undertaking concerned to prove that all the conditions to benefit from the exception are fulfilled. As a result, the "lack of data capable of meeting the standard of economic proof demanded by the Commission" cannot mean that "*the burden of proof*" on MasterCard under Article 101(3) "is eased, or even reversed".<sup>71</sup> In other words, given the difficulty in finding evidence of the benefits which merchants can obtain from a greater diffusion of the system, the Court considered that risks of anti-competitive harms stemming from MIF setting offset possible benefits. As for peculiarities deriving from the two-sidedness of the market, the Court first ruled that "the appreciable objective advantages to which the first condition of Article 81(3) EC relates may arise not only for the relevant market but also for every other market on which the agreement in question might have beneficial effects".<sup>72</sup> However, it eventually rejected the appellant's argument regarding the Commission's failure in assessing the benefits that cardholders obtain from the MIF, by stating that the lack of proven efficiencies on the merchants' side, which are one of the two customer groups, makes it unnecessary to verify whether some objective advantages attributable to the MIF benefited cardholders.<sup>73</sup>

On 31 December 2007, the VISA exemption expired and on 3 April 2009 the Commission sent Visa a statement of objections<sup>74</sup> containing a competition assessment on MIF similar to the assessment made in the then recently taken *MasterCard's* decision. In addition, the statement of objections addressed also some network rules such as the honour all cards rule, and the no surcharge rule. Given that Visa Europe offered commitments that were in line with *MasterCard's* decision for debit card payments<sup>75</sup>, the European Commission accepted them and closed part of the investigation through a commitment decision under Article 9 of Regulation 1/2003 (*Visa III* decision).<sup>76</sup> Subsequently, new proceedings were opened

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<sup>71</sup> *Ibid.*, § 232.

<sup>72</sup> *Ibid.*, § 228. See also General Court, judgments of 28.2.2002, case T-86/95, *Compagnie générale maritime and Others v Commission*, [2002] ECR II-1011, § 343 and of 27.9.2006, case T-168/01, *GlaxoSmithKline Services v Commission*, [2006] ECR II-2969, § 248.

<sup>73</sup> Finally, the Court endorsed the Commission's view that, even after the IPO, MasterCard remained "*an institutionalized form of coordination of the conduct of the banks*" (§ 259). The Court pointed out, on the one hand, that MasterCard continued to be an association of undertakings due to the fact that banks were not only customers but participated in essential decisions regarding the MasterCard system. On the other hand, it ruled that both the card brand and the participating banks had a common interest in high fees.

<sup>74</sup> European Commission (2009), "Antitrust: Commission Sends Statement of Objections to Visa", Press Release MEMO/09/151, 26.4.2009.

<sup>75</sup> The fee reduction offered by Visa was in line with MasterCard's decision to cut cross-border MIFs in order to comply with 2007 Commission decision. See, *infra*, § 3.4.

<sup>76</sup> Commission Decision of 8.12.2010, *Visa MIF*, [2010] COMP/39.398. See European Commission (2010), "Antitrust: Commission Makes Visa Europe's Commitments to Cut Interbank Fees for Debit Cards Legally Binding", Press Release IP/10/1684, 8.12.2010. It is important to underline that this is the first Commission decision to formally acknowledge the Merchant Indifference Test (MIT) as a

addressing possible anti-competitive effects caused by consumer credit MIF. In this framework, the Commission sent Visa a supplementary statement of objections regarding MIF for credit cards and related practices.<sup>77</sup> The Commission was concerned over certain practices of the payment company, specifically in regards to rules on ‘cross-border acquiring’, which limit cross-border competition and segment the internal market insofar as they oblige banks to apply the inter-bank fees of the country of the transaction. Additionally, the Commission looked into interchange fees set and applied by Visa for transactions with consumer credit cards. Subsequently, Visa proposed commitments to cut its inter-bank fees for credit card payments to a level of 0.3% of the value of the transaction for cross-border and domestic transactions and to reform its system in such a way that cross-border competition is facilitated.<sup>78</sup> Pursuant to Article 27(4) of Regulation 1/2003, the Commission published a “market test notice’ inviting the interested parties to send their comments.

The story does not seem to have ended for MasterCard either: on 9 April 2013, the Commission opened a new formal investigation against MasterCard in relation to the credit card company’s inter-bank fees and other practices.<sup>79</sup> Specifically, and similarly to VISA, in the Commission’s view, a violation of Article 101(1) is likely to have arisen from: (i) rules on cross-border acquiring and related business rules such as the honour all cards rule; and (ii) inter-bank fees in relation to payments made by cardholders who are not from the European Economic Area.

Whilst awaiting for new developments, at this stage, it can be concluded that there has been a clear trend towards more severity in the Commission’s analysis (as upheld by the General Court): after MasterCard, even though the possibility that MIF agreements can be exempted under Article 101(3) is not excluded *a priori*,<sup>80</sup> as a matter of fact, it is not the level of MIF but rather their existence which seems to constitute a competition concern.<sup>81</sup> More specifically, the Commission clearly held that networks can continue using MIF only when it is bilaterally agreed between individual issuers and acquirers. In the absence of bilateral agreements, transactions should be cleared “at par”.<sup>82</sup>

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benchmark to verify whether conditions under Article 101(3) are satisfied. For the sake of precision, the decision is without prejudice to the right of the Commission to initiate proceedings against Visa Europe into credit card transactions and network rules.

<sup>77</sup> European Commission (2012), “Antitrust: Commission Sends Supplementary Statement of Objections to Visa”, Press Release IP/12/871, 12.7.2012.

<sup>78</sup> European Commission (2013), “Antitrust: Vice President Almunia Welcomes Visa Europe’s Proposal to Cut Inter-Bank Fees for Credit Cards”, Press Release MEMO/13/431, 14.5.2013.

<sup>79</sup> European Commission (2013), “Antitrust: Commission Opens Investigation Into MasterCard Inter-Bank Fees”, Press Release IP/13/314, 9.4.2013.

<sup>80</sup> European Commission (2008), “Antitrust: Commission Notes MasterCard’s Decision to Temporarily Repeal Its Cross-Border Multilateral Interchange Fees within the EEA”, Press Release MEMO/08/397, 12.6.2008.

<sup>81</sup> L. Ceccarelli (2008), “Commissione Europea vs MasterCard: l’Analisi Antitrust di un Mercato Bilaterale”, *Mercato concorrenza regole*, Vol. 3, pp. 607-608.

<sup>82</sup> For the sake of completeness, it should be noted that the Commission’s view on this point was indirectly expressed in the *Mastercard* decision (see footnote No. 517 where it stated that: “[I]n the Commission’s view in the absence of a default MIF banks may or may not enter into bilateral agreements on interchange fees. The existence of such bilaterally agreed interchange fees is no pre-requisite for the viability of the MasterCard payment card scheme. In the absence of a default MIF prices are established on both sides of the MasterCard scheme as set out in section 7.3.4.1, i.e.: each bank determines its service levels and prices in a manner that maximises its individual profits”).

### 3.2 At the National Level within the EU

MIF were scrutinised also by several national competition authorities which, according to Article 3 of Regulation 1/2003,<sup>83</sup> have to apply EU competition law when agreements have a Community dimension,<sup>84</sup> while, at the same time, have to cooperate and coordinate with the Commission in order to ensure a consistent application of the legal framework in the analysis of MIF.

In April 2005, the Spanish Tribunal de Defensa de la Competencia (hereinafter, TDC)<sup>85</sup> adopted an approach stricter than that used in the *Visa II* decision when three card schemes (Sistema 4 B, Servired and Euro 6000) applied for individual exemptions of their domestic interchange fee. The TDC, on the one hand, did not accept the two-sided market argument, taking the view that interchange fees constitute a restriction of competition under Article 101(1) that could be justified only on the grounds of efficiency considerations; on the other, it criticised the method of determining interchange fees arguing that it did not reflect costs.<sup>86</sup> One scheme - 4 B - and some merchants appealed the decision. To date, the Court has supported the competition authority's decision, although it has not yet issued a final judgement on the appeal.<sup>87</sup>

In September 2005, the UK Office of Fair Trading (OFT) came to the conclusion that<sup>88</sup> members of the MasterCard UK Members Forum and other MasterCard licensees in the UK were party to an agreement which was illegal both under Article 101(1) TFEU and the Chapter I prohibition in Section 2 of the national Competition Act. Even if the OFT stressed the similarities to the *Visa II* decision, it reached different conclusions on exemptability, arguing that collective price restrictions are not indispensable for the attainment of the benefits of MIF agreements<sup>89</sup> and that they do not allow a fair share of the benefits to be passed onto consumers. On appeal, the decision was withdrawn by the Competition Appeal Tribunal. Subsequently, the authority launched an investigation into MasterCard's and Visa's UK MIF arrangements for credit and debit cards whose outcome is still pending.<sup>90</sup>

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<sup>83</sup> Council Regulation 1/2003/EC of 16.12.2002, on the implementation of the rules on competition laid down in Arts. 81 and 82 of the Treaty, [2003] O.J. L. 1, 04.01.2003.

<sup>84</sup> Freigang and Grün, op. cit., pp. 159-161.

<sup>85</sup> Decisions of the TDC of 11.04.2005, N. A 314/02, *Tasas Intercambio SISTEMA 4B*; A 318/02, *Tasas Intercambio SERVIRED*; and N. A 287/00 *Sistema Euro 6000*.

<sup>86</sup> J. Briones (2005), "The Spanish Tribunal Rejects Bank Commissions on Credit Cards", €-Konomica's Newsletter No. 7 ([http://www.e-konomica.net/\\_pdf/7\\_bank-commissions-on-credit-cards.pdf](http://www.e-konomica.net/_pdf/7_bank-commissions-on-credit-cards.pdf)).

<sup>87</sup> More information can be found in the ECN Brief 01/2011, available at: [http://ec.europa.eu/competition/ecn/brief/01\\_2011/brief\\_01\\_2011\\_short.pdf](http://ec.europa.eu/competition/ecn/brief/01_2011/brief_01_2011_short.pdf).

<sup>88</sup> Decision of the OFT of 06.09.2005, *Investigation of the Multilateral Interchange Fees Provided for in the UK Domestic Rules of MasterCard UK Members Forum Limited (formerly known as MasterCard/Europay UK Limited)*, No. CA98/05/05.

<sup>89</sup> *Ibid.*, § 533-540.

<sup>90</sup> OFT (2006), Statement Regarding Expansion of OFT Investigation into Interchange Fees, Press Release 97/06, London, 20.6.2006 and *Id.* (2007), OFT to Refocus Credit Card Interchange Fees Work, London, 9.2.2007. See also the pending investigation opened in order to clarify whether the interbank-fees arrangements for UK domestic POS transactions made using MasterCard/Maestro and Visa consumer payment cards are agreements in violation of Article 101(1) and the corresponding national rules. More information on the latter proceeding is available at: [http://www.of.gov.uk/OFTwork/competition-act-and-cartels/ca98-current/interchange-fees#Ug\\_1-qv9PgV](http://www.of.gov.uk/OFTwork/competition-act-and-cartels/ca98-current/interchange-fees#Ug_1-qv9PgV).

In December 2006, the Polish Office of Competition and Consumer Protection also criticised the multilateral setting of fees on the ground that they would hamper the development of new payment systems and innovation which is explicitly prohibited by Article 101(1) (b) TFEU.<sup>91</sup> As a result, the authority imposed the elimination of MasterCard's and Visa's MIF for credit and debit cards in Poland.<sup>92</sup> MasterCard and the banks lodged an appeal with the Court of First Instance (the so-called "Competition and Consumer Protection Court") which, in November 2008, reversed the decision, holding that the MIF did not restrict competition in the relevant market, *i.e.* the acquiring market. However, the Appellate Court, by referring to the Commission's decision in MasterCard, stated on 22 April 2010 that the MIF did restrict competition in the acquiring market and remanded the case to the Court of First Instance, which will need to review its decision in light of the Court of Appeal's reasoning. The new proceeding before the Court of Competition and Consumer Protection, started in December 2011, is still on-going.<sup>93</sup>

Finally, and interestingly, in a few recent cases, national competition authorities have found that banks' conduct consisting in coordinating their behaviour by setting excessive levels of interchange fees amounted to an abuse of the dominant position collectively held by them in the relevant market.<sup>94</sup>

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<sup>91</sup> Decision of the Polish Office of Competition and Consumer Protection of 29.12.2006, *Decision on Determining the Interchange Fee in Visa and MasterCard Systems*, case DDF3-580/1/01/DL/EK.

<sup>92</sup> For example, in November 2010 the Italian Competition Authority (hereinafter, ICA) fined MasterCard and eight banks for card fee practices. The Authority identified two conducts in breach of Article 101(1) TFEU, namely the structure and functioning of MasterCard's network and the parallel network of license contracts between the scheme on the one hand, and licensees on the other. The Authority held that MasterCard, an association of undertakings, determines specific domestic MIF for Italy. Given that MasterCard members collectively set the price, MIF constitutes a restriction of competition by object. The second conduct, which represents the main difference from the Commission's MasterCard decision, is the combination of licensing contracts between MasterCard and licensee banks, namely acquirers. Through these vertical agreements, the MasterCard network sets the MIF which is passed on to customers. Moreover, licensees adopt additional conducts that enhance the negative effect of the MIF to their own benefit and to the benefit of the network. This effect is produced through clauses and contractual conditions with merchants such as blending (also on us and off us), no discrimination rules, honour all cards rule. MasterCard and the acquiring banks appealed the ICA's final decision. On 11.7.2011, the Italian Court of First Instance (Tribunale Amministrativo Regionale, TAR Lazio) upheld the Parties' appeal and overturned the ICA's decision. The ICA then appealed the TAR decision to the appellate administrative Court (Consiglio di Stato). The proceeding is still pending.

For an analysis of the credit card network industry in Italy and interchange fees, although prior to these most recent developments, see G. Ardizzi (2003), "Cost Efficiency in the Retail Payment Networks: First Evidence from the Italian Credit Card System", Banca d'Italia - Collana Temi di discussione del Servizio studi, Rome.

<sup>93</sup> More information is available at: [http://www.uokik.gov.pl/news.php?news\\_id=2045](http://www.uokik.gov.pl/news.php?news_id=2045).

<sup>94</sup> See the decision handed down by the Austrian Federal Competition Authority of 12.9.2007, *Europay Austria Zahlungsverkehrssysteme GmbH*, case 16Ok4/07, where it was ascertained that Europay Austria and its shareholding banks, by charging high debit card interchange fees to competitors for using Europay POS-terminals, had concluded an agreement the object of which was contrary to the national competition act and had abused their dominant position. The fine imposed by the decision was increased by the Supreme Court. Moreover, an investigation, still pending, has been opened by the Cypriot Competition Authority, which is concerned that JCC Payment Systems Limited (JCC) and a number of commercial banks hold a collective dominant position and are in violation of competition law. According to the authority, these banks, *inter alia*, coordinated their behavior, subsequently resulting in high levels of domestic interchange fees. More information can be found in the document



Many other authorities in the European Competition Network have opened procedures<sup>95</sup> or have already adopted decisions addressing interchange fees.<sup>96</sup> Some of them accepted and made legally binding the commitments offered by the parties, thus leading to an interchange fee reduction.<sup>97</sup> Taken all together, these proceedings demonstrate the restrictive approach adopted by competition authorities when scrutinising possible anti-competitive effects stemming from MIF.

### 3.3 In the United States

High levels of interchange fees have raised many competition and regulatory concerns also in the United States (hereinafter, U.S.).<sup>98</sup>

These have been partially addressed in litigation.<sup>99</sup>

In the U.S., contrary to what occurs in Europe - where the Commission or the national competition authorities can grant an exemption under Article 101(3) to any kind of restrictive agreement that fulfils the conditions laid down in the article - antitrust claims are evaluated under two standards of review: (1) the rule of reason, which entails the need to take into account all the information to determine the extent, or even existence of, the competitive or anticompetitive effects of the restraint; and (2) the *per se* rules that make invalid some

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prepared by the ECN Banking and Payments Subgroup, *Information paper on competition enforcement in the payments sector*, March 2012 ([http://ec.europa.eu/competition/sectors/financial\\_services/information\\_paper\\_payments\\_en.pdf](http://ec.europa.eu/competition/sectors/financial_services/information_paper_payments_en.pdf)), p. 27.

<sup>95</sup> In particular, investigations, which are still pending, have been opened in the following countries: Cyprus (the case has already been cited *supra*); Germany (where the proceeding concerns a possible violation of Article 101(1) and the corresponding national rules concerning MIF for domestic transactions within Germany using MasterCard/Visa branded credit cards). More information can be found in the document prepared by the ECN Banking and Payments Subgroup, *cit.*, p. 36.

<sup>96</sup> *See*, for example, the decision taken by the Hungarian Competition Authority, of 24.9.2009, where it was ascertained that the Hungarian banks' setting of uniform interchange fees for Visa and MasterCard card transactions infringed Article 101(1) and the corresponding national rules. The parties lodged an appeal before the Court, which suspended the proceeding with respect to the MasterCard case before the General Court. More information can be found in the document prepared by the ECN Banking and Payments Subgroup, *cit.*, pp. 42-43.

<sup>97</sup> This happened in the following Member States: Estonia (decision of 20.2.2012 regarding the interchange fees for card payments applied by the main Estonian banks); France (decisions of 7.7.2011 on MIF on GIE cartes bancaires payment cards; of 20.9.2013 on interbank fees applied by MasterCard and Visa to payments and local withdrawals made using consumer cards); Greece (decision of 29.7.2008, regarding the MIF on debit card transactions and additional financial services set by many banks having residence in the Greek territory); Italy (decisions of 5.10.2010 regarding MIF for national transactions using national PagoBANCOMAT branded debit cards; of 5.10.2010 concerning MIF for national direct debit services; ATM cash withdrawal and other national payment services). More information on the cited cases can be found in the document prepared by the ECN Banking and Payments Subgroup, *cit.*

<sup>98</sup> United States Government Accountability Office (GAO) (2009), Report to Congressional Addressees, Credit Cards - Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges, GAO-10-45, Washington, p. 13; R.J. Shapiro and J. Vellucci (2010), "The Costs of "Charging It" in America: Assessing the Economic Impact of Interchange Fees for Credit Card and Debit Card Transactions", *Sonecon LLC Studies*, pp. 3-6. Moreover, in recent years, the MasterCard and Visa interchange rates have increased in the U.S. more than in other countries.

<sup>99</sup> A.A. Foer (2010), "Electronic Payment Systems and Interchange Fees: Breaking the Log Jam on Solutions to Market Power", <http://www.antitrustinstitute.org/sites/default/files/Interchange%20Foer.pdf>, p. 2.

practices without needing a further analysis.<sup>100</sup> According to antitrust doctrine, horizontal agreements between competitors to fix prices are *per se* illegal.<sup>101</sup> Therefore interchange fees appear to be a type of *per se* illegal price fixing. However, since the *NaBanco* case<sup>102</sup> of 1986, the courts, also following the Supreme Court's decision in *BMI*,<sup>103</sup> generally evaluate claims challenging interchange fees set under the rule of reason.<sup>104</sup> In *NaBanco*, the Court found that interchange fees were not illegal price fixing because, first, they were indispensable to recover costs borne by issuing banks and, second, they were essential to creating a payment card system. The Court considered also that less restrictive alternatives did not exist, given that bilateral negotiations are impractical and, even more importantly, that three-party systems such as American Express or Diners Club did not offer credit options at that time.<sup>105</sup> With regard to impact on competition, the Court held that it was negligible. The main reason for this conclusion was that the Court considered that there was no distinct credit card market, thus defining the relevant product market as including all payment systems.<sup>106</sup>

In recent years, the *NaBanco* Court analysis on market definition has been rejected by courts holding that there is an independent market for credit cards.<sup>107</sup> More precisely, this happened in a proceeding regarding Visa and MasterCard's rules preventing network banks from issuing other brands' cards.<sup>108</sup> In this case, the Second Circuit found that Visa and MasterCard jointly had market power as it was evident from their ability to raise prices and their market shares. As regards interchange fees, the Court held that there was evidence of the "defendant's power to control prices or exclude competition".<sup>109</sup> As a matter of fact, first of all "both Visa and MasterCard have recently raised interchange rates charged to merchants [...] without losing a single merchant customer as a result"<sup>110</sup> and, secondly, they are able to charge different prices to merchants as a monopolist according to how much each merchant uses the credit cards.

The *U.S. v. Visa* decision confirms the application of the rule of reason standard to payment card interchange fees. However, a rule of reason treatment implies also that the effects of interchange fees have to be assessed under market conditions, which have indeed changed considerably over recent years. American Express and Discover now issue nationwide credit

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<sup>100</sup> Semeraro, op. cit., pp. 54-55.

<sup>101</sup> *United States v. Socony-Vacuum Oil Co.*, [1940] 310 U.S. 150, 223.

<sup>102</sup> *NaBanco (National Bankcard Corporation) v. Visa U.S.A. Inc.*, [1986] 779 F.2d 592, 11<sup>th</sup> Circuit.

<sup>103</sup> *Broadcast Music Inc. v. Columbia Broad. Sys. Inc. (BMI)*, [1979] 441 U.S. This case can be considered the "leading case" in favour of a rule of reason treatment of restraints such as price fixing, when a form of collaboration between competitors is indispensable for the existence of a new product. In Semeraro, op. cit., pp. 54-56.

<sup>104</sup> D.S. Evans and R Schmalensee (1995), "Economic Aspects of Payment Card Systems and Antitrust Policy Toward Joint Venture", *Antitrust L.J.*, Vol. 63, pp. 891-897.

<sup>105</sup> Balto, op. cit., p. 217; K.C. Wildfang and R. W. Marth (2006), "The Persistence of Antitrust Controversy and Litigation in Credit Card Networks", *Antitrust L.J.*, Vol. 73, III, pp. 679-681; D.W. Carlton and A. S. Frankel (1995), "The Antitrust Economics of Credit Card Networks", *Antitrust L.J.*, Vol. 63, pp. 649-650.

<sup>106</sup> R.B. Hesse and J. H. Soven (2006), "Defining Relevant Product Markets in Electronic Payment Network Antitrust Cases", *Antitrust L.J.*, Vol. 73, III, pp. 719-721.

<sup>107</sup> *Ibid.*, pp. 721-723.

<sup>108</sup> *United States v. Visa U.S.A.*, [2003] 163 F. Supp. 2d 322, 335 (S.D.N.Y.).

<sup>109</sup> *Ibid.*, § 340.

<sup>110</sup> *Ibid.*, § 341.

cards, therefore the argument that cooperation among banks is necessary for a nationally accepted payment card to be created no longer exists. Moreover, while in the 1980s credit card transactions were costly, now they take place electronically and the risk and float in the system have been substantially reduced. Finally, the U.S. credit card market is more concentrated than in the past, thus making bilateral agreements or, generally, less restrictive alternatives to interchange fees not “impractical”.<sup>111</sup> Under these assumptions, it is questionable whether the *NaBanco* findings would still be confirmed today.

### 3.4 MIF and SEPA

As described, in the *MasterCard* decision, it seemed that the Commission had taken the view that MIF is anti-competitive, no matter how high it is. This position became an important point of reference for banks in the migration process to SEPA. By referring very often to those payment card systems within the European Economic Area - such as in Denmark, Norway and Finland - functioning without MIF, the Commission stressed that the *MasterCard* decision would have actually supported the creation of SEPA.<sup>112</sup> On the other hand, banks argued that MIF cannot be condemned and considered illegal *a priori* and that the Commission’s approach against the use of MIF would have damaged the SEPA initiative as banks would have had to devise new financing rules to substitute MIF. The risk was that this strict and formalist approach taken by the Commission would undermine the banks’ efforts toward SEPA and cause uncertainties and delays in the migration of domestic payments to SEPA.<sup>113</sup>

In April 2009 by means of press releases, the Competition Directorate General for Competition of the European Commission (hereinafter, DG COMP) made clear under what circumstances a MIF could fulfil the exemption criteria of Article 101(3) TFEU. This was an important step in respect of a request for certainty on the compatibility with competition rules of MIF in the SEPA process.<sup>114</sup> After stating that in the *MasterCard* decision it “did not rule out the possibility that a MIF may be indispensable to creating efficiencies the benefits of which may outweigh the restriction of competition”, the Commission explained that an exemption may be granted only if the method to determine the level of interchange fees is transparent. From this perspective, the methodology developed in economic literature and called ‘avoided-cost test’, ‘tourist test’ or ‘MIT’ (Merchant Indifference Test) is approved by the Commission insofar as it ensures that not only that merchants benefit but also the costs they have to sustain for card payments are taken into account.<sup>115</sup> At the same

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<sup>111</sup> Semeraro, *op. cit.*, p. 3.

<sup>112</sup> European Commission (2007), “Antitrust: Commission Prohibits MasterCard’s Intra-EEA Multilateral Interchange Fees”, Press Release IP/07/1959, Brussels, 19.12.2007.

<sup>113</sup> M. Van Empel (2009), “Retail Payments and the Arduous Road to SEPA”, *C.M.L.Rev.*, Vol. 46, pp. 935-936.

<sup>114</sup> European Commission (2009), “Antitrust: Commissioner Kroes Takes Note of MasterCard’s Decision to Cut Cross-Border Multilateral Interchange Fees (MIF) and to Repeal Recent Scheme Fee Increases”, Press Release IP/09/515, Brussels, 1.4.2009 and *Id.* (2009), “Antitrust: Commissioner Kroes Notes MasterCard’s Decision to Cut Cross-Border Multilateral Interchange Fees (MIF) and to Repeal Recent Scheme Fee Increases - Frequently Asked Questions”, Press Release MEMO/09/143, Brussels, 1.4.2009.

<sup>115</sup> As a matter of fact, according to this test, merchants do not pay higher charges than the value of the transactional benefits that card use generates for them - for example a reduction in transportation and security expenses - and the amount of the MIF - the so-called “balancing fee” - is calculated by

time, a low level of interchange rates for both debit and credit cards must be introduced by card brands. Furthermore, in order to increase transparency, cross-border MIF have to be published on the website of the card brand and the latter has to inform merchants that they can accept competing schemes' cards, thus excluding a full application of the honour all cards rule. Finally, card brands should introduce a rule requiring the acquiring banks to offer the merchants different rates according to the type of card that is used (unblending) - credit or debit cards issued by banks belonging to the same network or cards issued by competing schemes. In the MasterCard case, an independent trustee was appointed in order to monitor MasterCard's compliance every six months with the undertakings given to the Commission.

The aforementioned EU cases are relevant not only for their economic and practical implications but also for the Commission's statements on MIF for SEPA.

First of all, if it is a specific level of interchange fee that raises competition concerns, there is a risk for the Commission to become a quasi-regulatory agency either involved in market assessment every six months or forced to rely on the monitoring of an independent trustee appointed by card brands in order to determine the 'right' level of interchange fee that may lead to an exemption under Article 101(3) TFEU. In order to avoid running the risk of acting as regulators, competition authorities, including the Commission, tend to rarely attack excessive pricing abuses of dominant position under Article 102 TFEU, while concentrating their efforts on exclusionary conducts.<sup>116</sup> From this point of view, interchange fee cases can be considered to be excessive pricing cases but assessed under the framework of Article 101 TFEU.<sup>117</sup>

Secondly, under Regulation 1/2003, which made Article 101(3) directly applicable, companies are required to do a self-assessment of the consequences of their agreements and the obligation to notify restrictive agreements to the Commission is abolished.<sup>118</sup> In spite of a reduction in the Commission's workload, this new procedure raises many concerns in terms of legal certainty, especially for complex cases such as interchange fee agreements.<sup>119</sup>

Finally, two other elements that should be taken into account - and which were at the centre of the discussion in the U.S. on the need for a regulatory intervention from the Federal Reserve in this field - are the fact that litigation takes too long<sup>120</sup> and "even settlements and

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comparing the merchants' costs of accepting payments in cash to those of accepting payments made by a payment card. The implementation of the balancing fee ensures that the merchant is indifferent as to whether card or cash payments are made and that cardholders - to the extent that the fee is passed onto cardholders, make efficient choices with respect to payment instrument. See European Commission, Press Release MEMO/09/143, cit.

<sup>116</sup> G. Monti (2007), *EC Competition Law*, Cambridge: Cambridge University Press, pp. 218-220; Whish, R. (2012), *Competition law*, 7<sup>th</sup> edition, Oxford: Oxford University Press, pp. 718-721.

<sup>117</sup> D.S. Evans (2006), "Interchange Fees: Is There a Competition Problem and, if so, How Do We Approach Solving It?", based on a presentation given at the OECD Meeting on Payment Cards, Paris, ([https://www.ebaportal.eu/\\_Download/2\\_OECD\\_Presentation.pdf](https://www.ebaportal.eu/_Download/2_OECD_Presentation.pdf)).

<sup>118</sup> A notification procedure was provided under the old enforcement regime set up by Regulation 17/1962. Council Regulation 17/1962/EEC, First Regulation Implementing Articles 85 and 86 of the Treaty, [1962] O.J. 013, 21.02.1962.

<sup>119</sup> M. Piergiovanni and P. D'Elia (2008), "Self-Assessment of Agreements Under Article 81 EC: Is There a Need for More Commission Guidance?", GCP.

<sup>120</sup> Foer, op. cit., p. 2.

judgments do not always solve all the underlying problems, especially where the defendants retain market power even after the case is resolved.”<sup>121</sup>

As previously mentioned in the introduction, these shortfalls have opened - together with other issues - the debate on whether MIF should only be considered as a competition issue or whether it would be more appropriate to consider MIF within a wider regulatory framework. In that latter case, competencies of different authorities would need to be considered (in particular, the role of Central Banks *vis-à-vis* antitrust authorities).

## 4. Competition Law or Specific Regulatory Measures?

### 4.1 Which Public Policy Option?

Antitrust authorities seem to agree that the current method of determining interchange fees allows participants to set the fees at very high levels that are not desirable (that is to say, they are ‘excessive’ in competition terms) from an economic efficiency and consumer welfare perspective.<sup>122</sup>

With Vickers, three possible public policy approaches could be adopted to overcome this problem.<sup>123</sup>

The first one would be to give the market and their participants discretion to decide the level of interchange fees without any kind of public intervention. This option may be justified if the costs of the public intervention outweigh its benefits. However, regulating MIF is unlikely to be excessively costly.

There are thus two ‘interventionist’ alternatives to this approach. On the one hand, one may argue that agreements among banks to determine the level of interchange fees should come under close scrutiny of competition authorities. On the other, one may be in favour of a regulatory intervention by a regulator, such as a central bank.

While in recent years many antitrust authorities all over the world have opened proceedings against card brands in order to verify whether agreements to establish collectively the level of interchange fees are anticompetitive, the Central Banks have also started looking into the issue. In particular, in Australia the RBA addressed market failures in the payment card sector by mandatorily lowering the level of interchange fee from approximately 0.95 percent to 0.55 percent, and changing some network rules. In parallel, in the US, under the Durbin Amendment, the Bureau for Financial Consumer Protection and the Fed are called to intervene.

Besides these experiences, we could also learn a lot from the discussion in the UK, where the government published consultation paper “*Opening up UK payments*”<sup>124</sup> proposing the establishment of a new competition-focused, utility-style regulator for retail payment systems. In this paper, the starting point was the government’s concerns on the governance of payment systems, under the oversight of the Payments Council, an industry body lacking

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<sup>121</sup> Ibid., p. 9.

<sup>122</sup> J.C. Rochet and J. Tirole (2002), “Cooperation Among Competitors: Some Economics of Payment Card Associations”, *RAND Journal of Economics*, Vol. 33, pp. 568-569.

<sup>123</sup> J. Vickers (2005), “Public Policy and the Invisible Price: Competition Law, Regulation and the Interchange Fee”, *Competition Law Journal*, Vol. 4, I, p. 12.

<sup>124</sup> HM Treasury (2013), *Opening up UK payments*, March, ([https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/221903/consult\\_opening\\_up\\_uk\\_payments.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221903/consult_opening_up_uk_payments.pdf)).

effective public accountability. In particular, the dominance of large UK banks over the decision-making process of the Payments Council made it unable to perform adequately its advisory and strategy-setting tasks in order to respond to the needs of payment system users and to secure agreement to deliver projects not in the members' immediate commercial interests. As a result of these problems, three alternatives were envisaged:<sup>125</sup> (i) to make changes to the current system's governance; (ii) to introduce the Payments Strategy Board ("PSB") - a new body open to strong industry influence - to set strategy across the UK payments industry; or (iii) to create a new economic regulator with responsibility for payment systems. While, at first glance, the PSB was thought to be the best option, the government then realised that giving regulatory powers to a body susceptible to strong industry influence would not tackle the aforementioned issues. Consequently, the only solution was to create a formal system of utility-style regulator for retail payment systems.<sup>126</sup> From this point of view, three options<sup>127</sup> were set out by the UK government for the body to which the regulatory powers will be given: (i) a new stand-alone regulator; (ii) the Financial Conduct Authority ("FCA"); or (iii) one of the existing economic regulators. In its summary of responses to the consultation, the government decided that the FCS should be given the role of Payment Systems Regulator for reasons mainly related to its knowledge of existing regulation, its existing financial services knowledge and understanding of the market as a whole and, finally, its relationship with relevant UK and EU regulatory bodies.<sup>128</sup> Moreover, the consultation proposed that the Payment Systems Regulator would exercise concurrent competition powers<sup>129</sup> in order to tackle ant-competitive conditions in the market.

The UK example, even if related to payment systems as a whole, is extremely interesting from three points of view. The first is that it warns against the risks of self-regulatory initiatives eventually establishing a body subject to strong industry influence and thus unable to create an environment where consumers and the economy as a whole can benefit from payment systems. Second, the consultation paper highlights pros and cons of creating an entirely new, stand-alone regulator which, while it has the advantage of offering a fresh start, single-focus body, would result in an extremely expensive way of proceeding. Third, the government's proposal to give the Payment Systems Regulator competition powers has been opposed by some respondents - mainly larger banks, payment scheme companies and card networks - who argue that it would be better for the Regulator to refer competition issues to the competent national authority.

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<sup>125</sup> To be precise, these options were set out in the consultation issued by the UK government in July 2012, *Setting the Strategy for UK Payments*, ([https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/81567/setting\\_strategy\\_uk\\_payments190712.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81567/setting_strategy_uk_payments190712.pdf)). This consultation was initiated in response to the Treasury Select Committee recommendation to bring the Payments Council within the system for financial regulation, and can be considered the first document where the government highlighted the need to address all the problems faced by the current system of governance for the UK payment system.

<sup>126</sup> HM Treasury, *cit.*, pp. 8-9.

<sup>127</sup> *Ibid.*, p. 10.

<sup>128</sup> HM Treasury (2013), *Opening up UK payments: response to consultation*, October, ([https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/249085/PU156\\_3\\_Opening\\_up\\_UK\\_payments\\_Government\\_response.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/249085/PU156_3_Opening_up_UK_payments_Government_response.pdf), pp. 5-6).

<sup>129</sup> *Ibid.*, pp. 11-12.

## 4.2 The Debate Surrounding SEPA Cards Framework: Competition Meeting Integration Issues

Before considering how regulators outside the EU have acted on MIF, it is worth considering how the EU Commission itself switches from competition to regulatory stances and instruments in the way it approaches the sector. We can start with the most common feature: the overlapping of competition and integration issues, specifically arising within SEPA.

In order to implement the SEPA process, the European banking sector has built a working group, the European Payments Council (hereinafter, EPC), whose main task is to define standardisation rules for payment instruments. More precisely, the project creates three pan-European payment schemes (the SEPA Credit Transfer Scheme Rulebook,<sup>130</sup> SEPA Direct Debit Scheme Rulebook<sup>131</sup> and SEPA Cards Framework)<sup>132</sup> for the three payment instruments which are regarded to be the most relevant ones from an economic perspective (credit transfers, direct debits and cards).

This self-regulatory initiative has progressed in parallel with the action taken by the European Commission to create the legal framework for such integration: in November 2007 the Payments Service Directive (hereinafter, PSD)<sup>133</sup> was definitively agreed upon. Moreover, some recent regulatory interventions at EU level were clearly aimed at fostering and accelerating the EU payment market integration, including proposals for reform of the PSD, as will be illustrated in the following sections.

As regards interchange fees, the position expressed by the EPC in the latest version of the SEPA Cards Framework is the following: “Interchange fees can be a necessary enabler for the operation and development of the card business, and for sound co-operation between banks in competition with each other”.<sup>134</sup>

It is interesting to note that the first sentence was less nuanced in the previous version of the framework for cards, which stated instead that: “Interchange fees have proven to be a necessary enabler for the operation and development of card business” (emphasis added).<sup>135</sup> The change in language is mainly due to the many modifications that have occurred in recent years in the Commission’s position on interchange fees, thus making the costs-based argument that supports the necessity of interchange fee less compelling.

In light of these statements, it is not surprising that the preferred solution within the ECP schemes has been to allow a multilateral fall-back interchange fee. Nevertheless, this does not solve the problem of the level of interchange fee that, according to the Commission, would be compatible with competition rules and at the same time accepted by all participating banks in all countries.

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<sup>130</sup> EPC (2009), SEPA Credit Transfer Scheme Rulebook, Version 3.3, Frankfurt.

<sup>131</sup> EPC (2009), SEPA Direct Debit Scheme Rulebook, Version 3.4, Frankfurt.

<sup>132</sup> EPC (2009), SEPA Cards Framework, EPC, Version 2.1, Frankfurt.

<sup>133</sup> European Parliament and European Council (2009), Directive 2007/64/EC on Payment Services in the internal Market Amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and Repealing Directive 97/5/EC, O.J. L. 319, 5.12.2007. The main aim of this directive is to harmonise the legal environment for European payments. See M. Verdier (2008), “Payment Card Systems in Europe: Convergence or Disappearance?”, *Communications & Strategies*, Vol. 69, pp. 141-142. See also M. Van Empel (2009), “Retail Payments and the Arduous Road to SEPA”, *C.M.L.Rev.*, Vol. 46, p. 923.

<sup>134</sup> EPC, *SEPA Cards Framework*, Version 2.1, cit., p. 16.

<sup>135</sup> EPC (2006), *SEPA Cards Framework*, Version 2.0.

Independently from the option finally preferred at the EU level, three alternatives would exist in theory.

First, one payment brand could set the interchange fee at a level that corresponds to the average of interchange fees in the countries within the SEPA territory. However, since there are wide discrepancies in the interchange rate levels, this solution could lead some countries to be better off and others worse off.

Another possible scenario would be the conclusion of bilateral agreements between the largest European banks that have many cross-border card transactions. The problem with this alternative is that it is almost impossible to negotiate bilaterally with all European players.

Although it could be argued that a MIF is necessary so that all the transactions are possible, as illustrated, this might result in high tariffs. Therefore, one may be in favour of a differentiated interchange fee structure that depends on the development of the payment cards market in each country.<sup>136</sup> According to this third option, given the market fragmentation across Europe, the interchange fee could be a 'balancing mechanism' between the issuers and the acquirers only if there is a country-by-country approach.

While the ECB was previously clearly in favour of a "single interchange fee (if any) for the whole area within a given brand",<sup>137</sup> in a more recent report on SEPA it states that a differentiation of interchange fees "could be accepted during a transition period in order to facilitate change in national markets [...]".<sup>138</sup> In addition to the difficulty international brands can face when defining for each country a different MIF,<sup>139</sup> the absence of a unified interchange fee is still in conflict with the idea of SEPA and especially with the goal of having converging tariffs between countries.

Another major element in the analysis of SEPA is the problem of "migration". This is related to the fact that, in order to have a truly integrated payment system, both domestic payments and cross-border ones should be processed over the same infrastructure. Consequently, domestic payments have to migrate from the domestic systems to the SEPA one. To this end, the SEPA Cards Framework identifies three possibilities for a payment scheme to become SEPA-compliant: (1) replacement of a national scheme by an international one which is already SEPA-compliant; (2) the expansion of national schemes to the entire euro area or the creation of a new European Card scheme; and (3) to co-brand a national scheme with an international one.<sup>140</sup>

Due to the supply-driven characteristic of the migration<sup>141</sup> and the higher level of interchange fees in the case of migration to an international brand (option 1), the decisions taken by banks to move from domestic brands to an international one merit close

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<sup>136</sup> L. Van Hove (2007), "SEPA & Debit-Card Interchange Fees: One Size Fits None?", *SPEED - Settlements, Payments, E-money & E-trading Development*, Vol. 2, II, p. 28.

<sup>137</sup> ECB (2006), *The Eurosystem's View of a "SEPA for Cards"*, Frankfurt, p. 13.

<sup>138</sup> ECB (2007), *Single Euro Payments Area (SEPA): From Concept to Reality*, Frankfurt, p. 13.

<sup>139</sup> However, MasterCard announced in 2007 that it is considering the possibility of country-specific interchange rates at least during a transition period. See MasterCard (2007), *MasterCard Europe Extends Timetable for Introduction of Maestro SEPA Fallback Interchange Rates*, 31.5. 2007. ([http://www.mastercard.com/us/company/en/newsroom/pr\\_sepaeurope.html](http://www.mastercard.com/us/company/en/newsroom/pr_sepaeurope.html), 10.3.2010).

<sup>140</sup> ECB (2006), *cit.*, pp. 6-10.

<sup>141</sup> NMa (2008), *SEPA Vision Document. A Single Payments Market, Increasing Competition?*, The Hague, pp.17- 22. *Contra* Van Empel, *op. cit.*, pp. 936-937.



competition scrutiny. Moreover, in addition to the advantage of already having SEPA-compliant products, international brands also provide processing services for banks. In spite of the prohibition - provided for in the SEPA Cards Framework<sup>142</sup> - on tying the card schemes and the processing services, there may be a risk that card companies cross-subsidise the processing services through the revenues generated by the card schemes.<sup>143</sup> In this way, they can exclude potential competitors from the market and raise prices. If the company occupies a dominant position, this conduct may amount to an abuse of dominant position under Article 102 TFEU. Cross-subsidisation is defined as the situation in which an “undertaking provides financial support in whatever form to one of its activities or a segment of activity from internal resources generated by another activity or segment”.<sup>144</sup> Even if there is consensus that cross-subsidisation does not constitute an abuse in itself,<sup>145</sup> it “may facilitate abusive pricing practices such as predation and selective price cutting”.<sup>146</sup>

As the ECB points out, the co-branding option also gives rise to concerns, since “it could crystallise national fragmentation” without bringing about the economies of scale that SEPA aims to create in the euro area.<sup>147</sup>

To overcome these potential anti-competitive/anti-integration effects, national payment schemes could develop a new European card brand. At the moment, three European initiatives have emerged: Euro Alliance of Payment Schemes (EAPS), launched by six payment systems,<sup>148</sup> the Monnet initiative<sup>149</sup> and the PayFair initiative.<sup>150</sup> In spite of the potential benefits that these European schemes may create, there is still a high level of uncertainty on the determination of MIF. This is the main reason that the Commission decided to take further steps and propose a regulation introducing a cap on MIF, as we will discuss further.

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<sup>142</sup> ECB, *The Eurosystem’s View of a “SEPA for Cards”*, cit., p. 12.

<sup>143</sup> NMa (2008), cit., p. 24.

<sup>144</sup> G. Abbamonte (1998), “Cross-Subsidization and Community Competition Rules: Efficient Pricing Versus Equity”, *E.L.Rev.*, p. 414.

<sup>145</sup> R. Whish, op. cit., p. 748; L. Hancher and J. Buendia Sierra (1998), “Cross-Subsidization and EC Law”, *C.M.L.Rev.*, p. 912. On the lack of a need for cross-subsidisation as an abusive conduct in itself, see also case T-175/99, *UPS Europe SA v. Commission*, [2002] ECR II-1915, § 61.

<sup>146</sup> R. Whish, op. cit., p. 737. On the difference between cross subsidy and predatory pricing, see also Case 1007/2/3/02, *Freeserve.com plc v. Director General of Telecommunications* [2003] Competition Appeal Tribunal (CAT) 5. However, generally speaking, cross-subsidisation has been considered in cases of monopoly or reserved sectors. In this perspective, one of the most significant cases is the Commission Decision of 20.03.2001, *Deutsche Post AG*, [2001] O.J. L. 125/27, 5.5.2001. It should be added that in the “Guidance on the Commission’s Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings”, the Commission did not address the specific problem related to the standard applicable to cases concerning multi-product firms. This is may be because cases like *Deutsche Post* are likely to become less frequent because of the process of liberalising many reserved sectors. See Geradin, D. and D. Henry (2009), “Abuse of Dominance in the Postal Sector - The Contribution of the Guidance Paper on Article 82 EC”, ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1435362](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1435362)), pp. 9-11.

<sup>147</sup> ECB (2006), cit., p. 10. See also G. Carosio (2009), “Payment Cards Between the Payment Services Directive (PSD) and the Single Euro Payments Area (SEPA)”, *BIS Review* 155/2009 1, p. 3.

<sup>148</sup> PagoBancomat (Italy), SIBS (Portugal), Link (United Kingdom), Euro6000 (Spain), ZKA (Germany), EUFISERV (Europe). More information on EAPS can be found at: <http://www.card-alliance.eu>.

<sup>149</sup> It is driven by German and French banks. See Bolt and Schmiedel, op. cit., pp. 10-11.

<sup>150</sup> This is a merchant-oriented initiative with private funding, independent from banks and retailers. More information on PayFair can be found at: <http://www.payfair.eu>.

## 4.3 EU Regulatory Intervention

### 4.3.1 *The Green Paper*

Competition versus integration is not the only issue the Commission has addressed for payments. As mentioned, it has now deeply regulated the sector, with a number of measures addressing various different objectives.

In January 2012, the European Commission published a Green Paper on card, internet and mobile payments<sup>151</sup> which, on the one hand, identified secure, efficient and competitive payments as a crucial factor for the development of the single market in the EU and, on the other hand, outlined the increasing importance of mobile and on-line payments and their likelihood to affect the future functioning of the market.

In this framework, the Commission first assessed the current landscape and obstacles that potentially prevent market integration in the card, internet and mobile payments market. It subsequently set out the gaps between the current situation and its vision and the ways to stimulate market integration.

As regards the Commission's vision and objectives for the payments market, the Green Paper clearly states: "there should be no distinction between cross-border and domestic payments" or "non-euro payments within the EU".<sup>152</sup> This means that, in order to facilitate competition and increase innovation, transparency and market security, more integration of payment systems is needed so that: (i) consumers are able to use a single bank account for all payments of transactions, independently from the country where they live or operate, if different from the one of origin; (ii) businesses and public administrations can centralise financial operations across the EU; (iii) merchants can benefit from cheap, efficient and secure electronic payments; (iv) payment service providers can benefit from economies of scale brought about by payment instrument standardisation; and (v) technology providers can base their research for innovation on pan-European instruments.

The Commission then makes reference to six issues which must be addressed in order to achieve full market integration. One of them is particularly important from a competition point of view, that of regulating MIFs and related measures.

More precisely, the Commission doubts that the existence of different MIF levels throughout the EU, and on-going or completed proceedings before competition authorities, could lead to distortions and exacerbate market fragmentation. Moreover, MIF are likely to act as entry barriers to low-cost card schemes and mobile or internet means of payment. In light of the aforementioned issues, the Green Paper asks stakeholders to contribute to the Commission's analysis regarding the need to regulate fees, to increase legal clarity and transparency so that market access is facilitated.

In addition, a violation of competition rules may derive from cross-border acquiring and, in particular, from the rule pursuant to which acquiring banks must pay the MIF of the country where the merchant is located, so that the merchant is prevented from choosing an acquirer, possibly cheaper, outside its own Member State.

Other measures linked to the MIF are those regarding transparency and business rules. According to the Commission, the key issue here is whether empowering merchants to make use of rebates, surcharging and other steering practices - such as the merchant's selective

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<sup>151</sup> European Commission (2011), Green Paper, Towards an Integrated European Market for Card, Internet and Mobile Payments, COM(2011)941 final, Brussels.

<sup>152</sup> Ibid., § 3.

acceptance of certain cards, or the clear indication of the preferred payment instrument - would stimulate the use of the most efficient payment means. These concerns are increased by the current legal framework, which is far from having increased transparency in the consumer-merchant relationship. This would be due to the fact that, according to Article 52(3) of the PSD, merchants are allowed to surcharge and offer rebates, but Member States can still prohibit or limit surcharging if some conditions are fulfilled. Member States have applied this provision in different ways, thus increasing confusion among consumers and merchants, especially in the case of cross-border transactions.

#### 4.3.2 *The Proposed Amendments to the Payment Services Directive (PSD)*

The main aim of the Green Paper was to launch a public consultation process with stakeholders in order to validate the Commission's analysis and to help identify the main obstacles to a full market integration in the payment sector. The comments and contributions received led to the conclusion that further measures and regulatory updates were needed so that the payment legislative framework could better contribute to the creation of an effective, efficient and competitive European payments environment.

This review process also strongly affected the PSD,<sup>153</sup> adopted in 2007 with the aim of harmonising the rules on any transfer of money and, in particular, the relations between users and providers of the payment services, thus providing the legal framework of the SEPA project.<sup>154</sup> While the consultation results called for various adjustments to the existing rules, in this paper attention will be focused only on the proposed policy measures addressed in the revised PSD which relate to our analysis.

In particular, two adaptations to the existing PSD and which are contained in the proposed new Directive require an in-depth investigation.

The first main modification concerns Article 28 of the current PSD, on access to payment systems. Pursuant to this provision, rules on access must be objective, non-discriminatory and proportionate. This language seems to make reference to the essential facility doctrine, an elaboration of competition law according to which any network, infrastructure or technology connecting or exclusively shared among a number of actors that results to be essential for competitors to provide down-stream services, needs to be potentially open to any actor requesting access, providing that this respects the rules on access to the system, which in turn must indeed be objective, non-discriminatory and proportionate. Furthermore, the article contains a list of requirements that payment systems cannot impose on payment service providers, payment service users, or other payment systems once these are part of the system. Nonetheless, given that the main aim of these prohibitions seems to be a guarantee of non-discrimination among different institutions (credit vs. non-credit institutions), and not to regulate access *stricto sensu*, it is arguable that this provision is a competition rule or a regulatory measure. Two arguments militate in favour of this last interpretation. First, such prohibitions apply also to payment service users that are not actual or potential competitors, and thus contravene the general principle that competition law only

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<sup>153</sup> European Commission (2013), Proposal for a Directive of the European Parliament and of the Council on payment services in the internal market and amending Directives 2002/65/EC, 2013/36/EU and 2009/110/EC and repealing Directive 2007/64/EC, COM(2013)/0547 final - 2013/0264 (COD), Brussels.

<sup>154</sup> For a detailed analysis of the "legislative labyrinth" which the PSD may contribute to see Malaguti, M.C. (2009), "The Payment Services Directive: Pitfalls Between the *Acquis Communautaire* and National Implementation", *ECRI Research Report*, ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2001388](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2001388)).

intervenes in relationships between (actual or potential) competitors, or when the competitive context could be altered.

Secondly, according to Article 28 paragraph 2, the rules described (established in paragraph 1) do not apply to systems with a sole payment service provider, since they offer services in a niche market, which has never been a relevant criterion for competition, when only *de minimis* rules might apply and under certain conditions.<sup>155</sup> A niche market may in fact be a separate market by itself, subject to competition law like any other market. It would thus seem that Article 28 of the PSD addresses regulatory requirements beyond competition issues. If this is the case, it can be concluded that the PSD itself recognises room for regulation of these matters under policy considerations encompassing competition but going much further. To confirm this, Article 28 would be applied by domestic authorities in charge of licensing and monitoring payment institutions rather than by antitrust authorities.

Having said this, Article 29 of the revised new Directive proposes to improve the rules regarding access to payment systems by clarifying that indirect access of payment institutions to payment systems should also be provided to other authorised or registered payment service providers under objective, non-discriminatory and proportionate rules.

Moreover, the Impact Assessment carried out by the Commission with the purpose of analysing the potential consequences of a lack of a fully integrated European payment market, examined, *inter alia*, problems arising from diverse charging practices between Member States. From this point of view, as mentioned above, the existing PSD rules, which are quite flexible in allowing Member States to limit or even prohibit surcharging under certain conditions, have led to extreme heterogeneity in the market, where 13 Member States have used this option to forbid surcharging. The existence of different regimes applied throughout Europe exacerbates market fragmentation and creates a confused situation for consumers, especially when they shop abroad or via the internet. In light of the issues arising from the Impact Assessment, Article 55(4) of the revised Directive prohibits surcharging for the use of payment instruments for which interchange fees are regulated under the new Commission proposal for a regulation on interchange fees for card-based payment transactions,<sup>156</sup> presented in parallel with the proposed new PSD (and discussed below). This is because caps on interchange fees as proposed by this Regulation will have the effect of reducing the fees merchants have to pay to the acquirers. As a result, for MIF-regulated cards, amounting to approximately 95% of the consumer card market, there is no longer a possibility to surcharge. Finally, as regards cards which are not subject to the proposed regulation on interchange fees (*i.e.* three-party scheme cards and corporate cards) Article 55(3) provides that merchants are still empowered to apply an additional charge which cannot exceed the costs borne by the payee for the use of the payment means.

#### 4.3.3 *The SEPA Regulation and the Recent Commission Proposal for a Regulation on Interchange-Fees for Card-Based Payments*

The proposal for a regulation on interchange fees is a challenging initiative which will complement the existing rules regarding the creation of a fully-integrated payments market

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<sup>155</sup> *Ibid.*, pp. 24-25.

<sup>156</sup> European Commission (2013), Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions, COM(2013)/0550 final - 2013/0265 (COD), Brussels.

and the migration to pan-European payment instruments, and will affect the structure of the market.<sup>157</sup>

Among the already applicable regulatory interventions, one cannot ignore the importance of Regulation (EC) No. 924/2009 on cross-border payments.<sup>158</sup> From a competition point of view, the Regulation on cross-border payments, in order to support the migration and the launch of EU-wide schemes, regulated the MIF for SEPA Direct Debit (SDD), related to services which enable customers to give companies or other organisations authorisation to withdraw funds directly from their bank accounts in order to pay their bills. Article 7 of the Regulation thus provided for a transitional regime until 1 November 2012, during which MIF for domestic direct debit transactions could continue to be applied at or below their existing level in the six Member States which had a MIF. On the contrary, according to Article 6, a MIF of up to 8.8 cents was applicable for each cross-border direct debit transaction executed before 1 November 2012. Then, in 2012, the SEPA Regulation was adopted, laying down rules for credit transfer and direct debit transactions denominated in euro within the European Union, where both the payer's payment service provider (PSP) and the payee's PSP are located in the Union, or the sole PSP is located in the Union.<sup>159</sup> The SEPA Regulation sets the final end-date for national credit transfer and direct debit schemes at 1 February 2014. As a result, from this date, the transactions will move to EU-wide schemes created by the SEPA, that is SEPA Credit Transfer (SCT) and SDD Schemes. The SEPA Regulation also provides that no per transaction MIF for national direct debits must be applied from 1 February 2017. Additionally, MIF for cross-border direct debits were to be prohibited from 1 November 2012. Nonetheless, MIF for transactions which are rejected, refused, returned or reversed because they cannot be properly executed or result in exception processing (known as "R-transactions") will be allowed subject to certain conditions from February 2014. This exception is directly linked to the costs generated by direct debits which are not properly executed: an appropriate level of MIF applied to R-transactions aims at ensuring that the costs for the failure of the transaction are imposed on the party which is responsible, as this boosts efficiencies and discourages transactions failures.

Despite the existence of the aforementioned rules, the Commission considered that a further step could have been taken in order to enable consumers, retailers and other undertakings to enjoy the full benefits of the EU internal market, by imposing caps also on the MIF applied in four-party card schemes.

The Commission considered several adverse effects caused by interchange fees.<sup>160</sup> It noted that price increases caused by MIF and scheme rules applied by card brands are harmful to consumers and merchants, given that consumers are unaware of fee differences and merchants, because of network rules such as the honour all cards rule, cannot act to reduce the fees. Moreover, market transparency reducing measures and collectively agreed fees

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<sup>157</sup> Against the EU regulatory initiative, see J. Haans (2013), "Capping Interchange Fees", *Competition Law Insight*, 15.10.2013.

<sup>158</sup> European Parliament and Council (2009), Regulation 924/2009/EC of 16.9.2009, on cross-border payments in the Community and repealing Regulation (EC) No. 2560/2001, O.J. L 266, 9.10.2009. The text of the latter can be found in European Parliament and Council (2009), Regulation 2560/2001/EC of 19.12.2001, on cross-border payments in euro, OJ L 344, 28.12.2001.

<sup>159</sup> European Parliament and Council (2012), Regulation 260/2012/EC of 14.3.2012, establishing technical and business requirements for credit transfers and direct debits in euro, and amending Regulation (EC) No. 924/2009, OJ L 94, 30.3.2012.

<sup>160</sup> European Commission, Proposal for a Regulation on interchange fees for card-based payment transactions, cit., pp. 3-4.

discourage banks from competing on the level of their fees, thus leading to higher retail prices for all consumers, independently from the payment instrument chosen. Another effect related to the existence of a wide variety of interchange fees would be market fragmentation and retailers' difficulty in formulating an EU price strategy for their products and services. Finally, inter-bank fees would also hinder market entry, as they operate as a minimum threshold to convince issuing payment service providers to issue payment cards or other payment instruments. This situation is perceived as even more problematic for pan-European players, given that domestic MIF varieties force new entrants to offer fees which are at least comparable to those prevailing in each market they want to enter.

Against this background, the proposal first introduces a cap on interchange fees for all card transactions that are widely used by consumers, that is: consumer debit and credit card and card-based payment transactions. Consequently, the proposed regulation would not apply to transactions with commercial cards, close networks, or cards issued by three-party schemes.

First of all, under Article 3, within two months of entry into force, a maximum level of interchange fees are imposed on cross-border transactions, amounting to 0.20% for cross-border debit card transactions, and 0.30% for cross-border credit card transactions. Article 4 then provides that, after a transitional period of two years, all (cross-border and domestic) consumer debit and credit card transactions fees will be subject to the aforementioned caps. In the Commission's view, the proposed level of interchange fee regulation is reasonable and does not negatively affect the viability of the network or retailers and consumers' welfare, provided that the caps are proposed by card schemes in competition proceedings<sup>161</sup> and ensure legal certainty.<sup>162</sup>

The proposed regulation also sets out permitted business rules that will be applicable to all categories of card transaction, as well as card-based payment transactions based on them. So, for instance, pursuant to Article 10, the application of the honour all cards rule will be limited, so that no rule will be permitted that obliges the payee to accept cards or other payment instrument schemes issued by one party issuing PSP within the framework of a payment instrument scheme, but that also accepts other payment instruments of the same brand, except if they are subject to the same regulated interchange fees. Nonetheless, no discrimination can be allowed on the basis of the identity of the issuing payment service provider or of the cardholder. Moreover, Article 11 prohibits the application of any rule preventing or limiting merchants from steering consumers towards the use of specific payment instruments preferred by the retailer.

Overall, the proposed Regulation of interchange fees ensures legal clarity, favours a level playing field, and allows consumers and retailers to have accurate information. From this point of view, it has been correctly pointed out that a regulation was the best legislative instrument for pursuing the aforementioned aims, provided that a directive could not ensure standardisation at the technical level and the fullest possible harmonisation. Moreover, there seemed to be no alternative to such a proposal, given that both the legislative and regulatory measures already in force and competition law enforcement at European and national levels were not able to address directly the issues arising from different levels of MIF throughout

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<sup>161</sup> As mentioned above, in 2009 MasterCard undertook to lower its cross-border consumer MIF to 0.20% for debit and 0.30% for credit cards, and made many changes to the business rules. Similar commitments were offered by Visa Europe in 2010 for consumer debit, and in 2013 for consumer credit cards. Finally, the French Competition Authority made binding commitments offered in 2010 by the *Groupement des Cartes Bancaires* to set its MIF for domestic transactions at equivalent levels.

<sup>162</sup> European Commission, Proposal for a Regulation on interchange fees for card-based payment transactions, cit., § 1, pp. 3-4.

Europe, and lack of transparency in the consumer-merchant relationship. This is because, for one thing, there is no specific domestic legislation regulating inter-bank fees, except in Denmark,<sup>163</sup> although a certain number of Member States, including Poland, Hungary, the UK and Italy, seem to be in the process of adopting similar legislation.<sup>164</sup> At the same time, the European Commission and many national competition authorities have on-going proceedings aiming at scrutinising compatibility with competition law of interbank-fee levels and network rules. As a result, it is clear that the intended national laws and the different time-paths and procedures of competition law enforcement may result in an even more fragmented market, and are likely not to unlock market integration and innovation in the payment sector.

It must also be appreciated that the Commission acknowledges the substantially unpredictable overall impact of interbank-fees caps on PSPs and, indirectly, on consumers.<sup>165</sup> Nevertheless, it makes reference to effects on the market produced by other EU and extra-EU experiences where schemes are currently functioning without MIF, or where an interchange fee regulation has already been adopted and implemented, and where an interbank-fee decrease has resulted, on the retailers' side, in lower fees and greater savings, some of which are passed on to consumers, for example through higher card acceptance.<sup>166</sup> A consequent positive effect of higher card usage would be the compensation of losses suffered by banks because of the MIF caps with higher revenues arising from an increase in the volume of card transactions. As a consequence, banks would not need to increase cardholder fees in order to ensure the network operation. So, for example, in the US, banks tried to raise annual card fees after the MIF regulation introduction, but they had to stop this initiative because of consumer revolt.<sup>167</sup> Finally, low interchange fees incentivise new entry into the payment market, as occurred in the Netherlands, where fees below 0.20% encouraged the development of "Ideal", a cheap on-line payment solution.<sup>168</sup>

However, the Proposed Regulation also raises concerns for the Commission's competition approach to card schemes. The proposal states that the envisaged measures "broadly support other Union policies, in particular competition policy";<sup>169</sup> yet recital 14 clarifies: "The application of this Regulation is without prejudice to the application of Union and national competition rules." What does this second statement mean exactly? Does it mean that the card schemes' compliance with the regulation does not prevent that, in certain circumstances, MIF applied to credit and debit card transactions could be considered contrary to Article 101(1) and not exempted under Article 101(3)? If this is the actual meaning of the statement, it risks posing problems from two points of view. First, the Commission cannot ignore the need to ensure that the proposed regulatory intervention is

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<sup>163</sup> See Article 80 of the Danish Payment Services and Electronic Money Act, Consolidating Act no. 365 of 26.4.2011, available at: [http://www.finanstilsynet.dk/en/Regler-og-praksis/Translated-regulations/~~/media/Reglerog-praksis/2012/C\\_Act365\\_2011\\_new.ashx](http://www.finanstilsynet.dk/en/Regler-og-praksis/Translated-regulations/~~/media/Reglerog-praksis/2012/C_Act365_2011_new.ashx). This legislative act regulates MSCs for face-to-face transactions, and sets out an annual fee which must be paid by merchants.

<sup>164</sup> European Commission, Proposal for a Regulation on interchange fees for card-based payment transactions, cit., § 1, pp. 4-5.

<sup>165</sup> Ibid., § 2, p. 11.

<sup>166</sup> Ibid., § 2, p. 10. This is true, for example, in Denmark, where no fees are applied to debit card schemes and are associated with the highest card usage rates in the EU.

<sup>167</sup> Ibid., § 2, p. 11. The absence of a direct link between decrease of MIF and higher card annual fees can be also observed in Switzerland, Australia and Spain.

<sup>168</sup> Ibid., § 2, p. 12.

<sup>169</sup> Ibid., § 1, p. 5.

consistent with competition law enforcement. Thus competition enforcement would be questionable in the case of ascertaining a competition law infringement due to card brands' observance of MIF levels, which, apart from having been regulated, were regarded in many EU and national proceedings as addressing competition concerns. Second, in this scenario, the objectives and the benefits envisaged in the proposal risk disappearing, given that card brands' concern that their conduct could still be subject to competition scrutiny would increase uncertainty and discourage innovation and market entry.

It is therefore desirable that the Commission clarify its position on this point.<sup>170</sup> This is particularly so if one considers the effects of the lack of consistent approach between regulatory intervention and competition law enforcement experienced in the telecommunications sector, where it has been stated that sector-specific regulation did not prevent companies from adjusting their charges in order to avoid margin squeeze.<sup>171</sup> The idea standing behind this conclusion is that competition and regulation rules are aimed at different goals.<sup>172</sup> So, if competition law ensures the protection of the market in order to maximise consumer welfare, some goals (e.g., pluralism in the media or control of financial institutions' solvency) can be achieved only by adopting regulation. In these cases, competition law and regulation could be considered complementary instruments, and they may be applied in a cumulative way. However, it could be argued that sectoral regulation is actually an alternative to competition law.<sup>173</sup> Regulators in Europe intervene in some industries to enhance competition by means of several measures, such as mandatory third-party access/interconnection of networks at regulated prices or corporate separation. If properly applied, these measures can actually prevent anti-competitive conduct.<sup>174</sup> In these cases, it should be up to the legislator to decide what the best option is, taking into account benefits and drawbacks of the instruments available. On the one hand, competition law should be preferred when there is no need for oversight of the market, or if *ex ante* regulatory enforcement is too costly or may even lead to a distortion of market outcomes. On the other hand, regulation could be better-suited when: (i) consistent, definitive and fast basic rules are desirable in order to avoid excessive uncertainty; (ii) the standard of proof applicable in competition law cases cannot be reached; (iii) issues at stake require a technical expertise; and (iv) similar cases come under scrutiny.

From this point of view, discussions within Europe may be enriched by looking at the experience in the US. There, with the incorporation of economic analysis in antitrust investigations, it has been stated that antitrust law should pursue consumers' welfare rather

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<sup>170</sup> From this point of view, it would be interesting to follow the discussion in the UK, related to the government's proposal to create a new competition-focused, utility-style regulator for retail payment systems. Some market players have called into question the actual need to empower the regulator with concurrent competition tasks. *See, supra*.

<sup>171</sup> *See* Commission decisions of 21.05.2003, *Deutsche Telekom AG*, [2003] O.J. L. 263, 14.10.2003, upheld by the General Court and the Court of Justice, and of 04.07.2007, *Wanadoo España vs. Telefónica*, upheld by the General Court. Nevertheless, the existence of the regulatory framework was taken into account as a mitigating circumstance in the calculation of the fine. *See, also*, Commission decision of 22.06.2001, *Telekomunikacja Polska*, concerning a constructive refusal to supply abuse, where the Commission dismissed the argument regarding a possible violation of *ne bis in idem* principle, § 97.

<sup>172</sup> D. Geradin (2011), "Refusal to Supply and Margin Squeeze: A Discussion of Why the 'Telefonica Exceptions' are Wrong", ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1750226](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1750226)).

<sup>173</sup> J.C. Laguna de Paz (2012), "Regulation and Competition Law", *ECLR*, Vol. 33, II.

<sup>174</sup> N. Petit (2004), "The Proliferation of National Regulatory Authorities Alongside Competition Authorities in the EC: A Source of Jurisdictional Confusion", ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=527403](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=527403)).



than small competitors' welfare, and that it should never become a *de facto* tool for liberalisation to encourage new entry into the market. As a result, given that, in some markets, regulation (as the Supreme Court held in *Trinko* and in *linkLine*)<sup>175</sup> is an "effective steward of the antitrust function", an antitrust authority should not intervene when a regulatory regime exists to deter and remedy the anti-competitive harm, as the costs of antitrust enforcement are likely to be greater than the benefits.<sup>176</sup>

#### 4.4 The Australian and the US Cases

As mentioned, the RBA is the first regulator to have addressed market failures in the payment card sector by lowering the level of interchange fees and by changing network rules in order to increase competition.

After having received the power to regulate payment systems in 1998, and having carried out some research, the RBA concluded that: "Co-operative behaviour [...] is anti-competitive and, where it is allowed, it typically requires some form of dispensation by competition authorities on the basis that there are offsetting benefits to the public".<sup>177</sup> In 2003, Visa and MasterCard's MIF were lowered from approximately 0.95 to 0.55%.<sup>178</sup> Apart from capping interchange fees, the RBA modified network rules, prohibiting no surcharge rules and honour all cards rule. Moreover, the RBA encouraged increased transparency in retail payment systems.

Interesting effects of the reform on the retail payment market have been identified.

Despite what card brands had predicted, the "average merchant fees for MasterCard and Visa [...] fell as much as the reduction in interchange fees, then even further".<sup>179</sup> Moreover, even if price regulation was not imposed on three-party systems, "the combined average merchant service fee for the American Express/Diners Club schemes continued to decline in 2008/2009 falling by 0.1 percentage points to 2.04%. These fees have fallen steadily since the implementation of the reforms and in June 2009 were around 0.43 percentage points lower than they were prior to the reforms".<sup>180</sup> This result is similar in size to that obtained by regulation of four-party systems.<sup>181</sup>

The Australian reform attracted many criticisms.<sup>182</sup> The most significant was that, considering that the commitments to cap interchange fees did not apply to three-party systems, the market shares of three-party systems were likely to rise. Nonetheless, "although

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<sup>175</sup> Supreme Court of the United States, *Pacific Bell Telephone Co. v. linkLine Communications Inc.*, 555 U.S. 438, 25.2.2009.

<sup>176</sup> G. Alan Hay and K. McMahon (2012), "The Diverging Approach to Price Squeezes in the United States and Europe", ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1997384](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1997384)).

<sup>177</sup> OECD (2006), *Policy Roundtable: Competition and Efficient Usage of Payment Cards*, Paris, p. 42.

<sup>178</sup> Heimler, op. cit.

<sup>179</sup> Frankel, op. cit., p. 59.

<sup>180</sup> RBA (2009), *Annual Report*, Sydney, p. 14.

<sup>181</sup> Heimler, op. cit. and Frankel, op. cit., pp. 60-63.

<sup>182</sup> H. Chang, D. S. Evans and D. D. Garcia Swartz (2005), "The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia", *Review of Network Economics*, Vol. 4; Muris, op. cit., pp. 533-541; J.S. Gans and S. P. King (2002), "A Theoretical Analysis of Credit Card Regulation", *Melbourne Business School Working Paper* N. 2002-11, pp. 3-6; J.S. Gans and S. P. King (2003), "Approaches to Regulating Interchange Fees in Payment Systems", *Review of Network Economics*, Vol. 2, II, pp. 140-142.

there was some growth in the usage of American Express and Diners Club cards relative to four-party cards, the growth occurred in early 2004 and did not initiate a persistent trend. [...] Since the beginning of 2005, the three-party share of transactions has averaged 2.0 percentage points higher than during the period January 2002 through September 2003, and the percentage of transaction value only 1.5 percentage points higher than in the earlier period. *For the past three and a half years, there has been no increase in the three party share of card transactions*" (emphasis added).<sup>183</sup>

It seems that the main reason for which three-party systems did not grow at the expense of four-party systems was the elimination of the no-surcharge rule that allows merchants to set different prices even for different card brands, thus inducing customers to use the less expensive cards. This decision was taken by the RBA in spite of strong opposition expressed by card brands. The result was that "some Australian merchants did begin to surcharge - and sometimes surcharged only three-party card transactions, or surcharged them at higher rates. According to both MasterCard and Diners Club, these surcharges on American Express and Diners Club transactions contributed to the lack of growth in the three-party networks' share of transactions".<sup>184</sup>

According to the two-sided market argument, regulation of interchange fees in order to reduce their level would only have the effect of shifting the costs of card payments from merchants to cardholders. Yet this did not happen in Australia. As a matter of fact, "[t]he reduction of the interchange fee by 45 basis points has so far generated a 57 basis point reduction in the average Visa/MasterCard merchant service charge". Some economists have suggested that 30 to 40% of the lost interchange fee revenue was compensated for by setting higher fees to cardholders. If this finding is correct, "that still leaves a net decline in the total 'price level' equal to roughly 41 basis points - nearly as much as the reduction in interchange fees. Moreover, this does not take into account at all the reduction in American Express and Diners Club merchant fees [...]".<sup>185</sup>

According to the RBA, the 2007/2008 review of the 2003 regulatory intervention shows that "reforms have delivered significant benefits, improving the overall efficiency of Australia's payment system".<sup>186</sup> Given this industry progress, the RBA decided to postpone consideration of any further reduction of the level of MIF. However, in the latest review, started in August 2009, the RBA, despite acknowledging considerable progress towards enhancing competition, reached the conclusion that the developments made were not sufficient to remove regulation in the sector.

In parallel, in the US a strong debate on the need to regulate interchange fees for debit cards has culminated in what is known as the "Durbin Amendment"<sup>187</sup> to the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>188</sup> This provision inserts a new Section 920 into the EFTA on Reasonable Fees and Rules for Payment Card Transactions. While the EFTA

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<sup>183</sup> Frankel, *op. cit.*, p. 60.

<sup>184</sup> *Ibid.*, p. 61. *Contra* Chang, Evans and Garcia Swartz, *op. cit.*, p. 20.

<sup>185</sup> Frankel, *op. cit.*, p. 63. *Contra* Chang, Evans and Garcia Swartz, *op. cit.*, pp. 9-10.

<sup>186</sup> RBA, *op. cit.*

<sup>187</sup> This was submitted on 2.5.2010 and added Section 1075 on Reasonable Fees and Rules for Payment Card Transactions to the Dodd-Frank Act. SA 3989, available at <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:SP03989>.

<sup>188</sup> Pub.L. 111-203, H.R. 4173; commonly referred to as "Dodd-Frank", available at: <http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm>. The Act, making many changes to the system of financial regulation, was adopted on 21.7.2010.

addresses consumer transactions and is meant to protect consumers, and the Bureau of Consumer Financial Protection is in charge of most implementing regulations, Section 920 has to be implemented by the Fed (under Section 904). The Board has the mandate to study debit card interchange fees charged by the largest card issuers, and to issue rules regarding fees charged to merchants by card companies for debit card transactions. In doing this, the Board needs to consult with other agencies. While the Fed has the authority for its role, it must take into consideration input from other authorities in charge of financial markets and/or products, as well as technology matters (Section 904(B)(1)).

Moreover, the Durbin Amendment imposes that interchange fees for any electronic debit transaction be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction",<sup>189</sup> and asks the Fed to prescribe regulations to establish standards for determining whether fees are "reasonable" and "proportional". On 20 July 2011, the Board set the maximum level of interchange fees for debit card transactions at 21 cents per transaction and 5 basis points multiplied by the value of the transaction.<sup>190</sup> At the same time, issuers implementing certain fraud-prevention measures were allowed to increase their interchange fees by as much as one cent. This cap took effect from 1 October 2011.

Recently trade associations in the retail industry, together with individual retailers, filed a claim against the Fed Rules, and received a court decision on 31 July 2013. Interestingly, they did not oppose the rules as such, but stated that the Fed had abused its powers by exceeding the standards imposed by the Act in the calculation of reasonable fees. According to Section 920(4), the Fed had to: "(A) consider the functional similarities between (i) electronic debit transactions; and (ii) checking transactions that are required within the Federal Reserve bank system to clear at par; [and] (B) distinguish between (i) the incremental cost incurred by an issuer for the role of the issuer in the authorisation, clearance, or settlement of a particular electronic debit transaction, which cost shall be considered under paragraph (2) [i.e., the calculation of a reasonable interchange fee] and (ii) other costs incurred by an issuer which are not specific to a particular electronic debit transaction, which costs shall not be considered under paragraph (2)". Some adjustments for fraud prevention are also established.

Whereas in a provisional version of the rules the Board had proposed only to include costs associated with the authorisation, clearing and settlement (ACS costs) of an electronic debit transaction that vary with the number of transactions sent to the issuer within the reporting period, in the final rules - under the pressure of the market - it increased the suggested caps to also include additional costs "not explicitly excluded from consideration by the statute" (those costs which are specific to a particular transaction but are not incremental ACS costs).<sup>191</sup>

The judge agreed with the plaintiffs that the Durbin Amendment limits the costs allowable to the ACS costs. On 26 August 2013, the Fed appealed the decision, and the proceeding is still pending. However, besides the technicalities of calculation of "reasonable fees", the case is of interest because it sets the limits under which the Fed can define standards for the market on prices. Whereas the RBA acted within its general regulatory powers over the financial sector,

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<sup>189</sup> An overview of the competition enforcement proceedings and regulatory initiatives in the US payment sector can be found in OECD (2012), Policy Roundtable: Competition and Payment Systems, Paris, p. 139 et seq.

<sup>190</sup> Final Rule on Debit Card Interchange Fees and Routing and Interim Final Rule on Fraud-Prevention Adjustment. See also Federal Reserve Press Release, of 29.6.2011, available at: <http://www.federalreserve.gov/newsevents/press/bcreg/20110629a.htm>.

<sup>191</sup> § 17 of the decision.

the action of the Board is framed within a statutory act and under clear policy lines. Although it is hoped that a final decision will recognise an inherent margin of flexibility in the Fed's actions, it is of relevance that the power to influence prices is inserted into a general context and is the result of at least consultation, if not coordination with other authorities.

## 5. Conclusions

Payment markets present some similarities with the telecoms sector, where networks compete for customers in the retail market, but cooperate in the wholesale market by providing call termination ('network industries').<sup>192</sup> Telecom operators charge access fees when customers of other operators use their network. The operators generally agree bilaterally on high access fees, thereby committing to artificially high marginal costs and, therefore, high call prices. As a result, entry into the telecoms market has no effect on call prices paid by customers, and the collusive outcome prevails independently of the market structure. This simple comparison shows that competition would not always prevent high customer fees being charged.

From government intervention in network industries, we can learn that an economic case for price regulation requires the existence of a market failure.<sup>193</sup> From this perspective, the issue of whether interchange fees lead to an "overprovision or underprovision of payment card services relative to the social optimum"<sup>194</sup> should be addressed. According to the governor of the RBA, the need to regulate interchange fees results from the observation of empirical evidence: the use of credit cards is growing faster than the other and less-expensive means of payment.<sup>195</sup> This situation, which can be considered the expression of Gresham's law, is the direct consequence of 'price coherence'. Given that competition in the card payment market leads to higher prices, there is a strong case for regulation.

Some economists<sup>196</sup> agree with this but believe that increased competition among issuing banks – and not surcharges on card use – would reduce the level of interchange fees. This analysis is linked to one of the main arguments in favour of the existence of interchange fees, the two-sided market argument. It fails, however, to consider that merchants tend to shift onto all customers (independently of the payment instrument they use) the extra costs they pay for electronic transactions. Therefore, there is a clear free-riding problem that seems to be addressed adequately only by regulatory intervention.<sup>197</sup>

Moreover, the idea that greater competition in the industry, together with a reduction in switching costs, would lower interchange fees puts too much emphasis on the number of customers who would change banks. Only if private individuals were allowed to change

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<sup>192</sup> J. Stennek and T. Tangerås (2008), "Competition vs. Regulation in Mobile Telecommunications", NET Institute Working Paper No. 08-09 1, pp. 2-8.

<sup>193</sup> J.T. Lang (2009), "European Competition Policy and Regulation: Differences, Overlaps, and Constraints", in F. Lévêque and H. Shelanski (eds), *Antitrust and Regulation in The EU and US. Legal and Economic Perspectives*, Cheltenham: Edward Elgar, pp. 30-31.

<sup>194</sup> Evans and Schmalensee, op. cit., p. 30.

<sup>195</sup> Macfarlane, op. cit., pp. 8-9; Heimler, A. (2006), "Competition Policy, Antitrust Enforcement and Banking: Some Recent Developments", OECD, Paris, (<http://www.oecd.org/daf/competition/prosecutionandlawenforcement/38821319.pdf>), p. 9.

<sup>196</sup> Rochet and Tirole, op. cit., pp. 21-26.

<sup>197</sup> A. Heimler and S. F. Ennis (2008), "Competition and Efficiency in Payment Cards: Which Options for SEPA?", *W. Comp.*, Vol. 31, I, p. 28.

accounts automatically, and if number portability were introduced, would switching services be likely to enhance competition.<sup>198</sup>

Some arguments also lead to the conclusion that a regulatory approach might reduce shortcomings of a purely antitrust approach, as they were considered in previous sections.

First of all, litigation takes too long, and it does not give card brands the legal certainty they need to operate in the market. At the same time, decisions by the European Commission and national competition authorities may be characterised by a lack of consistency. From this point of view, a regulator would be better suited, since it usually has more flexibility in designing all structural reforms necessary to enhance competition in the industry.

Secondly, it is extremely difficult to calculate the exact level of MIFs that maximises social welfare and therefore could be exempted. Because of these difficulties, a regulator is in a better position to consider these problems than a competition authority, whose action in this field risks being qualified as 'quasi-regulatory'. In this scenario, competition authorities would play a complementary role and would act only when their intervention was needed.

Thirdly, it is evident that public intervention should depend on the level of development of the market, since all considerations made until now might apply differently if a country's payments industry is less developed, based almost exclusively on cash and cheques, and in need of structural intervention towards electronic means of payment and interoperability, as opposed to countries where the payments market is highly mature and the final customer can exercise an effective choice among alternative and equally efficient instruments of payment.

Finally, as we believe has been shown in EU regulation of the sector until now, the structure of the market as a whole has to be considered, and issues such as MIFs need to be evaluated in a wider context. This wider context would include not only other potentially anti-competitive clauses, but also the level of concentration of the market, the working of the processing infrastructure and access (as the MIF Regulation recognises and regulates, although this is not discussed in this paper). These issues – including that of definition of the relevant market according to anti-trust standards – would require a wider approach than can be taken by competition policy alone.

On the other hand, competitiveness and contestability of markets are among the goals of national payment system oversight, together with efficiency and soundness (avoidance of risks for financial stability). These are certainly not meant to interfere with the specific antitrust competences of competition authorities, which still need to play a fully-fledged role according to the institutional framework of a country. However, the role of a central bank as the oversight authority of the national payment system, especially in a country in need of strong structural intervention in its financial infrastructure, can fruitfully be that of balancing all policy stances and guaranteeing their overall respect. Whereas central banks and competition authorities should work in close cooperation to reach these common objectives, it seems that the most recent developments in the field of MIFs confirm the results of the 2008 WB study.

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<sup>198</sup> Ibid., pp. 28-29. As a matter of fact, one standard that the banks participating in the SEPA project have agreed on concerns the use of IBAN codes, which contain the name of the bank and its country of origin, thus affecting the 'switching behaviour' of individuals and enterprises. Therefore, it is not possible, at least in the short term, to rely on switching services to intensify competition and lower the level of MIFs within SEPA.

Notes:



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