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CONSUMER PRICING FOR ATM SERVICES: ANTITRUST CONSTRAINTS AND LEGISLATIVE ALTERNATIVES

Karen L. Grimm and David A. Balto[†]

INTRODUCTION

Over the last decade, automatic teller machines (ATMs) have become an integral and increasingly important component of the consumer banking delivery system. As usage of ATMs has skyrocketed, however, so too have the fees charged consumers for their use, and this development, in turn, has sparked increasing interest in regulatory or legislative action to address the situation.

What may not be adequately understood is that *consumer* pricing for ATM services is intimately related to the pricing policies of the many shared ATM networks which were formed in the 1980s to permit reciprocal sharing of ATMs by their member financial institutions. Unlike the traditional check-clearing system in which the Federal Reserve System sets the rules, these ATM networks, most of which are joint ventures of banks and other financial institutions, are self-regulated, private sector creations that set their own pricing and related operating rules subject only to the constraints imposed by the antitrust laws.

This article explores the nature of these constraints in two areas which have been the subject of antitrust challenge in the last decade, and which are likely to spark additional controversy in the 1990s: (1) network-established interchange fees and surcharge prohibitions; and (2) network-established transaction routing rules.

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I. BACKGROUND

A. *The Institutional Setting: Growing Competition Among Shared ATM Networks*¹

Most shared ATM networks were formed in the early 1980s, generally by large banks that had already established their own proprietary ATM systems. Two models emerged. The first was an expanded *proprietary* system. A large bank or bank holding company would develop its own proprietary ATM system and then create a shared network by marketing network participation and other ATM data processing services to other financial institutions, essentially as a franchised, correspondent banking service. In these networks, the network owner unilaterally establishes pricing, access, and other policies for the network and deals with the other participants by contract.

The second type of shared network that developed in the 1980s was a *joint venture* of leading banks, sometimes created in response to the competition offered by an aggressive proprietary system. The joint venture partners would link their proprietary systems, adopt an identifying logo, and invite other depository institutions in a given area to join the network. All members would execute a standard membership or participation agreement obligating each member to adhere to the rules and policies (including the pricing and transaction routing policies) adopted by the joint venture's board of directors.

Most of the largest shared ATM networks currently operating in the United States are joint ventures of banks or bank holding companies, including the leading regional networks (such as Star in California, NYCE in New York, and PULSE in Texas), as well as the two largest national networks, CIRRUS and Plus.² Unlike

1. For a useful general background on the history, structure, and technology of ATM networks, see D. BAKER & R. BRANDEL, *THE LAW OF ELECTRONIC FUND TRANSFER SYSTEMS*, chs. 6, 23 (2d ed., 1988); *ELECTRONIC FUNDS TRANSFERS AND PAYMENTS: THE PUBLIC POLICY ISSUES* (E. Solomon ed., 1987).

2. CIRRUS is owned by MasterCard, and Plus is affiliated with VISA. See generally *1992 EFT Network Data Book*, BANK NETWORK NEWS, Nov. 27, 1991, for statistical data and other information on these and the many other shared ATM networks. Recently, several networks have consolidated and formed "super-regional" networks. For example, the Honor, Relay and Avail networks in the Southeastern United States consolidated into a single network in 1990, and more recently the bank holding company owners of the MAC, Green Machine and Owl networks formed a joint venture known as the Electronic Payment Services network. See *The Shared Network Merger Games Begin*, BANK NETWORK NEWS, Aug. 12, 1992, at 1.

shared proprietary networks where competitively sensitive issues, such as pricing policies, are established unilaterally by a single bank or bank holding company owner, the joint venture network's pricing and other rules are established by collective "agreement" of its board of directors, which is typically comprised of a subset of the network's competing financial institution members.

During the 1980s, a hierarchical system developed, with local networks linking into statewide and regional networks, and with these networks in turn linking into the national networks. Local transactions typically would be "switched"³ by the local network. The national networks did not compete for local transaction activity, nor could they offer the same degree of ATM access in any local area that the regional network could offer. By the same token, regional networks could not offer nationwide coverage.

A new competitive relationship began to take shape in mid-1990, when CIRRUS and Plus implemented "ATM duality" which permitted any ATM already handling either network's transactions to handle both.⁴ By dramatically increasing local ATM access, the national networks were able to compete against regional networks for local transactions. At the same time, the regional networks began to offer much wider geographic coverage through reciprocal interchange arrangements (gateways) with one another.⁵ Since most institutions belong to both a national network and at least one regional network, the stage is set for greatly increased competition between national and regional networks in the 1990s, and this increase in internetwork competition is likely to further exacerbate the pricing and transaction routing issues explored in this article.

3. The primary task of an ATM network is to provide a computer switching facility through which transactions between the members' data processing centers can be routed and settled. ATM networks may perform their own switching or may contract that function to a third party.

4. Six months after duality was implemented, 44% (35,000) of the nation's ATMs were capable of accepting both cards. See *Bankers Give ATM Duality a 6 Month Thumbs Up*, BANK NETWORK NEWS, Mar. 9, 1991, at 3. By mid-1991, this percentage had risen to about 50%.

5. A "gateway" is an electronic interconnection between two networks through which transactions can be sent. For a list of gateway relationships, see *Plus' Routing Rule Produces More Ire Than Volume*, BANK NETWORK NEWS, June 12, 1992, at 6.

B. Pricing Structures of Joint Venture ATM Networks: The Emerging Conflicts

Most joint venture networks have three basic classes of fees: membership, switch, and interchange.⁶ Both the membership and the switch fees are paid by the bank member to the *network*. The ATM interchange fee, by contrast, is paid by the card-issuing bank to the owner of the ATM at which the transaction is performed (the "acquirer"). It is a per-transaction fee, which typically varies by type of transaction.⁷ The interchange fee is intended to compensate ATM owners for the costs of handling network transactions and also provides an incentive for ATM owners to place their ATMs in the network. Although one ATM network, because of antitrust concerns, has long permitted each of its ATM owning members to set its own interchange fee,⁸ other joint venture networks adopted a uniform fixed interchange fee collectively set by their respective boards of directors.⁹ Because the interchange fee is intended to compensate fully ATM owners for the use of their ATMs by other members' cardholders, many networks also adopted rules prohibiting their acquirer members from imposing any additional charge on the cardholder, commonly called a surcharge.¹⁰

Thus, unlike the credit card systems, the fee structures that were adopted by ATM networks placed the cost burden on the

6. For a summary of the fee structures of the major regional networks, see *How Shared Regional Network Pricing Varies*, BANK NETWORK NEWS, Mar. 12, 1992, at 5.

7. In most networks, the interchange fee varies by type of transaction, with a higher charge for cash withdrawals than for balance inquiries, and a still higher charge for deposits. For a summary of the interchange fees currently charged by regional networks, see *Networks Put Breaks On Pricing Free-Fall*, BANK NETWORK NEWS, Mar. 12, 1992, at 4.

8. This network—the Nebraska NetWorks network—was denied a business review clearance by the Department of Justice in 1977 to create a near-monopoly network. See Letter from Donald I. Baker, Assistant Attorney General, Antitrust Division, Department of Justice, to William B. Brandt, Nebraska Bankers Ass'n (Mar. 7, 1977), discussed in Baker & Brandel, *supra* note 1, at ¶ 21.03[2][a]. Subsequently, the state issued guidelines requiring that interchange fees be set unilaterally by each individual financial institution. See *Interchange Fees: EFT Staple or Pricing Dinosaur?*, BANK NETWORK NEWS, Sept. 10, 1990, at 2. Recently, concerns have been raised in Nebraska about spiraling increases in the interchange fees, which have reportedly led to escalating consumer fees. See *A Nebraska Pricing Free-For-All*, BANK NETWORK NEWS, Feb. 11, 1992, at 3.

9. See discussion of the *Financial Interchange* arbitration at Part II.B.2.

10. See *Like Jericho, ATM Surcharge Walls Are Tumbling Down*, BANK NETWORK NEWS, Jan. 11, 1992, at 1.

card-issuing institutions. In order to recover the costs of the switch and interchange fees, some banks in the mid-1980s began assessing their customers a service fee for network (*i.e.*, “foreign”) transactions. Now this practice is common; most card-issuing institutions charge their customers “foreign fees” for using ATMs of other banks, and many even charge for nonnetwork (on-us) transactions as well.¹¹

The traditional pricing structure of joint venture networks has recently come under even greater pressure from acquirer banks that are increasingly deploying ATMs, not so much to enhance banking convenience for their customers, but to generate fee income from network transactions.¹² This, in turn, has led to a growing interest on the part of some acquirer banks and processors in surcharging for ATM transactions conducted at their machines.¹³ However, because most networks still have fixed interchange fees and prohibit their members from adding a surcharge at the ATM,¹⁴ the stage is set for increasing intranetwork disputes about network pricing policies in which the antitrust laws will likely play an increasingly prominent role.

C. *The Relationship Between Pricing and Routing Rules*

The interchange fee and surcharge issues are, in turn, directly related to network-established transaction routing rules. Routing issues arise because most banks belong to a number of different ATM networks and therefore may have a number of alternatives for processing ATM transactions initiated by customers at their ATMs. Different networks compete for a transaction whenever a cardholder uses a dual card (a card providing access to more than one network) in a dual ATM (an ATM providing access to more

11. See *Networks Bend, Don't Break Under Pricing Pressure*, BANK NETWORK NEWS, Feb. 11, 1992 (reporting that 91 of the 100 largest card issuers charge foreign fees ranging from \$.15 to \$2.00, and that 32% of the largest financial institutions charge transaction fees for use of their own machines with another 12% planning to implement such fees within two years). For a summary of network pricing and consumer fees, see *Consumer ATM Pricing Begins an Uphill Climb*, BANK NETWORK NEWS, Mar. 12, 1992, at 5.

12. See *Interchange-Hungry Deployers Seek Network Relief*, BANK NETWORK NEWS, Jan. 25, 1992, at 2; *Surcharging: The Debate Continues*, EFT REP., Aug. 19, 1991, at 1.

13. See *Surcharging: The Debate Continues*, *supra* note 12, at 1-2.

14. See *supra* note 10; *Surcharging: The Debate Continues*, *supra* note 12, at 4-5.

than one network), and the card and ATM belong to more than one common network.

To illustrate the problem, let us assume that a cardholder of Bank A, which has multiple network memberships, including MOST (a large regional network) and CIRRUS, a national network, makes a cash withdrawal from Bank B's ATM. Bank B is also a member of MOST and CIRRUS, as well as a number of other regional and national networks. Bank B could route the transaction through MOST, CIRRUS, or any of the other networks that it has in common with Bank A.¹⁵ If a transaction is sent via Regional Network A, that network's interchange and switch fees and rules will govern the transaction. If it is sent via National Network B, the fees may be higher or lower and the rules more or less stringent. Card-issuers that pay the fees and ATM owners that receive the fees may have highly contentious views as to which network is the proper one to use for a particular set of transactions. Networks have sometimes responded to this competitive reality by adjusting their interchange fees or instituting compulsory routing rules. As is discussed, *infra*, when this happens, antitrust suits may ensue.

At stake in the issue of control over routing are the fees involved in ATM transactions. The *switch fee* is paid by the card-issuing bank to the network every time a transaction made by one of its cardholders is routed through the network's switch. Since this fee traditionally has been the largest source of income for most networks, they have an economic interest in both maximizing the number of transactions that flow through the network switch, and discouraging any action by their members either to bypass or to route their transactions to another network. The *interchange fee*, by contrast, is paid to the ATM-owning member (often referred to as the "acquirer") by the card-issuer.

15. In addition, the ATM-owning bank may bypass all branded networks by routing the transaction to a third-party processor, which processes transactions for many unaffiliated financial institutions. The third-party processor may then "subswitch" the transaction without ever sending it to the branded network for processing.

The ATM owner (or its processor¹⁶), which typically controls the routing, will have an incentive to choose the network with the *highest* interchange fee in order to maximize its revenue.¹⁷ On the other hand, the card-issuer, which pays both the interchange and switch fees, will typically want the transactions for its cardholders routed over the network with the *lowest* combined interchange and switch fees. The cardholder has no control over how the transaction is routed and usually has no knowledge of the switch or interchange fees, even though they may well affect *cardholder fees*.¹⁸ Because the four parties to a transaction (the cardholder, the ATM owner, the card-issuer, and the network) have very different views on the question of which network should switch the transaction, questions arise as to who should control routing, and whether the network can mandate

16. An acquirer processor is one that "drives" or operates a bank's ATMs and connects them to the processor's host computer, which is, in turn, linked to the network switch. A processor either may be affiliated with a bank or may be an independent computer service bureau. Many network members, particularly small banks, prefer to have a third-party processor drive their ATMs.

17. While the interchange fee may be the major incentive for an acquirer or an acquirer processor to route transactions to one network rather than another, the switch fee may also play a part in the decision. As the trade press has observed:

In the past several years . . . major shared networks such as Star System and others have adopted routing rules that help protect card issuers. Regional networks in part fear that if they don't institute routing rules, third party processors could, through contractual [sic] arrangements that financially benefit them, dictate transaction routing. The benefit to the processor would come by charging the acquirer a flat fee for switching transactions. If, for instance, the acquiring bank is a member of a national network with a switch fee lower than that of the regional network and the contract price, the processor routes the transaction through the national switch, thus profiting from the difference between the national switch fee and the contract price.

Texans Form an ATM Routing Battle Line, BANK NETWORK NEWS, Mar. 9, 1991, at 6.

18. As noted in *supra* note 11 and accompanying text, most banks charge their cardholders fees for ATM transactions conducted at the ATMs of other banks (foreign fees). Routing choices can affect these fees because a bank may vary its foreign fee according to the amount of the interchange fee or the network to which the transaction is routed by the acquirer. A higher interchange fee may be passed on to cardholders through a higher foreign fee. Or, a card-issuing bank may assess no foreign fee for transactions through a network in which the bank has a financial interest, or it may charge a higher foreign fee for national network transactions which may be viewed as a "premium" product. In each of these cases, the amount of the foreign fee paid by the cardholder may vary depending upon the routing decision made by the acquirer, which typically does not have any relationship with the cardholder who is assessed the foreign fee.

who should exercise that control without violating the antitrust laws.

Increased competition among networks for transaction volume—particularly between regional networks and the national networks, CIRRUS and Plus—has led to increased interest on the part of many networks in the adoption and enforcement of various types of routing rules. In part, this may be because another method of competition—lowering interchange fees—poses the risk of an antitrust challenge from ATM owners who may allege that they are disadvantaged by lower fees. As a result, many networks, in an effort to acquire additional transaction volume, have considered imposing rules that dictate how transactions must be routed. The risk is that such rules—depending on how they are structured—could also be challenged as unreasonable restraints of trade under Section 1 of the Sherman Act.

II. ANTITRUST RISKS ASSOCIATED WITH INTERCHANGE FEES AND NO-SURCHARGE RULES

A. *The Analytical Framework*

An antitrust challenge to interchange fees and no-surcharge rules would likely be based on section 1 of the Sherman Act, which makes unlawful “agreements” that unreasonably restrain trade.¹⁹ In evaluating competitive restraints under section 1, the courts historically have used two basic modes of analysis: the *per se* rule and the rule of reason. Under the *per se* rule, certain types of agreements or practices are conclusively presumed to be unlawful without any examination of market effect or justifications for the restraint. Other types of restraints are examined under the rule of reason, which requires careful analysis of the nature of the challenged restraint, its market effects, and, because it may help to predict those effects, its business purpose.²⁰

19. 15 U.S.C. § 1 (1988), which reads in pertinent part: “every contract, combination . . . or conspiracy in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.” *Id.*

20. See generally ABA ANTITRUST SECTION, ANTITRUST LAW DEV. 31 (3d ed. 1992). Among the practices that have been considered *per se* illegal are naked price-fixing, bid rigging and market allocation agreements among competitors, vertical minimum resale pricefixing, certain tying arrangements and certain group boycotts. *Id.* at 33-34.

This traditional dichotomy between the *per se* rule and the rule of reason has posed particular definitional problems in the joint venture context. At the time that many ATM networks were being formed, horizontal agreements that “fit” into one of the traditional *per se* categories were likely to be found *per se* illegal, regardless of legitimate business reasons for the restraint.²¹ Since 1979, however, the Supreme Court has made it clear that in a joint venture context, where there is an integration to which the horizontal restraint is ancillary, the courts should not apply a rigid *per se* rule, but instead should examine the restraint under the rule of reason.

This is the teaching of *Broadcast Music, Inc. v. Columbia Broadcasting System (BMI)*,²² in which the Supreme Court rejected a claim that blanket licenses issued by BMI and American Society of Composers, Authors, and Publishers (ASCAP) for copyrighted musical compositions of their members at fees negotiated by the two joint ventures constituted *per se* illegal price-fixing under section 1 of the Sherman Act. The Court recognized that the blanket license, which was not mandatory, was a practical necessity because it was virtually impossible for thousands of composers to negotiate with thousands of potential users, and that the blanket license therefore created a new product that otherwise would not have been available.²³ In addition, the Court noted that the blanket license was not mandatory and that individual copyright owners could negotiate separately with respect to their own compositions.²⁴ Accordingly, the Court held that the blanket license was not *per se* illegal, but rather “should be subject to a more discriminating examination under the rule of reason.”²⁵ On remand, the court of appeals upheld the blanket license under the rule of reason largely because the individual composers could negotiate fees for their own compositions outside the framework of the blanket license.²⁶

21. See, e.g., *United States v. Topco Assocs.*, 405 U.S. 596 (1972) (exclusive territories established by cooperative association of independent regional supermarket chains *per se* illegal).

22. 441 U.S. 1 (1979).

23. *Id.* at 21-22.

24. *Id.* at 24.

25. *Id.*

26. *Columbia Broadcasting Sys. v. American Soc’y of Composers, Authors & Publishers*, 620 F.2d 930, 936 (2d Cir. 1980). Joint fee-setting by ASCAP survived a separate antitrust challenge brought by local television stations on similar grounds. See also *Buffalo Broadcasting Co. v. American Soc’y of Composers, Authors &*

In 1984, the Supreme Court again declined to apply the *per se* rule to joint venture imposed restraints in *National Collegiate Athletic Association v. Board of Regents*.²⁷ The NCAA collectively set the price of televised intercollegiate football games and restricted the number of games that each college could televise. The Court held that, while the plan constituted horizontal price-fixing and limited output, restraints that ordinarily would be held illegal *per se*, "it would be inappropriate to apply a *per se* rule . . . [where] horizontal restraints on competition are essential if the product is to be available at all."²⁸ It then proceeded to apply what was essentially a truncated rule of reason analysis. Finding that the plan "on its face constitute[d] a restraint upon the operation of a free market,"²⁹ and that the plan had operated to raise prices and reduce output, the Court concluded that "these hallmarks of anticompetitive behavior place[d] upon [NCAA] a heavy burden of establishing an affirmative defense which competitively justify[d] this apparent deviation from the operations of a free market."³⁰ In so doing, it rejected the NCAA's argument that its television plan could have had no significant anticompetitive effect since it had no market power, concluding somewhat cryptically that "[a]s a matter of law, the absence of proof of market power does not justify a naked restriction on price or output,"³¹ and "[a]s a factual matter, it is evident that [NCAA] [did] possess market power."³² The Court then examined whether the restraints were

Publishers, 774 F.2d 917, 933 (2d Cir. 1984) ("Since the blanket license restrains no one from bargaining over the purchase and sale of music performance rights, it is not a restraint unless it were proven that there are no realistically available alternatives."), *cert. denied*, 469 U.S. 1211 (1985).

27. 468 U.S. 85 (1984).

28. *Id.* at 100-01.

29. *Id.* at 113.

30. *Id.*

31. *Id.* at 109. The Court explained that:

[W]hen there is an agreement not to compete in terms of price or output, "no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement." . . . [T]he plan is inconsistent with the Sherman Act's command that price and supply be responsive to consumer preference. We have never required proof of market power in such a case. This naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis.

Id. at 109-10 (citation and footnote omitted).

32. *Id.* at 111.

necessary in order to market the broadcast rights. It noted that, unlike the situation in *BMI*, the NCAA members were able to negotiate on an individual basis because of the relatively small number of games involved.³³ Moreover, unlike the *BMI* blanket license, no NCAA member was permitted to sell television rights except in accordance with the plan. Accordingly, the NCAA plan was held unlawful on the ground that it had "curtail[ed] output and blunt[ed] the ability of member institutions to respond to consumer preference."³⁴

The Court in both cases declined to apply a rigid *per se* rule, but reached different conclusions under the rule of reason. The NCAA plan was held unlawful while the *BMI* blanket license was upheld because: (1) the price restraint was found necessary to market the joint venture product in *BMI*, and (2) each BMI member, unlike the NCAA schools, remained free to sell its own product outside the joint venture. As explained below, these factors are also important in analyzing the legality of collectively set interchange fees and surcharge prohibitions.

B. Decisions on Interchange Fees and Surcharge Prohibitions

During the 1980s, there were two antitrust challenges to collectively set interchange fees and one challenge to a no-surcharge rule. *National Bancard Corp. (NaBanco) v. VISA USA*³⁵ involved a challenge to VISA's interchange fee on credit card transactions; *In re First Texas Savings Association and Financial Interchange Inc.*³⁶ was an arbitration over the collective setting of ATM interchange fees by the PULSE network; and *Valley Bank v. Plus System*³⁷ involved a challenge to a surcharge prohibition of the PLUS network. In all three cases, the key question was whether the challenged restraint was reasonably necessary for the network to provide its joint product.

33. *Id.* at 114 n.53.

34. *Id.* at 120.

35. 596 F. Supp. 1231 (S.D. Fla. 1984), *aff'd*, 779 F.2d 592 (11th Cir.), *cert. denied*, 479 U.S. 923 (1986).

36. 55 Antitrust & Trade Reg. Rep. (BNA) 340 (Aug. 19, 1988).

37. 749 F. Supp. 223 (D. Nev. 1989), *aff'd*, 914 F.2d 1186 (9th Cir. 1990).

1. National Bancard Corp. (NaBanco) v. VISA USA

In *NaBanco*, a processor for merchant banks (NaBanco) alleged that VISA's interchange fee, set by VISA's board of directors, constituted *per se* illegal horizontal price-fixing.³⁸ The district court rejected that characterization since the fee was not mandatory (i.e., banks could enter into alternative arrangements), and instead analyzed the restraint under the rule of reason.³⁹ In that analysis the key question was whether the fee was "unduly" restrictive of competition.⁴⁰ The court also rejected NaBanco's contention that VISA had market power in a narrowly defined market of credit card processing, instead defining the market broadly as all payment systems.⁴¹ Once it determined that VISA did not have market power in a market broadly defined as "all payment systems,"⁴² the district court examined VISA's justification for the fee and concluded that the fee was a reasonable, cost-based mechanism necessary to market the product. The facts that the interchange fee was based on a cost study conducted by an independent accounting firm,⁴³ and that VISA's merchant and card-issuing members were free to negotiate separate interchange arrangements with each other⁴⁴ were important factors in the district court's decision.

On appeal, the Eleventh Circuit affirmed.⁴⁵ It explained that

38. *NaBanco*, 596 F. Supp. at 1236.

39. *Id.* One reason for rejecting *per se* treatment was that the fee was not mandatory. "A practice is not unlawful *per se* where as in this case, there is no legal, practical or conspiratorial impediment to making alternate arrangements." *Id.* at 1254-55 (citing *BMI*, 441 U.S. at 24).

40. As the court explained:

Under the rule of reason test it is plaintiff's burden to establish that the practice complained of has an adverse impact on competition. It should be stressed, however, that in making this a determination, the relevant question is not whether the challenged practice is the *most* competitive device that can be imagined, or the "least restrictive," but simply whether it is reasonable; i.e., not "unduly" restrictive of competition. So long as a practice is "fairly necessary" to achieve a legitimate purpose, it is not unlawful under the rule of reason. In applying this standard, the competitive benefits of the challenged practice are weighed against its alleged harmful effects and a violation of the Sherman Act will be found only where the balance tips decidedly in favor of the latter.

Id. at 1256-57 (citations omitted).

41. *Id.* at 1257.

42. *Id.*

43. *Id.* at 1261-63.

44. *Id.* at 1264.

45. *National Bancard Corp. (NaBanco) v. VISA USA*, 779 F.2d 592 (11th Cir. 1986),

the primary question was “whether the restraint [was] necessary for the existence of the product”—that is, whether the interchange fee had to be collectively set by the joint venture in order to market the joint product.⁴⁶ The court concluded that VISA satisfied this requirement: VISA had developed a product that no one member could have developed independently and the interchange fee was necessary to offer the joint product.⁴⁷ The court viewed the interchange fee as an internal accounting procedure between the joint venture members that shifted a portion of the revenues from the merchant bank to the card-issuer bank to pay for some of the fraud and other risks assumed by the card-issuer, and therefore evaluated it under the rule of reason.⁴⁸

In applying the rule of reason, the Eleventh Circuit upheld the lower court’s broad market definition and also found that, even if VISA did have market power, the fee was, on balance, procompetitive.⁴⁹ On the latter point, it explained that “[t]he ‘fundamental economic interdependence’ between the card-issuing and merchant-signing banks . . . demonstrate[d] that redistribution of revenues or costs [was] a must for the continued existence of the product.”⁵⁰ Individual price negotiations were impractical and would result in instability, higher fees, and the ultimate demise of the product.⁵¹ Hence, the court concluded that collectively set interchange fees were necessary for VISA to offer its joint product and upheld the fee as “‘reasonably ancillary to [a] procompetitive efficiency-creating endeavor[].’”⁵²

cert. denied, 479 U.S. 923 (1986).

46. *Id.* at 601-02.

47. *Id.* at 602-03.

48. *Id.*

49. *Id.* at 604-05.

50. *Id.* at 605. On this point the Court relied on an article by defendants’ expert, Professor William Baxter, regarding the economic effects of the interchange fee. See W. Baxter, *Bank Interchange of Transactional Paper: Legal and Economic Perspectives*, 26 J.L. & ECON. 541, 586 (1981). The article concluded that interchange fees were “not horizontal price fixing, but rather act as equilibratory devices necessary to avoid ‘chaotic results . . . higher fees and instability within card systems.’” *Id.* at 600 n.13.

51. *NaBanco*, 779 F.2d at 605.

52. *Id.* at 602 (quoting *United States v. Realty Multi-List*, 629 F.2d 1351, 1365 (5th Cir. 1980)).

2. *The Financial Interchange Arbitration*

The opposite result was reached in the 1988 *Financial Interchange* arbitration,⁵³ where a collectively-set ATM interchange fee was successfully challenged under the antitrust laws. That proceeding involved the PULSE network in Texas and its largest acquirer member, First Texas Savings Association.⁵⁴ In part because of potential antitrust risks, PULSE's interchange fees were originally based on a cost study performed by an independent third party accounting firm, as had been done for VISA. When the PULSE board of directors sought to reduce the interchange fee for off-premise transactions and increase it for on-premise transactions, however, First Texas objected and threatened to sue PULSE under the antitrust laws. Because both parties wanted a quick resolution to the controversy, a novel arbitration process⁵⁵ was agreed to in lieu of taking the case to court.

There were two parts to First Texas's antitrust case. First Texas first argued that *any* setting of interchange fees by PULSE (whatever the level of fees) was a horizontal price-fixing agreement among competing buyers and sellers which unreasonably restrained trade in violation of section 1 of the Sherman Act.⁵⁶ Second, it argued that, even if collective fee-setting was lawful, PULSE's planned reduction in the interchange fee for off-premise ATMs violated section 1 because the proposed fee schedule was not established on the basis of neutral and objective criteria, but rather was the action of a "buyers cartel" which favored the substantial majority of

53. *In re* First Texas and Financial Interchange, Inc., 55 Antitrust & Trade Reg. Rep. (BNA) 340 (Aug. 19, 1988). The authors of this article were among the counsel representing Financial Interchange in this arbitration proceeding.

54. In the parlance of EFT networks, First Texas was a "net acquirer," that is, it paid less in interchange fees for access to ATMs owned and operated by other PULSE members than it received in interchange fees for the use of its ATMs by cardholders of other PULSE members. Most PULSE members, on the other hand, were "net purchasers" of ATM usage in that they paid out more in interchange fees than they received. Thus, First Texas would have been the member most adversely affected by the proposed reduction in the off-premise interchange fee.

55. The arbitration won an award for "Excellence and Innovation in Alternative Dispute Resolution," from the CPR Legal Program for 1988. For a discussion of the innovative aspects of the arbitration proceeding, see J. Groton, *Solving the Conflicting Expert Witnesses Dilemma*, ARB. J. (Dec. 1992).

56. *Financial Interchange*, 55 Antitrust & Trade Reg. Rep. at 348.

PULSE's members that were "net purchasers" of ATM transactions.⁵⁷

The centerpiece of First Texas' first claim was what it termed a "free market" proposal under which all interchange fees would be eliminated and the ATM owner would charge consumers directly for use of its ATMs by electronically debiting the cardholder's account.⁵⁸ With compensation to the ATM owner limited to the interchange fee, First Texas contended, output (in terms of the number of ATMs) was restricted, and consumers did not receive the full range of ATM availability, quality, and convenience that would be achievable in a "free market" environment.⁵⁹

The arbitrator⁶⁰ first addressed the antitrust standards and burden of proof to be applied. Fashioning a novel "rule of presumptive illegality," which it suggested was supported by NCAA,⁶¹ First Texas claimed that proof of market power was unnecessary and argued that once it had demonstrated the existence of a restriction on output, the defendant faced the "heavy burden" of justifying the departure from the free market.⁶² The arbitrator did not agree. Instead, he concluded that the lawfulness of collectively set interchange fees in a shared network had to be tested under a broad "rule of reason" standard, using a shifting burden of proof.⁶³ First Texas bore the initial burden of establishing that the interchange fee was likely to affect consumer welfare adversely. Demonstrating that PULSE possessed market power was the linchpin of that burden. The burden then shifted to PULSE to establish that the restraint was "reasonably necessary to the achievement of efficiencies

57. *Id.*

58. *Id.* Under this proposal, an ATM owner's fee for use of its ATM by other banks' cardholders would be prominently displayed on each ATM. Upon completion of an ATM transaction, the posted fee would be electronically debited from the customer's account at the card-issuing bank and paid to the ATM owner. For an extensive discussion of this proposal by First Texas's economic expert, see S. Salop, *Deregulating Self-Regulated Shared ATM Networks*, ECON. INNOV. & NEW TECH. (1990).

59. *Financial Interchange*, 55 Antitrust & Trade Reg. Rep. at 348.

60. The arbitrator was Thomas E. Kauper, a Professor of Law at the University of Michigan and a former Assistant Attorney General in charge of the Antitrust Division of the Department of Justice.

61. *Financial Interchange*, 55 Antitrust & Trade Reg. Rep. at 349.

62. *Id.*

63. *Id.* at 349-50.

within the network."⁶⁴ Finally, First Texas had to establish that, on balance, the interchange fee was anticompetitive.⁶⁵

The arbitrator analyzed PULSE's market power in two markets: a "wholesale" market of "network switching" and a "retail" market of "ATM services."⁶⁶ In the wholesale market, the market power determination turned on whether existing subnetworks, regional networks, or national networks provided a reasonable substitute for the service PULSE provided to its members.⁶⁷ None of the regional network alternatives was found to be a "reasonable substitute" because none could duplicate the broad access to ATMs and cardholders offered by PULSE.⁶⁸ The national networks, Plus and CIRRUS, were considered a greater competitive threat:⁶⁹ at the time, approximately twenty-seven percent of the transactions handled by PULSE could be routed through CIRRUS and seven percent could be routed through Plus.⁷⁰ Nevertheless, Professor Kauper found that "substantial barriers" with respect to national networks were likely to ensure PULSE's continued market power.⁷¹ The arbitrator also determined that universal access, as PULSE offered, was not necessary to constitute a "reasonable substitute" for PULSE, but

64. *Id.* at 350.

65. *Id.*

66. *Id.* at 352-56.

67. *Id.* at 355.

68. The arbitrator found that these other networks had far fewer ATMs than PULSE, so that members placing sole reliance on these alternatives would be competitively disadvantaged by their limited access. *Id.*

69. The arbitrator observed that:

[T]hese national networks pose a competitive threat to PULSE in two quite different ways. First, a significant percentage of PULSE transactions could be routed over Plus or CIRRUS by financial institutions dissatisfied with PULSE Second, PULSE members could drop out of PULSE altogether (or could take some or all of their cards out of PULSE while leaving their ATMs in), electing instead to rely entirely on Plus or CIRRUS.

Id. at 354.

70. *Id.* at 353.

71. *Id.* These barriers included the facts that: (1) the national networks (Plus and CIRRUS) prohibited dual membership; (2) local banks preferred local networks; (3) PULSE was very efficient, already well-established, and provided better service; (4) national networks had slower response times and higher rejection rates; and (5) there would be a high cost of conversion by member banks. *Id.* at 354. As explained *infra* at Part II.C.1, ATM duality between Plus and CIRRUS, implemented in 1990, may produce a different market power determination today. *Id.*

suggested that access to “50% of the machines and cardholders . . . in a given market might suffice.”⁷²

PULSE defined the retail product market as including all means of obtaining cash, including checks, credit cards, travelers checks, POS (point of sale) “cashback,” and ATMs, but this definition was rejected on the ground that there are consumers for whom ATMs were the preferred source of cash.⁷³ Because PULSE members represented nearly all of the available ATMs in Texas, the arbitrator concluded that PULSE also possessed market power in the retail market.⁷⁴

Having found that PULSE had market power, the arbitrator reasoned that PULSE’s collectively set interchange fee restricted output by affecting the number and location of ATMs as well as the quality and cost of ATM services.⁷⁵ He agreed with First Texas that, since the ATM owner was in the best position to assess and respond to consumer demand, individual pricing by ATM owners was more likely to maximize consumers’ options than a uniform interchange fee.⁷⁶ Accordingly, he concluded that First Texas had established that PULSE’s interchange fee had some anticompetitive effect.⁷⁷

The burden then shifted to PULSE to demonstrate that the interchange fee was necessary for the efficient functioning of the network. PULSE contended that elimination of the interchange fee would lead members to consider withdrawing from the network and impair PULSE’s ability to compete.⁷⁸ The interchange fee balanced the interests of card-issuers and ATM owners and assured ATM owners compensation at an amount known in advance by both parties. Adoption of the “free market” proposal would result in substantial external costs and burdens to the network and its membership (externalities), including significant price variation and consumer confusion since the price could vary by machine, location, or time of day.⁷⁹ Price-gouging by some ATM owners might alienate some consumers altogether

72. *Id.* at 355.

73. *Id.* at 356 (“ATMs are themselves a relevant, if fragile, market for antitrust purposes.”).

74. *Id.*

75. *Id.*

76. *Id.* at 364.

77. *Id.*

78. *Id.* at 357.

79. *Id.* at 357-61.

and cause them to use other network cards, or at least spend time searching for an ATM with a lower fee. Further, the costs of consumer confusion, including re-education and loss of goodwill, would be borne by the card-issuing banks rather than the ATM-owning banks. Finally, the free market system would result in substantial conversion costs and would impair PULSE's ability to interact with other networks that had fixed interchange fees.⁸⁰

Instead of weighing the likely anticompetitive effects of PULSE's interchange fees against the likely adverse effects of the "free market" system proposed by First Texas, the arbitrator relied on PULSE's concession that allowing ATM owners to impose surcharges or provide rebates (which were found to be procompetitive) would involve far less costly externalities. He therefore concluded that PULSE's system of setting interchange fees would violate section 1 unless PULSE adopted the "less restrictive alternative" of allowing ATM owners to impose surcharges or grant rebates and, further, settling these surcharges and rebates electronically through the PULSE system.⁸¹

With respect to its second claim, First Texas contended that the proposed change in fees was the action of a "buyers cartel" of purchasers of ATM transactions designed to reduce their costs. PULSE defended its decision as an exercise of reasonable business judgment, based on both an independent cost study and competition from other networks. Although the arbitrator recognized the necessary tension between "net purchasers" and "net acquirers" in any ATM network, he observed that these tensions were particularly pronounced in PULSE since the change in fees appeared to be directed at First Texas.⁸² Moreover, he found that the cost study did not clearly support the reduction in interchange fees,⁸³ and PULSE had not made a sufficient evaluation of the competitive threats it faced.⁸⁴ Thus, the arbitrator ruled that PULSE could not alter its interchange fees until it permitted its members to surcharge.⁸⁵

80. *Id.* at 361-62.

81. *Id.* at 366. Interestingly, First Texas opposed the surcharge option, claiming that it would impose "first mover" costs on those choosing to surcharge. *Id.*

82. *Id.* at 367-68.

83. *Id.* at 369.

84. *Id.* at 371.

85. *Id.*

Although the *Financial Interchange* decision, as an arbitration, has no formal precedential value, the in-depth nature of the arbitrator's factual and legal analysis would likely be carefully considered by a court in deciding any future case involving ATM interchange fees or surcharges. In the industry, the decision had the effect of not only casting doubt on the legality of fixed interchange fees, but also awakening the interest of ATM owners in surcharging consumers directly for use of their ATMs.⁸⁶

3. Valley Bank of Nevada v. Plus System, Inc.

Within several months, the impact of the *Financial Interchange* decision was felt in Nevada when Valley Bank of Nevada (Valley) began assessing a surcharge of one dollar at some of its casino and airport ATMs. Valley planned to deploy a significant number of additional ATMs, based on its surveys that found most consumers would be willing to pay a one dollar surcharge for the convenience of getting cash at these locations. When Valley informed Plus of its intent to surcharge, Plus responded that Valley would have to conduct more extensive consumer studies before the network could change its rules to permit surcharging. Valley then sued Plus and VISA, alleging that the Plus surcharge prohibition constituted illegal horizontal price-fixing.⁸⁷

While the antitrust suit was pending, Valley successfully lobbied the Nevada state legislature, which in June 1989 enacted a statute explicitly forbidding ATM networks from restricting Nevada banking institutions from surcharging.⁸⁸ When Plus objected on the ground that the Nevada statute was unconstitutional under the Commerce Clause,⁸⁹ Valley amended its complaint to include a claim for declaratory judgment on the

86. See *Networks Warily Eye Surcharge Momentum*, BANK NETWORK NEWS, Feb. 9, 1989, at 4.

87. See *Valley Bank v. Plus System*, No. CV-S-89-171 (PMP/RJJ) (D. Nev. filed Mar. 3, 1989).

88. The legislation provided in pertinent part:

An agreement to share mechanical tellers or electronic terminals may not prohibit, limit or restrict the right of a financial institution to charge a customer any fees allowed by state or federal law, or require a financial institution to limit or waive its rights or obligations under this chapter.

NEV. REV. STAT. ANN. § 660.095 (Michie 1990 Supp.). The statute also requires detailed consumer disclosures. *Id.*

89. U.S. CONST. art. 1, § 8, cl. 3.

constitutionality issue. Both parties moved for summary judgment.⁹⁰

The district court upheld the statute, holding that it did not directly regulate, discriminate against, or place an excessive burden on interstate commerce.⁹¹ It concluded that the statute regulated in an evenhanded fashion to protect legitimate state interests, and that the effects on interstate commerce were "incidental at best."⁹² The Ninth Circuit affirmed on similar grounds.⁹³

Although the courts' analyses focused on the Commerce Clause issues, many of the arguments presented by the parties were similar to the "pricing freedom versus externalities" debate of the *Financial Interchange* arbitration. Like First Texas, Valley claimed that the surcharge prohibition restricted output and limited consumer convenience in terms of the number of ATMs.⁹⁴

Plus defended its surcharge prohibition as protecting each card-issuer's exclusive control over the relationship with its own customers, as well as avoiding cardholder confusion over unanticipated and varying ATM charges.⁹⁵ Plus characterized the no-surcharge rule, like the interchange fee, as allocating the risks and benefits between card-issuer and ATM-owning institutions.⁹⁶ Emphasizing the interdependent economic relationships between members of a national joint venture, Plus argued that its efficient functioning depended upon uniformity of state laws,⁹⁷ and further claimed that the Nevada statute discriminated against out-of-state cardholders and Plus members. It described ATM pricing "as a type of 'zero sum game'—that is, if the ATM-deploying bank receives more, then the card-issuing bank must get less."⁹⁸

90. *Valley Bank v. Plus System*, 749 F. Supp. 223, 225 (D. Nev. 1989) *aff'd*, 914 F.2d 1186 (9th Cir. 1990).

91. *Id.* at 229. For an extensive discussion of the Commerce Clause arguments, see D. Prywes, *ATM Network Restraints on Surcharges*, 45 BUS. LAW. 1973 (June 1990).

92. *Valley Bank*, 749 F. Supp. at 229.

93. *Valley Bank v. Plus System*, 914 F.2d 1186 (9th Cir. 1990).

94. See *Valley Bank v. Plus System*, No. CV-S-89-171 (PMP/RJJ) (D. Nev. filed Mar. 3, 1989).

95. *Valley Bank*, 914 F.2d at 1190.

96. *Id.*

97. *Id.* at 1192.

98. *Id.* at 1194.

The district court and Ninth Circuit rejected each of Plus's arguments. Particularly damaging was the fact, repeatedly cited by the court of appeals, that other networks successfully permitted their members to surcharge.⁹⁹ The "zero sum game" argument was characterized as factually unsupported and inconsistent with the experience of the In-Nevada Network, whose transaction volume had increased rapidly after surcharges were imposed. Thus, the Ninth Circuit concluded that "[t]he success of other networks that permit their member institutions to charge such fees demonstrates that uniformity [of regulation] is unnecessary to a shared ATM network's survival."¹⁰⁰

The Ninth Circuit held that the statute advanced legitimate state interests because increased ATM deployment would benefit Nevada residents in remote areas as well as tourists who desired access to cash twenty-four hours a day.¹⁰¹ Although the court did not explicitly address the arguments of consumer confusion or price-gouging, it observed that enhanced competition between ATM owners should lower costs to consumers.¹⁰²

After the Ninth Circuit decision was handed down, the parties reached an agreement whereby Plus permitted surcharges in Nevada and the antitrust case was dismissed.¹⁰³ As a result, Valley Bank now imposes surcharges on national as well as regional network transactions at its ATMs, and other Nevada banks have begun to do likewise.¹⁰⁴

99. See *id.* at 1190 ("Other networks exist without [the surcharge prohibition], for example, Star and In-Nevada Network, two other networks operating in Nevada."); *id.* at 1193 (noting growth in In-Nevada Network after surcharges were imposed).

100. *Id.* at 1192-93.

101. *Id.* at 1196.

102. *Id.*

103. See *Plus Retires the Colors on Its Valley Bank Battles*, BANK NETWORK NEWS, Dec. 12, 1990, at 8.

104. CIRRUS complied with the statute by providing an exception to its surcharge prohibition for Nevada banks. See *CIRRUS to Allow an ATM Surcharge*, AM. BANKER, Aug. 16, 1990, at 6. Presently, both Plus and CIRRUS prohibit surcharging unless state law specifically permits it. See *Southwest Banks Enter the Surcharge Arena*, BANK NETWORK NEWS, Apr. 26, 1992, at 3. Since the decision in *Valley Bank*, two states—Maine and Utah—have passed legislation permitting financial institutions to impose surcharges. The laws enacted by both states were modeled after the Nevada statute, and require the ATM owner to disclose the existence of the fee and permit the consumer to cancel the transaction without incurring the fee. See *Utah Opens the National ATM Surcharge Door*, BANK NETWORK NEWS, Apr. 26, 1992, at 3. In addition, in 1991, the Arizona, Georgia, and Wyoming legislatures reportedly considered the introduction of legislation which would have permitted surcharges. See *Round One Begins in a Maine Surcharge Title Bout*, BANK NETWORK NEWS, July 12,

C. Antitrust Analysis of Network Interchange Fees and No-Surcharge Rules

These cases create considerable uncertainty about the legality of fixed interchange fees and no-surcharge rules under the antitrust laws. While *NaBanco* upheld a fixed credit card interchange fee, the arbitrator in *Financial Interchange* concluded that an ATM network with market power could not use fixed interchange fees unless it also permitted ATM owners to impose surcharges or rebates. Meanwhile, because *Valley Bank* was decided on constitutional grounds, there is still no judicial precedent on the legality of a surcharge prohibition under the antitrust laws. Although it seems clear that fixed interchange fees and network-imposed surcharge prohibitions will not be deemed *per se* illegal, there remains considerable uncertainty about their legality under a rule of reason analysis. This uncertainty is traceable to a number of factors.

1. Determining Market Power

Although *NCAA* may provide a limited evidentiary short-cut where a pricing restraint clearly reduces output,¹⁰⁵ the prevailing view is that a plaintiff in a rule of reason case must establish that the defendant has market power.¹⁰⁶ To do so, the plaintiff must demonstrate that the network has the ability to maintain a sustained price increase for its service without attracting new entry or losing significant business to an alternative network. Assessing the degree of market power requires defining the relevant market and determining the network's market share within the market.¹⁰⁷

Market definition, however, is a complex, fact-based inquiry, and the decided law as to bank card services is inconsistent. In

1991, at 2.

105. As noted above, First Texas in *Financial Interchange* contended that the interchange fee reduced ATM deployment. However, that argument failed to distinguish between "output" in terms of the number of ATMs, and "output" in terms of the number of transactions. In fact, the alleged output reduction effect was not at all clear because "output" in terms of transactions could well have decreased in a "free market" environment.

106. See, e.g., *General Leaseways, Inc. v. National Truck Leasing Ass'n*, 744 F.2d 588, 596 (7th Cir. 1984) (holding defendant must have "sufficient market power to restrain competition substantially If not . . . the practice is lawful") (citations omitted).

107. See, e.g., *Financial Interchange*, 55 Antitrust & Trade Reg. Rep. at 352-56.

NaBanco, the district court rejected a definition confined to credit cards, and instead defined the product market very broadly to include "all payment services used in retail sales . . . includ[ing] VISA, MasterCard, T&E cards, merchants' proprietary cards, merchants' open book credit, cash, travelers cheques, ATM cards, personal checks and check guarantee cards."¹⁰⁸ Similarly, in *Treasurer, Inc. v. Philadelphia National Bank*,¹⁰⁹ the district court rejected the plaintiff's narrow market definition, which included only shared ATM networks, and defined the market instead as "electronic data processing to all ATMs *plus* all of those institutions which have unaffiliated ATM systems and those institutions which do not currently have ATMs but have the capacity to install them and utilize market technology to its fullest."¹¹⁰ In *Financial Interchange*, however, the product market was defined narrowly in terms of "network switching" and "ATM services."¹¹¹ The Federal Reserve Board, in approving applications under the Bank Holding Company Act to acquire stock in ATM network joint ventures, has likewise defined the relevant product market in a variety of ways.¹¹²

108. *NaBanco*, 596 F. Supp. at 1259.

109. 682 F. Supp. 269 (D.N.J.), *aff'd mem.*, 853 F.2d 921 (3d Cir. 1988). This case involved a challenge by The Treasurer network to the acquisition of the Cashstream network by Philadelphia National Bank, the owner and operator of the MAC network.

110. *Id.* at 279.

111. See *supra* notes 66-74 and accompanying text.

112. See, e.g., *Citicorp*, 72 FED. RESERVE BULL. 583 (1986) ("provision of EFT switching services" and "ATM networks"); *Bank South Corp.*, 72 FED. RESERVE BULL. 581 (1986) ("provision of ATM services"); *Sovran Financial Corp.* 72 FED. RESERVE BULL. 347, 348 (1986) ("provision of ATM services" and "provision of EFT switching services"); *Barclays Bank PLC and Barclays Bank Int'l, Ltd.*, 71 FED. RESERVE BULL. 113, 114 (1985) ("provision of EFT switching services"); *First National Cincinnati Corp.*, 70 FED. RESERVE BULL. 889, 890 (1984) ("provision of ATM services" and "provision for unaffiliated financial institutions of data processing services"); *Atlantic Bancorporation*, 69 FED. RESERVE BULL. 639, 640 (1983) ("provision for unaffiliated financial institutions of data processing services"); *Atlantic Bancorporation*, 69 FED. RESERVE BULL. 639, 640 (1983) ("provision for unaffiliated financial institutions of data processing services"); *Centerre Bancorporation*, 69 FED. RESERVE BULL. 643 (1983) ("the provision to unaffiliated financial institutions of data processing services, particularly the operation of an ATM network exchange"); *Interstate Financial Corp.*, 69 FED. RESERVE BULL. 560, 561 (1983) (same). In some of these cases, the Federal Reserve Board also found that there were low barriers to entry, a factor which may also impact on the market power analysis. See *Citicorp*, 72 FED. RESERVE BULL. at 583; *Bank South Corp.*, 72 FED. RESERVE BULL. at 582; *Sovran Financial Corp.*, 72 FED. RESERVE BULL. at 348; *Barclays Bank PLC and Barclays Bank Int'l, Ltd.*, 71 FED. RESERVE BULL. at 114.

As these cases demonstrate, the factfinder has considerable discretion in defining the market. An important factor in this determination is the value accorded to the network trademark. If the focus is on the data processing function of shared ATM networks, a factfinder may conclude, as did the district court in *Treasurer*, that the data processing industry is unconcentrated, that there are numerous alternatives available to financial institutions to perform their data processing, and that a network—even a dominant regional ATM network—does not have market power. On the other hand, if the network is viewed as the purveyor of a unique, branded product marketed under a well-recognized logo, a factfinder may reach a very different conclusion, as in *Financial Interchange*.

Furthermore, even if the product market is defined narrowly as “network switching” or “ATM networks,” market power cannot automatically be presumed. Typically, in assessing market power, the factfinder must identify all competitors and determine their market shares; market shares are then used as one measure of the defendant’s market power.¹¹³ In ATM networks, however, calculating market shares may give distorted results because of both the structural peculiarities of the industry and questions as to the proper unit of analysis.¹¹⁴ As a result, the factfinder will normally have to rely primarily on nonquantitative evidence of the presence and power of other actual or potential substitutes, rather than a detailed market share analysis. This will include,

113. Although there is no “bright line” test of how much market share confers market power, the courts have indicated that a market share of 30% or below would not be sufficient. *See, e.g.,* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 26-27 (1984) (30% market share was insufficient to infer market power); American Floral Serv. v. Florists’ Transworld Del. Ass’n, 633 F. Supp. 201, 221 (N.D. Ill. 1986) (firms with less than 30% market share are presumed to lack market power).

114. Different factfinders have used various measures to determine market shares. For example, in *Financial Interchange*, the arbitrator examined shares of: (i) all ATM transactions (which “understate[d] [the venture’s] position in the market”), (ii) interprocessor switching transactions, and (iii) available ATMs. 55 Antitrust & Trade Reg. Rep., at 340. The *Treasurer* court focused on the number of ATMs utilized by the network, but the plaintiff urged that financial institution deposits be used. *Treasurer*, 682 F. Supp. at 269. The Justice Department at least at one time used the “percentage of the available ATM transactions.” *See* BAKER & BRANDEL, *supra* note 2, app. F at A-144 (speech by Charles F. Rule, then Acting Assistant Attorney General, Antitrust Division, Department of Justice). Any of these statistical measures, however, may overstate the level of market power since ATMs, cardholders, and institutions may have simultaneous access to multiple networks. *See generally* W. Blumenthal, *Three Vexing Issues Under the Essential Facilities Doctrine: ATM Networks as Illustration*, 58 ANTITRUST L.J. 855 (1989).

most importantly, an analysis of the alternate routings available to the network's members through other network alternatives. Other facts relevant to the existence of market power would include evidence of: members of the defendant network dropping out of one network and joining another; pricing changes by one network in reaction to pricing changes by other networks; and consumers turning to other cash access alternatives due to increases in ATM fees.

The market power determination will also be strongly influenced by increasing competition between the national and regional networks. In *Financial Interchange*, the arbitrator concluded that PULSE had market power in part because neither CIRRUS nor Plus could provide the *degree* of local ATM coverage that PULSE could.¹¹⁵ Now with the implementation of ATM duality, both CIRRUS and Plus may provide nearly the same degree of local coverage offered by large regional networks.¹¹⁶ In many sections of the country, there is also increasing competition between different regional networks as many venture outside their original markets in search of additional financial institution members and transaction volumes.¹¹⁷ These changes in internetwork competition may offer a significantly stronger basis for persuading a factfinder that a particular network does not have market power than was the case in *Financial Interchange*.

2. *The Need for Fixed Interchange Fees and No-Surcharge Rules*

If the plaintiff can demonstrate that the defendant network has market power, the burden will shift to the network to justify the challenged restraint—that is, to prove that the interchange fee or no-surcharge rule is reasonably necessary to the efficient functioning of the network.¹¹⁸

As with market power, it is difficult to predict how a factfinder would assess the types of “interdependency” and “externalities” justifications that were articulated in *Financial Interchange* and *Valley Bank*. While the passage of time may make it easier for

115. See *supra* notes 69-71 and accompanying text.

116. See *supra* note 4.

117. See *Network Turf Wars Leave Few Survivors*, BANK NETWORK NEWS, Dec. 10, 1990, at 1.

118. See *supra* note 64 and accompanying text.

many networks to avoid a finding of market power, it may have the opposite effect in evaluating the continued necessity of interchange fees and no-surcharge rules. At the time that *Financial Interchange* and *Valley Bank* were decided, there was little evidence of the effect that surcharges would have on customer behavior or on card-issuer and network costs and burdens. While *Valley Bank* presented some preliminary evidence that surcharges had not adversely affected transaction volume, and that consumers were not averse to paying up to a one dollar surcharge,¹¹⁹ it was not then clear whether these results would necessarily be replicated in a non-casino environment. Since these decisions, a number of networks, including Pulse, Honor, Gulfnet, Star, and Yankee 24 now permit surcharges.¹²⁰ Thus, a "track record" has developed that should be highly relevant in assessing the necessity question in the future.

3. *The Issue of Less Restrictive Alternatives*

The availability of less restrictive alternatives to a challenged pricing restraint is also probative on whether a given restraint is reasonably necessary to the network's efficient functioning.¹²¹ However, it is not entirely clear that potentially less restrictive alternatives must be considered in a rule of reason analysis,¹²²

119. *Valley Bank*, 914 F.2d at 1186, 1190-93 (noting that the success of other networks that assess surcharges demonstrated that uniformity in regulation was unnecessary); *id.* at 1193 (noting growth in In-Nevada Network after surcharges were imposed); *id.* at 1196 (noting that in *Valley Bank* survey, 96% of respondents were willing to pay surcharge).

120. For a summary of network surcharge policies, see *Surcharging: The Debate Continues*, EFT REP., Aug. 19, 1991, at 5-6. Both Plus and CIRRUS prohibit surcharging unless state law specifically permits it. See *Southwest Banks Enter the Surcharge Arena*, BANK NETWORK NEWS, Apr. 26, 1992, at 3.

121. See *supra* note 40.

122. Compare *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 229 n.11 ("[o]nce it is clear that restraints can only be intended to enhance efficiency rather than to restrict output, the degree of restraint is a matter of business rather than legal judgment"), *cert. denied*, 479 U.S. 1033 (1987), and *National Bancard Corp. (NaBanco) v. Visa USA*, 596 F. Supp 1231, 1257 (S.D. Fla. 1984), *aff'd*, 779 F.2d 592 (11th Cir.) ("in making this a [sic] determination, the relevant question is not whether the challenged practice is the *most* competitive device that could be imagined or the 'least restrictive,' but simply whether it is reasonable' *i.e.*, not 'unduly restrictive of competition'), *cert. denied*, 479 U.S. 923 (1986) with *United States v. Realty Multi-List*, 629 F.2d 1351, 1375 (5th Cir. 1980) (defendant must show that the restraint is "reasonably necessary to the accomplishment of the [defendant's] legitimate goals and narrowly tailored to that end").

or, even if properly considered, whether surcharging would be deemed the only acceptable "less restrictive" alternative to a fixed interchange fee that could pass antitrust muster. For example, a variable interchange fee structure such as that used in Nebraska or a collectively set interchange fee which permitted members to deviate from the fee through private negotiations may be acceptable under *NCAA*, *BMI*, and *NaBanco*.

Other options might also be acceptable. For example, a network could consider limiting surcharging to off-premise machines. This option presents less risk than a total surcharge prohibition since it would be difficult for the plaintiff to demonstrate that the restraint reduced output because the deployment of on-premise ATMs is rarely influenced by the ability to surcharge.

Another option would be for a network to place a price cap on surcharges. The network could argue that the price cap was necessary to restrict price-gouging and, hence, minimize any injury to the goodwill of the network and its card-issuing institutions. On its face, this option resembles maximum price-fixing and thus runs some risk of *per se* condemnation.¹²³ However, the cases in which maximum price-fixing have been condemned have not involved a level of integration or "legitimate jointness" of a shared ATM network.¹²⁴ Therefore, most courts would probably analyze a price cap under the rule of reason,¹²⁵ and a private challenge to a price cap may also fail for want of "antitrust injury."¹²⁶

123. See, e.g., *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 356-57 (1982) (agreement among physicians to establish maximum fee schedule *per se* illegal where no legitimate integration).

124. Indeed, the result in *Maricopa* was premised on the assumption that no joint venture was involved. 457 U.S. at 356-57 ("the foundations [condemned as *per se* illegal] are not analogous to other partnerships or joint arrangements").

125. See, e.g., *Kartell v. Blue Shield*, 749 F.2d 920, 930-31 (1st Cir. 1984) (upholding health insurer's ban on balance billing under the rule of reason: "courts at least should be cautious—reluctant to condemn too speedily—an arrangement that, on its face appears to bring low price benefits to the consumer"), *cert. denied*, 471 U.S. 1029 (1985); *Consortium, Inc. v. Knoxville Int'l Energy Exposition*, 563 F. Supp. 56, 61-62 (E.D. Tenn. 1983) (upholding maximum price restrictions in a licensing agreement that protected the licensor's goodwill in its trademark).

126. A plaintiff in a private antitrust action must demonstrate the existence of antitrust injury, which is defined as "injury of the type that the antitrust laws were intended to prevent." See *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977). The concern of the antitrust laws is the protection of the competitive process, not competitors. *Id.* Accordingly, the fact that a restraint adversely affects a

Other restrictions on surcharges should be even less problematic. For example, a network could adopt consumer disclosure requirements as a condition to be able to surcharge without running antitrust risk—assuming, of course, that the rule does not have the purpose or effect of selectively disadvantaging a particular network member or class of members.¹²⁷ Similarly, a network should be able to adopt a nondiscrimination rule, which would permit members to surcharge so long as they do so without discriminating between networks.¹²⁸ Nondiscrimination rules resembling a “most favored nation” provision have in the past received careful antitrust scrutiny in other industries, the allegation being that they may facilitate price parallelism at noncompetitive levels.¹²⁹ Most favored nation provisions have, however, been upheld under a rule of reason analysis,¹³⁰ and it is likely that

firm’s business is insufficient to demonstrate antitrust injury, absent proof that the restraint injures competition (e.g., through higher prices). See *Tennessean Truck Stop v. NTS, Inc.*, 875 F.2d 86, 90 (6th Cir. 1989) (surcharge cap was a proconsumer device and even if it reduced the plaintiff’s profits, that was not “the type [of injury] the antitrust laws were intended to prevent” (quoting *Brunswick*, 477 U.S. at 489)).

127. Cf. *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U.S. 656 (1960) (reversing dismissal of claim against standard-setting association for refusing to grant “seal of approval,” where the decision allegedly was not based on objective standards, but rather was influenced by interests of association members that competed against plaintiff).

128. If an ATM owner can surcharge more for one network’s transactions than for those routed through another network, the higher priced network would be disadvantaged in the eyes of the cardholder, who has no power to route the transaction to the lower cost network. A network-imposed nondiscrimination rule might not even be needed, however, in those states that have ATM sharing laws which require ATMs to be shared on a fair and non-discriminatory basis. For a summary of such laws, see BAKER & BRANDEL, *supra* note 2, at Appendix E. Of those ATM networks that already permit surcharging, both Southeast Switch and Yankee 24 reportedly have such nondiscrimination rules. See *Surcharging: The Debate Continues*, EFT REP., Aug. 19, 1991, at 4.

129. See, e.g., *E.I. Du Pont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984) (use of most favored nation clause was not violation of FTC Act § 5); *Blue Cross & Blue Shield of Michigan v. Michigan Ass’n of Psychotherapy Clinics*, 1980-2 Trade Cas. (CCH) ¶ 63,351 (S.D. Mich. 1980) (upholding most favored nation clause under rule of reason analysis); *United States v. General Electric Co.*, 1977-2 Trade Cas. (CCH) ¶ 61,660 (E.D. Pa. 1977) (consent decree prohibiting use of most favored nation clause). See also *Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield*, 883 F.2d 1101, 1109-12 (1st Cir. 1989) (health insurance “prudent buyer” policy under which health insurer ensured that it would not pay a provider physician more for a particular service than he would receive from any other health insurer did not violate Sherman Act § 2).

130. See, e.g., *Blue Cross & Blue Shield of Michigan v. Michigan Ass’n of Psychotherapy Clinics*, 1980-2 Trade Cas. (CCH) ¶ 63,351 (S.D. Mich. 1980) (most

the same analysis would apply to a network-imposed nondiscrimination rule.

III. THE ANTITRUST RISKS OF TRANSACTION ROUTING RULES

A. *The Analytical Framework and Case Law Precedent*

An antitrust challenge to a network imposed routing rule would also likely rest on section 1 of the Sherman Act. For joint venture networks, a routing rule might be challenged as a horizontal "group boycott." Although the Supreme Court in the past held certain "group boycotts" *per se* illegal,¹³¹ its more recent decisions suggest that a rule of reason analysis should be applied.¹³² The lower courts have also generally applied the rule of reason in cases involving boycott challenges to joint venture and association rules.¹³³

ATM network routing rules would likewise probably be subject to rule of reason analysis. Although there is no case precedent involving ATM networks, two cases involving routing practices of other network joint ventures, *American Floral Services v. Florists' Transworld Delivery Association*,¹³⁴ and *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*,¹³⁵ provide useful guidance on the factors that should be taken into consideration by shared ATM

favorable nation clause upheld under rule of reason analysis); *cf.* *E.I. Du Pont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984) (most favored nation clause did not violate FTC Act § 5).

131. *See, e.g.*, *Eastern States Retail Lumber Dealers' Ass'n v. United States*, 234 U.S. 600 (1914).

132. *See* *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985), where the Supreme Court acknowledged that a "wholesale purchasing cooperative must establish and enforce reasonable rules in order to function effectively," and directed the lower courts to apply a rule of reason analysis absent a showing that "the cooperative possess[ed] market power or unique access to a business element necessary for effective competition." *Id.* at 296, 298; *see also* ABA ANTITRUST SECTION, ANTITRUST LAW DEV. 82-86 (3d ed. 1992).

133. *See, e.g.*, *Hahn v. Oregon Physicians' Serv.*, 860 F.2d 1501, 1509 (9th Cir. 1988), *cert. denied*, 493 U.S. 846 (1989); *Charley's Taxi Radio Dispatch Corp. v. SIDA*, 810 F.2d 869, 878 (9th Cir. 1987); *Goss v. Memorial Hosp. Sys.*, 789 F.2d 353, 355 (5th Cir. 1986); *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351, 1367 (5th Cir. 1980); *Worthen Bank & Trust Co. v. National BankAmericard, Inc.*, 485 F.2d 119, 130 (8th Cir. 1973), *cert. denied*, 415 U.S. 918 (1974); *Hassan v. Independent Practice Assocs. P.C.*, 698 F. Supp. 679, 693-94 (E.D. Mich. 1988); *National Bank of Can. v. Interbank Card Ass'n*, 507 F. Supp. 1113 (S.D.N.Y. 1980), *aff'd on other grounds*, 666 F.2d 6 (2d Cir. 1981).

134. 633 F. Supp. 201 (N.D. Ill. 1986).

135. 792 F.2d 210 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1033 (1987).

networks in evaluating the antitrust risks of routing rules under a rule of reason analysis.

In *American Floral Services*, the plaintiff, a floral service network, challenged the routing rules of two of its leading competitors, Florists' Transworld Delivery Association (FTD) and Teleflora. Floral service networks are similar to ATM networks in that they create and promote a logo, conduct advertising, and serve as a clearinghouse (or switch) for transactions. Florists are not restricted in the number of floral service networks to which they can belong, and in fact typically belong to a number of them.¹³⁶ American Floral Services (AFS), unlike the defendant networks, did relatively little advertising; rather, it chose to compete by offering a "rebate" to sending florists.¹³⁷ AFS could therefore "pirate" the order from another network if the sending florist sent the FTD or Teleflora order through AFS, thereby "free-riding" on the promotional efforts of FTD and Teleflora. In response, FTD promulgated "pirate order rules" that required that an FTD catalog order received by a member be transmitted and filled by FTD's wire service and clearinghouse, unless the customer indicated that he wanted the transaction routed to an alternative network.¹³⁸ The rule did not prohibit the sending florist from suggesting the use of the product of any competing network. Teleflora had a similar rule that required routing to Teleflora without the customer override. AFS alleged that both rules constituted *per se* illegal boycotts under section 1.¹³⁹

The district court rejected application of the *per se* rule to both rules, holding that they involved vertical distribution arrangements, and hence did not constitute horizontal group boycotts.¹⁴⁰ It found the restraints lawful under the rule of reason since their purpose was to eliminate the threat of free-riding by "pirate" networks such as AFS and the sending florists, who "double dip" by using the FTD or Teleflora designs "while at the same time collecting the AFS rebate."¹⁴¹ Thus, the routing

136. At one time, FTD prohibited its members from belonging to any other network, but that prohibition was rescinded after challenge by the Department of Justice. See *United States v. Florists' Telegraph Delivery Ass'n*, 1956 Trade Cas. (CCH) ¶ 68,367 (E.D. Mich. 1956).

137. *American Floral Servs.*, 633 F. Supp at 205.

138. *Id.* at 206.

139. *Id.* at 210.

140. *Id.* at 217-19.

141. *Id.* at 219.

rules were not “impermissible restrictions on interbrand free riding,” but rather “legitimate agreements ancillary to the cooperative agreements between florists and FTD or Teleflora.”¹⁴²

The D.C. Circuit Court of Appeals reached a similar conclusion in *Rothery*. *Rothery* involved rules of the defendant, Atlas Van Lines, which required that any Atlas order received by one of its carrier agents be transported under the operating authority of Atlas.¹⁴³ Interstate van lines employ independent moving companies as carrier agents throughout the country. These carrier agents execute a contract with the van line agreeing to adhere to standard operating procedures and uniform rates. The van line provides, among other things, equipment, facilities, training, and a clearinghouse for settlement of accounts among its agents. The deregulation of the moving industry in 1979 made it easier for the carrier agents to obtain their own interstate authority and compete against the van lines. Thus, carrier agents could free-ride on the efforts of the van line while cutting prices to attract business that otherwise would have gone to the van line. In response to this threat, Atlas imposed a rule that required its carrier agents, if they chose to take their own orders, to do so only through a separately owned enterprise using its own operating authority; the new entity could not use the facilities or services of Atlas, nor could it use the Atlas name.¹⁴⁴ As in *American Floral Services*, the plaintiffs charged that this rule constituted a *per se* unlawful group boycott in violation of section 1.¹⁴⁵

The D.C. Circuit rejected the claim. The carrier agent rule was not *per se* illegal since it was not a naked restraint but rather was ancillary to the economic integration of Atlas and its agents, and hence, had to be evaluated under the rule of reason.¹⁴⁶ Applying the rule of reason, the court concluded that the restraint was lawful, both because the defendant lacked market power and because the rule was justified as a legitimate attempt by Atlas to eliminate free-riding.¹⁴⁷

142. *Id.* at 219-20.

143. *Rothery*, 792 F.2d at 212-13.

144. *Id.* at 213.

145. *Id.* at 211.

146. *Id.* at 223-24.

147. *Id.* at 229.

Although ATM routing rules have been the subject of considerable controversy, there has been only one case, *BayBanks, Inc. v. New England Network, Inc.*,¹⁴⁸ in which a network routing rule was challenged on antitrust grounds. In that case, BayBanks, the operator of the XPress 24 network in Massachusetts, sued the Yankee 24 network and a number of New England banks that were instrumental in organizing the network. In its complaint, BayBanks challenged two proposed practices of the network—a compulsory routing rule that prohibited subswitching among the organizing banks, and a subswitching license fee that Yankee 24 proposed to levy on transactions that could have been routed to the Yankee 24 switch, but were instead routed to an alternate network.¹⁴⁹ In March 1988, the parties agreed to settle the case.¹⁵⁰ Accordingly, the important antitrust issues raised by the *BayBanks* complaint were never resolved.

B. Antitrust Analysis of Compulsory Routing Rules

As *Rothery* and *AFS* indicate, it is unlikely that a network-imposed compulsory routing rule would be condemned as *per se* unlawful. Instead, such a rule would be examined under the rule of reason, and its legality would rest primarily on two factors: (1) whether the network imposing the rule has market power; and (2) whether the network is able to demonstrate that the rule has the purpose and effect of eliminating free-riding on the network's logo, promotional efforts or other services, or serves other equally legitimate procompetitive goals.¹⁵¹

A finding of market power¹⁵² will be critical to finding a

148. No. 86-3532-K (D. Mass. filed Dec. 9, 1986).

149. *Id.*

150. See *New England's Antitrust Resolution: Yankee 24 Drops Its Subswitch Fee*, BANK NETWORK NEWS, Apr. 9, 1988, at 6. For a more detailed discussion of this case, see D. Goldstein, *The New England Network/Yankee Litigation in Consumer Financial Services Survey: Electronic Funds Transfer*, 44 BUS. LAW. 1130 (May 1989).

151. In addition, the network could argue that its routing rules are not a horizontal group boycott, but rather are vertical distribution arrangements between the network and its members. As noted above, this argument was persuasive in the *AFS* case. *AFS*, 633 F. Supp. at 218; see also *Chicago Professional Sports L.P. v. NBA*, 961 F.2d 667, 671-72 (8th Cir.) (suggesting that in certain cases a joint venture should be treated as a single entity), *cert. denied*, 113 S. Ct. 409 (1992).

152. In the routing context, the market power inquiry will focus primarily on the existence of alternative networks and routing arrangements. As the *AFS* court noted, however, "[m]arket power' is usually a very difficult concept to define," *AFS*, 633 F.

routing rule unlawful. The existence of market power is important because a court could reason that a network with market power might use a compulsory routing rule to foreclose the development of alternative networks or bypass arrangements, which could offer cardholders better service or prices. On the other hand, if the network imposing the rule does not have market power, it is questionable whether the routing rule can have any significant anticompetitive effect. It is in part for this reason that a compulsory routing rule limited to a network's start-up phase may be justifiable as a necessary means to ensure a steady revenue stream in the early, most vulnerable stages of the network's existence.¹⁵³ However, after the network is firmly established, an "infant industry defense" will not be available, and a routing rule should receive more careful antitrust scrutiny.

Aside from the market power inquiry, the key factor in most cases will be the network's ability to justify its routing rule.¹⁵⁴ As indicated by the decisions in *AFS* and *Rothery*, one important justification may be to prevent other networks (both branded and unbranded) from free-riding on the network's logo and promotional efforts. Depending on the type of routing rule adopted, however, it may be difficult to demonstrate with sufficient certainty (1) that free-riding is in fact occurring, and (2) that the challenged rule is intended to eliminate it. In *AFS*, there was no doubt that *AFS* was free-riding on the promotional efforts of *FTD* and *Teleflora* because the *customer* indicated when making the purchase which catalog item was intended to be purchased, and the pirating rules, by their terms, were carefully restricted only to the network's own sale items.¹⁵⁵

Supp. at 221, and, as explained in the pricing context, it is particularly difficult to apply to ATM networks because of the lack of clear precedent and difficulties in measuring market shares. See *supra* notes 113-14 and accompanying text.

153. Cf. *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545, 556-57 (E.D. Pa. 1960) (tie-in justified during development period of a new industry to assure effective functioning of complex equipment), *aff'd*, 365 U.S. 567 (1961).

154. In this regard, a defense based on the notion "that competition itself is unreasonable"—that is, that the network has to mandate compulsory routing to enhance its own income stream at the possible expense of other networks, subnetworks and processors—will not suffice. See *National Soc'y of Professional Engineers v. United States*, 435 U.S. 679, 693-96 (1978) (rule of reason did not support defense that "competition itself [was] unreasonable" as justification for ban on competitive bidding).

155. 633 F. Supp. at 206.

Unfortunately, however, the facts often may not be as clear in the ATM network setting.

For example, assume that National Network A imposed a routing rule that required its members to route all transactions to Network A. Bank X is a member of National Network A and a competing regional network, Network B. Bank X has labeled its ATMs with the logos of both networks, and its cards also bear both logos. When a customer of Bank X conducts a transaction at the ATM of Bank Y, which is a member of the same two networks as Bank X, there is no way of knowing which network "brought" the customer to the ATM. Moreover, unlike the situation in *AFS*, the *customer* does not choose the network through which the transaction will be routed; the compulsory routing rule of Network A requires the transaction to be routed to Network A, despite the fact that the customer may have been attracted to the ATM by Network B's logo. In short, where a network seeks to enforce a compulsory routing rule against another branded network (especially where the logo of that network also appears on the customer's card and at the ATM), it may be hard put to demonstrate a free-riding justification for its rule. Conversely, where a branded network seeks to impose a compulsory routing rule against a non-branded network or third-party processor, or where the other network's logo does not appear on the ATM, the free-riding justification is likely to be more persuasive.

Moreover, the antitrust risks associated with a mandatory routing rule can be mitigated by making the rule presumptive. The fact that there are alternatives to a collectively imposed restraint is vitally important to the antitrust analysis.¹⁵⁶ For example, the *AFS* court upheld the "pirate order rule" in part because it permitted the sending florist to suggest alternatives and override the rule if requested by the customer.¹⁵⁷ Thus, even a routing rule that required network members to route all transactions to the network *unless* pairs of individual members entered into separate agreements for routing their transactions to another network should be far less vulnerable to successful

156. See *Buffalo Broadcasting Co. v. ASCAP*, 744 F.2d 917, 924-28 (2d Cir. 1984) (whether there is a restraint of trade depends on whether the joint venture offers a realistic alternative), *cert. denied*, 469 U.S. 1211 (1985).

157. 633 F. Supp. at 207.

antitrust challenge than a “pure” compulsory routing rule imposed by a joint venture network.

C. *Alternatives to Mandatory Routing Rules*

For the reasons discussed above, compulsory network routing rules may well be vulnerable to antitrust challenge. There are, however, alternatives which pose far less antitrust risk, including (i) card-issuer determined routing, (ii) no higher-cost routing, and (iii) a subswitch license fee.

1. *Card-Issuer Determined Routing Rule*

As an alternative to compulsory routing rules, some networks are considering (or have already adopted) rules that permit the card-issuer to dictate routing.¹⁵⁸ Card-issuer routing has been especially controversial in Texas since Affiliated Computer Systems (ACS), a large third-party processor, decided to route transactions it acquired on behalf of certain PULSE member banks to CIRRUS rather than to PULSE.¹⁵⁹ As a result, PULSE card-issuers were charged higher fees for transactions conducted by their customers at the ATMs “driven” by ACS, and the routing was more circuitous than transactions routed to PULSE. In response, PULSE considered adopting a card-issuer routing rule but decided against this because of concerns about the network’s enforcement ability. Moreover, ACS had threatened to challenge such a rule on antitrust grounds. The controversy eventually led to a card-issuer routing bill introduced in the state legislature in 1991.¹⁶⁰ The legislation, which did not pass, would have permitted all Texas card-issuing institutions to determine the routing for their cardholder transactions.¹⁶¹

158. See, e.g., *Yankee 24 Drafts an Issuer Routing Rule*, BANK NETWORK NEWS, Mar. 23, 1991, at 7.

159. See *A Texas Battle Looms Over ATM Routing*, BANK NETWORK NEWS, Jan. 11, 1992, at 1.

160. See *Texas ATM Routing Takes a Legislative Twist*, BANK NETWORK NEWS, Apr. 26, 1991, at 5.

161. *Id.* The legislation provided that each card-issuing institution would notify each ATM owner of either its “preferred ATM network” or “order of preference among ATM networks” for routing of transactions. Any card-issuer and ATM owner would have been permitted to enter into separate routing agreements. The legislation provided for a civil penalty of \$500 per day for intentional violation of the statute and enforcement by the Texas attorney general or private suit. See S.B. 525, § 2 (to amend TEX. REV. CIV. STAT. ANN. art. 342-901). The effort to control routing by

Card-issuer routing is less risky than a compulsory routing rule. Unlike a compulsory routing rule, it is difficult to perceive how a card-issuer routing rule could be labeled a group boycott. While such a rule could conceivably be challenged as a horizontal restraint on interchange fee competition among networks based on the same type of card-issuer or “buyers’ cartel” theory advanced by First Texas in the *Financial Interchange* arbitration,¹⁶² such a theory would depend in part on establishing significant disparity between “net purchasers” and “net acquirers,” which is unlikely to be the case in most network settings. Moreover, since the focus of the antitrust laws is on maximizing consumer welfare and economic efficiency, the effect of a card-issuer routing rule would arguably be procompetitive, since it shifts the decision-making from the acquirer, who has an incentive to route the transaction through the *highest cost* network, to the card-issuing member, which has an interest in “buying” transactions at the *lowest cost*. Indeed, a private challenge to a card-issuer routing rule might well be dismissed on the ground that the plaintiff had suffered no “antitrust injury.”

2. *No Higher-Cost Routing Rule*

A second alternative is a rule barring higher-cost routing by ATM owners seeking higher interchange fees. Such a rule would require that a network transaction not be processed by any routing that would be more expensive to the card-issuer than the network’s routing—i.e., the network’s total switch and interchange fees would act as a ceiling. This alternative would also be less vulnerable to successful antitrust challenge than would a compulsory routing rule.

statute is not unprecedented. Iowa’s EFT law requires central routing of transactions by the network switch with direct links to all of the intercept processors in Iowa. See IOWA CODE § 527.9.2.f (1991). This law was challenged unsuccessfully by a competing out-of-state network in Iowa state court. See *NetWorks Loses Round Two in its Iowa EFT Bout*, BANK NETWORK NEWS, Aug. 10, 1991, at 3. In one respect, resolving routing disputes through legislation may be attractive. State legislative action could immunize ATM networks and their financial institution members from antitrust liability under the “state action” doctrine assuming the legislation is drafted carefully to satisfy the requirements of that exemption. See *infra* note 171 and accompanying text.

162. See *supra* note 82 and accompanying text.

A “no higher-cost routing” rule would appear to promote economic efficiency and would avoid the “buyers cartel” label. It would permit the acquirer to control routing (so long as the combined switch and interchange fees did not exceed the fees for the network imposing the rule), while at the same time protecting card-issuers and cardholders from an expensive and perverse form of competition. In addition, it could lead to lower prices for consumers by pressuring alternative networks and other “bypassers” to lower costs by performing efficiently. Although such a rule may be objectionable to some on the ground that the lowest price network may not be the “best” network in terms of quality, it is more likely than not that such a rule could pass antitrust muster, even if imposed by a network with market power.

3. *Subswitch License Fee*

A network could also adopt a subswitch license fee as an alternative to a compulsory routing rule. Under this approach, an ATM owner could choose to route transactions through an alternative network, but it would be required to pay a fee to the “bypassed” network for each transaction so routed.

In 1991, the Plus network adopted this alternative.¹⁶³ Reportedly based on concerns about “free-riding” by regional networks, which could divert transactions that otherwise would be routed to Plus through interregional gateways, Plus considered a number of routing rule alternatives. These included a compulsory routing rule that would have required its members to route transactions conducted at their ATMs to the Plus switch if the Plus logo was the only common mark on the card and the ATM, and a licensing fee charged to acquiring members for routing *any transaction* through a switch other than Plus.¹⁶⁴ Ultimately Plus decided to implement a three cent per-

163. See *Its Mulling Over, Plus Chooses a Routing Alternative*, BANK NETWORK NEWS, Aug. 10, 1991, at 3.

164. See *Plus Establishes a Routing Rule*, BANK NETWORK NEWS, Oct. 26, 1990, at 1. The rule created considerable concern among regional networks which reportedly saw it not only as an immediate threat to regional interchange arrangements, but also a more long-term shift to direct competition with the regionals for local transaction activity. The rule reportedly also attracted the attention of the Payment Systems Working Group, a group of state antitrust officials, which monitors EFT issues of potential concern. See *Plus's Routing Rule Faces an EFT Baptism by Fire*, BANK NETWORK NEWS, Nov. 10, 1990, at 1.

transaction subswitch license fee limited to those transactions routed through a regional network gateway where Plus is the only common mark.¹⁶⁵

Generally, such a subswitch license fee will be far less vulnerable to successful antitrust challenge than will a compulsory routing rule. Conceptually it is similar to trademark or franchising licensing fees which usually do not run afoul of the antitrust laws.¹⁶⁶ If the fee can be shown to mitigate the effects of free-riding by a competing network, and it is narrowly tailored to serve that purpose, it should survive antitrust challenge. Certainly such a fee should not be characterized as a "group boycott" (as could a mandatory routing rule) and characterization of it as an unlawful price-fixing agreement would appear to be similarly untenable under Supreme Court precedent.¹⁶⁷ Thus, while it is conceivable that the imposition of a subswitch license fee by a network with market power could be vulnerable to antitrust challenge under certain circumstances (for example, if the subswitch fee were set at such a high level that it essentially foreclosed all alternative routing) such a fee is likely to be far less vulnerable from an antitrust perspective than is a compulsory routing rule.

IV. ANTITRUST UNCERTAINTY AND LEGISLATIVE ALTERNATIVES

As suggested above, the antitrust laws create considerable uncertainty about how far a network and its financial institution members can safely go in: (i) setting (or changing) interchange fees, (ii) banning (or limiting) surcharges, or (iii) dictating routing rules. In part because of this legal uncertainty—and in part because of political deadlock among network bank members—many networks are reportedly reluctant to take any action to reduce interchange fees even though interchange fees, like network membership and switch fees, should arguably be

165. See *Its Mulling Over, Plus Chooses a Routing Alternative*, BANK NETWORK NEWS, Aug. 10, 1991, at 3. In the first year after its enactment the routing rule has not generated significant revenue for Plus. Rather, in order to comply with the "common mark" provision of the rule, a number of banks have added the logos of other regional networks to their ATMs so that Plus is not the only common mark. See *Plus' Routing Rule Produces More Ire Than Volume*, BANK NETWORK NEWS, June 12, 1992, at 6.

166. See generally ABA ANTITRUST SECTION, ANTITRUST LAW DEV. 821-23 (3d ed. 1992).

167. See *Broadcast Music, Inc. v. CBS*, 441 U.S. 1, 19-20 (1979).

declining because of the significant growth in transaction volumes that have occurred over the past decade.¹⁶⁸ Thus, the antitrust uncertainty may be having the perverse effect of discouraging decreases in the interchange fee, which, in turn, may result in higher foreign (consumer) fees.

The antitrust risks faced by networks (and their financial institution members) if they take action on their own may also have the effect of increasingly forcing pricing and pricing-related issues such as routing into the legislative arena.¹⁶⁹ Lobbying by networks or banks, even if done collectively, to obtain passage of legislation on matters such as surcharging should qualify for protection under the *Noerr-Pennington* exemption to the antitrust laws.¹⁷⁰ Moreover, state legislative action could immunize ATM networks and their member financial institutions from antitrust liability under the "state action" doctrine—assuming the legislation is drafted carefully to satisfy the requirements of that exemption.¹⁷¹

In some states, however, legislative action may not be required. A number of states already have EFT statutes which

168. See *Networks Heed a Price Rollback Call*, BANK NETWORK NEWS, Mar. 23, 1991, at 1. The *Financial Interchange* dispute, as noted above, resulted from a network effort to reduce interchange fees.

169. While interchange fees, surcharge prohibitions, and routing rules have, to date, been the subject of only private antitrust challenges, state antitrust officials have also indicated their opposition to collectively-set interchange fees by networks, and their preference for unrestricted, unilateral surcharging. See *Networks Put Brakes on Pricing Free-Fall*, BANK NETWORK NEWS, Mar. 12, 1992, at 4 (reporting that the Payment Systems Working Group, a group of 15 state attorneys general, views the setting of interchange fees by networks to be "collective price-fixing" and that it is 'an issue of concern'); see also *POS Fees Raise Some State Antitrust Eyebrows*, BANK NETWORK NEWS, Jan. 11, 1992, at 1 (reporting Payment Systems Group's investigation of interchange fees of VISA and MasterCard national POS programs).

170. *Noerr-Pennington* provides an exemption from the antitrust laws for group solicitation of governmental action, not only in the legislative arena, but before regulatory agencies and the courts as well. See *United Mine Workers v. Pennington*, 381 U.S. 657 (1965); *Eastern R.R. President's Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961).

171. See, e.g., *Federal Trade Comm'n v. Ticor Title Ins. Co.*, 112 S. Ct. 2169 (1992); *Patrick v. Burget*, 486 U.S. 94, 100 (1988). The "state action" doctrine immunizes from antitrust challenge restraints on competition that are imposed by the state. It covers state-authorized private conduct if two requirements are met. First, "the challenged [private] restraint must be 'one clearly articulated and affirmatively expressed as State policy.'" *California Retail Liquor Dealers v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980) (citations omitted). Second, "the [anticompetitive policy] . . . must be 'actively supervised' by the State itself." *Id.* at 105 (citations omitted).

regulate the terms—including the pricing terms—under which financial institutions are either required or permitted to share their terminals.¹⁷² There is an issue as to whether those state statutes, which contemplate the payment of non-discriminatory, cost-based fees by any *financial institution* sharing another financial institution's terminals, may be construed to prohibit other charges, including surcharges imposed directly on the *consumer*, for shared ATM use. At the very least, in those states with such sharing statutes, those opposed to the imposition of surcharges may already have an avenue of appeal to state banking regulators based on existing state law.¹⁷³

Conversely, financial institutions that want to surcharge despite network prohibitions may find it more expeditious (and less expensive) to take their cases to state legislatures rather than the antitrust courts. At the same time, however, consumer groups have begun to lobby Congress and state legislatures to limit and regulate ATM fees,¹⁷⁴ and it may be that a ban on ATM surcharges will be enacted just as it was with respect to credit card transactions.¹⁷⁵

172. See generally BAKER & BRANDEL, *supra* note 2, app. E, for a summary of these statutes.

173. On the other hand, Regulation E arguably contemplates ATM surcharges. See 12 C.F.R. § 205.9(a) (1992) ("A charge for the transfer may be included in this amount if the terminal is owned or operated by a person other than the financial institution holding the consumer's account, provided the amount of the charge is disclosed on the receipt and on a sign posted on or at the terminal."); see also Official Staff Interpretations, Regulation E, 12 C.F.R. § 205, Supp. II, Ques. 7-15.5 (1992) (card-issuer need not disclose charges imposed by ATM owner in initial disclosure); Ques. 9-31.5 (card-issuer need not separately disclose charges imposed by ATM owner on periodic account statements). Thus, if states enact laws prohibiting ATM surcharges, there may be a further issue as to whether such laws would be deemed preempted by Regulation E. While such state laws would appear to be more protective of consumers, and hence not be preempted, see 12 C.F.R. § 205.12(a), the preemption issue is not entirely free from doubt.

174. In 1991, the state legislatures in Massachusetts, New York and Illinois considered amendments to their banking statutes that would have addressed ATM fees, and other bills were introduced this year. The Ralph Nader led U.S. Public Interest Research Group has reportedly lobbied for Congressional action as well. See *EFT Revenues Prime the Fee Income Pump*, BANK NETWORK NEWS, Sept. 26, 1991, at 5. Moreover, while surcharging first surfaced in the ATM environment, it is increasingly being attempted by merchants in the point-of-sale area as well, which may further increase the likelihood of regulatory intervention. See *West Coast POS Surcharging Practices Raise Concerns About Regulation Growth*, EFT REP., Apr. 15, 1992, at 1.

175. In 1976, Congress enacted legislation, which, among other things, prohibited merchants from imposing surcharges on credit card purchases. See 15 U.S.C. §

CONCLUSION

During the 1980s, joint venture ATM networks developed as self-regulatory enterprises that established certain pricing policies, routing rules, and other competitively-sensitive rules for themselves and their members. Toward the end of the decade, a number of widespread network practices, including fixed interchange fees and surcharge prohibitions, were challenged under the antitrust laws. In the 1990s, disputes on these matters and transaction routing rules are likely to multiply, due in part to the increasing level of internetwork competition and in part to the increasing desire on the part of many ATM-owning network members (and third party processors)¹⁷⁶ to generate profits from their ATMs. At the same time, resolution of these disputes under the antitrust laws is likely to be uncertain, time-consuming and costly. Because of these factors, networks and their financial institution members may find it increasingly attractive to take their competitive disputes to the statehouse, rather than to the courthouse, but this, in turn, may well lead to increased direct governmental regulation of shared ATM networks and the pricing of ATM services.

1666f(a)(2) (1982). The surcharge ban expired on February 27, 1984 (see Cash Discount Act § 201, 95 Stat. 144 (1981)) and was not renewed. Some states also have statutes that prohibit credit card surcharges. *See, e.g.*, CAL. CIV. CODE § 1748.1 (West 1991 Supp.); COLO. REV. STAT. Ann. § 5-3-110 (West 1989); CONN. GEN. STAT. § 42-133ff (West 1987). While beyond the scope of this article, there is an issue as to whether these laws and other state consumer credit protection statutes could similarly impact on the ability of ATM owners to impose surcharges for credit card cash advances obtained at ATMs, and perhaps for certain other transactions with credit features as well.

176. *See, e.g.*, *EDS Plans Its Own Network of 10,000 Teller Machines*, AM. BANKER, Aug. 20, 1992, at 1 (reporting that a major third party processor intends to establish its own large ATM network and is considering participation only in the national networks because of their higher interchange fees); *Non Banks Step Up Their EFT Offensive*, BANK NETWORK NEWS, Sept. 25, 1992, at 1 (reporting that third party processors are increasingly deploying ATMs to garner interchange revenue).

