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Shared ATM Networks— The Antitrust Dimension

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WHERE HAVE ALL THE NETWORKS GONE?

The automated teller machine (ATM) has become an increasingly more important part of the average modern consumer's financial life and for this reason presents an ever-more pressing set of difficult antitrust questions for networks, financial institutions and government decision-makers. Thirty-two years ago, the Supreme Court emphasized in its landmark *Philadelphia National Bank* decision that convenience and location were key to competition in the retail banking sector and ruled that "the fact that banking is a highly regulated industry critical to the Nation's welfare makes the play of competition not less important, but more so."¹ Today ATMs are the key to consumer convenience in banking, and yet it is not at all clear that the Supreme Court's *Philadelphia National Bank* message about the importance of competition has gotten through to the policymakers and courts making decisions about ATM networks.

In the last decade, large and successful ATM networks have been created, and such names as MAC, NYCE, STAR and HONOR have become familiar landmarks in different parts of the country. Meanwhile, the number of ATM network alternatives available in any particular region has continued to decrease.

Why has antitrust policy been such a random—and not particularly construc-

tive—factor as mergers have helped create dominant ATM networks in various regions of the country? Natural monopoly economics? Or just honest uncertainty and indecision? The Board of Governors has told us that "the largest regional networks now account for 80 percent of all regional ATM network transactions in the United States" and used this as a reason for approving another network merger in the Electronic Payments Services, Inc./National City case.²

Meanwhile, Department of Justice (DOJ) officials have influenced the course of events over the years with what they have said, done or—more often—*not* done. They have thus left the field largely to private plaintiffs, the private attorneys general who are necessarily more interested in winning battles than in establishing policies and precedents. It is hard to dig out of the resultant patchwork of DOJ press releases and Business Review Letters, private complaints and a few consent judgments any coherent vision of the modern ATM network as a competitor or of the markets in which networks operate. Probably the most serious effort at illumination was entirely private: Former U.S. Assistant Attorney General Thomas E. Kauper's long opinion, as a private arbitrator in the 1988 *First Texas/Pulse* arbitration.³

DOJ has not been a factor in the network merger area. Its most instructive enforcement effort—its 1994 complaint, consent decree and competitive impact statement in *United States v. Electronic Payments Services, Inc.*—dealt with the consequences (rather than the creation) of monopoly power.⁴ It was DOJ's first antitrust enforcement action in the electronic funds transfer (EFT) sector in 17 years. Significantly, DOJ's complaint asserts that *branded ATM network access* is a relevant market and recognizes that ATM networks may enjoy substantial market power on a regional basis. (The DOJ

¹ *United States v. Philadelphia National Bank* in 374 United States Reports (U.S.) 321 (United States Supreme Court, 1963).

² *Banc One Corporation, et al.*, March 6, 1995, p.17 (the *EPS/National City* opinion). See also *Banc One Corp., Federal Reserve Bulletin*, vol. 81 (1995), pp.491-2. I have a client who is very interested in this proceeding. The views expressed here, however, are my own.

³ *First Texas Assn./Financial Interchange in 55 Antitrust & Trade Regulation Report* 340 (1988). Professor Kauper wrote that opinion because the parties had agreed that he would do so as part of their arbitration agreement. (I was lead counsel for Pulse in that unique proceeding.)

⁴ *United States v. Electronic Payments Services, Inc.*, No. 94-208 [U.S. District Court for the District of Delaware Apr. 21, 1994] 59 Federal Register (Fed. Reg.) 24711 (May 12, 1994).

consent decree enjoins one MAC network practice—concerning ATM driving—but leaves other restraints in place.)

By chance, the Federal Reserve System's most illuminating effort also involves the same ATM network—EPS or MAC—but the Board's extensive effort also turned out to be rather timid on both structural and conduct issues. On March 1, 1995, the Board of Governors announced that it was allowing a major expansion of this already dominant Pennsylvania network by allowing it to include National City Bank of Ohio in the ownership group. In a 28-page statement released five days later, the Board rejected the objection of a competing ATM network to "undue concentration of resources" with a statement that "the Board believes that, as a result of economic and market conditions, regions are likely to have one dominant ATM network."⁵ At the same time, as Vice Chairman Alan Blinder's dissent made clear, the Board declined to follow up on the perceptive sets of questions concerning allegedly anticompetitive network rules that the Board staff had presented during its investigation. The Board seemed to take comfort from DOJ's prior inaction on some subjects in its consent decree proceeding.⁶

As observers and students, we can all be grateful to the MAC network for having been such a patron of antitrust learning in the ATM field. As critics and consumers, we may come away with some doubts about how well government agencies have done in meeting the challenge.

In sum, those sporadic government activities—plus a few private cases challenging leading ATM networks' pricing practices and operating rules—cannot be said to have added up to the kind of comprehensible body of law that *Philadelphia National Bank* spawned in the bank merger area. It simply has proved difficult for the Fed, DOJ and the courts to come to grips with the market realities and the competitive effects of these new and important financial enterprises—branded ATM networks. Like the federal budget deficit, this accumulated learning deficit may pose

larger burdens on the next generation of consumers and regulators: the real competitive issues are not likely to go away, even if we end up with largely an antitrust regime of rule making for regulated monopoly.

NETWORK REALITIES: JOINT PRODUCTS, DIVERSE INTERESTS

Creation of any new network requires a great deal of cooperation among the proposed members. An ATM network is necessarily the reciprocal commitment by participants to issue cards, deploy machines, honor each others' cards at their machines and settle the resulting transactions.

A new network needs access to facilities for switching transactions among members, rules governing the terms and conditions on which members will honor each others' transactions and a recognizable trademark that will tell consumers where network services are available. The switching facilities may be (and often are) provided by a third-party processor under contract, whereas the rules and trademark may be created with extensive help from experienced professional advisors. Even so, somebody—presumably the investors and users—must work through a whole series of difficult business decisions to turn the network idea into an effective operational network.

The main reason for a depository institution to create or participate in such a network is competitive advantage—or at least the fear of being left behind in the changing payments marketplace. Different potential participants may have quite different visions of what they want a network to do for them. An aggressive growing bank may want a quite differentiated network offering its customers something not available from its sleepy competitors across the street or in the next town. Meanwhile, the competitor may want the opposite: a *universal or least-common denominator* network that guarantees the proverbial level playing field and ensures that nobody is left

⁵ See *EPS/National City* opinion, p. 17.

⁶ See *EPS/National City* opinion, p. 14.

behind in the new world of ATM-based banking convenience.⁷ Thus there is a great deal of room for business and competitive disputes over what the network should have its members do, what it should do, and what it was going to charge members for doing it.

ANTITRUST REALITIES

A shared ATM network requires collective action involving competitors. This can be in the form of: (1) a joint venture of participating institutions or (2) a series of contracts between a single system operator and the other participants in its network. Either way, the network arrangements fall within the "contract, combination, or conspiracy . . . in restraint of trade" rubric of section 1 of the Sherman Act.⁸ Therefore, disputes among members of a network over business questions that in any way relate to competition can be framed as antitrust cases. Because the Clayton Act automatically awards treble damages, disputes are very likely to end up as antitrust cases, especially when the plaintiff's hand is strengthened by being able to show that the defendant is a regionally dominant network or controls such a network.⁹ Effective network planning and antitrust counseling becomes ever more essential as regional ATM markets become more monopolistic.

The treatment of joint ventures has been one of the most confusing areas of antitrust jurisprudence in the United States, as well as in many foreign countries. Agreements among direct horizontal competitors have been treated severely under antitrust law and, where they involved pricing restraints or customer allocations, could be labeled cartels. Meanwhile, full integration by merger has generally been analyzed under market structure standards in which results depended primarily on the nature of the market and the parties' share of it. Joint ventures have historically—but unevenly—been subjected to cartel rules.¹⁰ The modern trend, however, has been to look at joint

ventures that created something new under merger rules or under the fact-based rule of reason theory.¹¹ Market power (rather than form) is critical to such an inquiry.

This conclusion is not so confusing as it might seem at first blush. Today, it is possible to say both that: (1) under modern antitrust rules, it is likely that creation of a joint venture and corresponding rules will be looked at in a context that includes evaluation of market power and relevant market, and (2) we have very little idea precisely what definition of a relevant market will be used to evaluate the competitive effect of an ATM network merger or of a rule imposed by a major ATM network. A narrow market definition, of course, may produce high market shares (and even an inference of monopoly power), whereas a broad market definition may make all activity appear benign.

DEFINING MARKETS FOR NETWORK SERVICES

Commentators, regulators, enforcers and the courts have not developed any consistent way of defining markets for ATM networks, or indeed for networks generally. They have not really figured out how to factor the brand element into the analysis of the relevant market for ATM networks. The presence of a brand would seem to make an ATM network very different from a joint venture pipeline or electric power pool (but not necessarily from a long distance telephone network or a credit card network). Both DOJ and the Fed have finally seemed to recognize this difference.

Recognizing the differences between brand and nonbrand markets is not just a matter of intellectual curiosity. Determination of the relevant market is often critical in antitrust litigation. The plaintiff tries to strengthen the claim that the defendant has market power or the ability to increase prices above the competitive level. The defendant argues that the market is almost

⁷ In more than 20 states, smaller banks have successfully led populist political campaigns to mandate universality solutions by passing compulsory sharing legislation that requires each bank to share its ATM facilities with every other bank on equal, or nondiscriminatory terms. See Baker and Brandel (1995) ¶ 25.03 [4] [a].

⁸ 15 United States Code (U.S.C.) § 1.

⁹ 15 U.S.C. § 15.

¹⁰ See, for example, *United States v. Topco Assocs.*, 405 U.S. 596 (1972); *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) (territorial and price restraints); *United States v. Columbia Pictures Indus.*, 507 Federal Supplement (F. Supp.) 412, 430 [U.S. District Court for the Southern District of New York (S.D.N.Y.) 1980, affirmed in a memorandum decision (aff'd mem.) 659 Federal Reporter 2d Series (F.2d) 1063 U.S. Court of Appeals for the Second Circuit (2d Cir.) 1981].

¹¹ See generally, Chapter 21 "Special Antitrust Problems of Joint Ventures" in Baker and Brandel (1988), discussing especially *Broadcast Music, Inc. v. CBS*, 441 U.S. 79 (1979) and *NCAA v. Board of Regents*, 468 U.S. 85 (1984).

¹² See, for example, *CB&T Bancshares, Inc.* (1984), *Atlantic Bancorporation* (1983), cf. *Center Bancorporation* (1983) (the provision to unaffiliated financial institutions of data processing services, particularly the operation of an ATM network exchange), *Interstate Financial Corp.* (1983) (same).

¹³ See, for example, *Citicorp* (1986) (provision of ATM services), *Sovran Financial Corp.* (1986) (same), *Barclays Bank PLC* (1985) (competition in the provision of ATM or POS services).

¹⁴ 682 F. Supp. 269 (U.S. District Court for the District of New Jersey (D.N.J.), aff'd mem., 853 F.2d 921 (3d Cir. 1988).

¹⁵ *Id.* at 279 (emphasis in original).

¹⁶ 59 Fed. Reg. 24713 (May 12, 1994). Similarly, in the *PULSE* arbitration, Professor Kauper rejected proposed markets of all payment systems and all means of obtaining cash, and instead identified a narrow retail market of ATM services on the grounds "that there is a significant group of ATM users who value the characteristics of ATMs and for whom other means of obtaining cash are not reasonable substitutes." He thus concluded that "ATMs are themselves a relevant, if fragile, market for antitrust purposes." 55 Trade Reg. Rep. (BNA) No. 1380, at 356.

¹⁷ 59 Fed. Reg. 24712 (May 12, 1994). In *PULSE*, Professor Kauper identified a wholesale market of network switching, and concluded that *PULSE* had market power because "existing subnetworks, regional networks and national networks do not presently provide a reasonable substitute for the [switching] service *PULSE* provides to its members." *Id.* at 355. Other regional networks were found to be only potential alternatives for Texas ATM owners and substantial barriers (including the national networks' antiduality membership rules, the preference by banks for local networks and the fact that *PULSE* was very efficient and well established) were said

boundless. The relevant market typically is determined on the basis of a factual inquiry into the practical alternatives available to customers—which in the ATM network business can mean either institutions or their depositors.

The decisions on relevant ATM network markets have been all over the board. In its early orders approving bank holding companies' acquisitions of voting stock in shared EFT networks, the Federal Reserve Board typically defined the relevant market as the provision of data processing services to unaffiliated financial institutions.¹² By the mid-1980s, however, it began to define the markets with reference to consumer payment networks (but it never found a case in which a merger would create market power).¹³ Similarly, in *The Treasurer, Inc. v. Philadelphia National Bank*, the District Court adopted a broad definition of the relevant product market in rejecting a private challenge to the acquisition of the Mellon Cashstream network by the owner and operator of the then proprietary MAC network.¹⁴ The court defined the relevant product market 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."¹⁵

Recently, the market definition issue has become more focused—thanks to DOJ, the Fed and the MAC network. In its *EPS* complaint, the Antitrust Division of the DOJ defined two relevant markets. The first was a market of regional branded ATM access, based on the needs of banks to provide their depositors "ubiquitous access to their accounts." It observed the following:

While a bank can deploy its own ATMs, the advantage to a shared ATM network is that a bank's depositors will be able to use ATMs at many more locations than one bank alone could practicably support. The areas a bank seeks to serve through a shared ATM network

include the areas in which its depositors live, work and sleep, and the broader areas in which they move regularly. A bank's ability to offer its depositors access to other banks' ATMs, and thereby to offer its depositors convenient access to their accounts, is in most bankers' view necessary to attract and retain deposits. . . . Because no other service constitutes a reasonably close substitute for regional ATM network access, regional ATM networks constitutes a product market."¹⁶

The DOJ's second market was ATM processing, which involved "providing the data processing services and telecommunications facilities and services used" in providing regional ATM access.¹⁷

The Board revisited the market definition question in its recent *EPS/National City* decision:

The Board notes that ATM networks have been recognized as encompassing separate product markets On the basis of these considerations and all the other facts of record, the Board concludes that network access, network services, and ATM processing constitute the relevant product markets for evaluating the competitive effects of this proposal."¹⁸

On the question of geographic market, the Board pointed to a Federal Reserve staff study that "suggests that the geographic market for network access is an area significantly larger than local banking markets."¹⁹ The Board then added that "the markets for network services and ATM processing are at least regional."²⁰

Ultimately, how a fact finder analyzes the relevant product market in cases involving bank networks depends in part on how much weight is accorded to the value of the network trademark. If one looks only to the data processing function of shared ATM networks, it may be plausible to conclude, as the Board of Governors has

in the past, that the data processing industry is unconcentrated, that entry barriers are low, and that there are numerous alternatives available to financial institutions that want to do their own data processing and that a network—even a dominant regional network—does not have market power. On the other hand, if the ATM network is viewed as the purveyor of a unique branded product marketed under the network logo, the fact finder should probably reach very different conclusions about the product market.

There have been very few new entries into the *branded ATM network* market anywhere in the country. It requires a critical mass of cards and ATMs. Participating institutions have a lot of reasons to be concerned about having to switch from one network to another—in part because it would involve reissuing cards, reassigning ATMs and, perhaps more important, reeducating customers.

Market analysis has been further complicated because networks are clearly subject to economies of both scope and scale. Indeed, DOJ noted the economies of ubiquity in analyzing ATM network arrangements back in the mid-1980s—a time when it was not particularly active as an antitrust enforcer.²¹

Continuing uncertainty as to what market concepts should be used to evaluate ATM network arrangements has no doubt caused government decisionmakers to be cautious about taking structural antitrust action in the ATM network area, while causing ATM networks to be cautious about accepting the risks of private litigation. Both effects have contributed to the regional monopolies that we have seen emerge in some key areas. Let us turn to that subject.

MARKET STRUCTURE ISSUES—THE ROAD TO REGIONAL MONOPOLY

Many ATM networks were started by those who sought competitive advantage for themselves over local competitors or out-of-state institutions that could become

increasingly competitive from the distance in the plastic and electronics mode. Despite this competitive advantage impetus in the early stages, network consolidation has turned out to be the trend. Two factors have led to this trend: (1) lack of government antitrust enforcement of ATM network mergers; and (2) *de facto* network mergers brought about by the ability of some banks to use antitrust boycott claims to force entry into competing networks and thereby defeat network exclusivity.

Mergers. Since the mid-1980s there has been tremendous consolidation among ATM networks. For a generation, DOJ and the Board of Governors have allowed every ATM network merger they reviewed, even when the result was a regional monopoly.²² The most striking example was the 1988 MAC-Cashstream acquisition (in which Philadelphia National Bank acquired Mellon's branded ATM network). These two networks together controlled virtually all the branded ATMs in Pennsylvania, where they competed vigorously for members and transactions. Their merger was challenged—unsuccessfully—by a third network, the acquisition of which (by MAC) eliminated most competition in southern New Jersey.²³ The DOJ had declined to act, and the Board was not involved in the transaction.

In the 1990s, the Board of Governors has continued to approve major network mergers. An important 1994 example, scrutinized carefully by both the Board and DOJ, was the merger of NYCE and Yankee 24, which competed in parts of New England and were together joined by Citibank's ATM network. In approving the merger, the Board noted that "a number of factors should mitigate the loss of Yankee 24 . . . as an independent competitor."²⁴ In particular, the Board relied on the network's operating rules, which permit (1) third-party processors to participate; (2) members to participate in other networks; (3) card issuers to determine routing; and (4) institutions to participate on a nondiscriminatory basis. Of particular importance may be the card issuer routing rule, which might

to impede competition from the national networks, PLUS and CIRRU. *Id.* at 353-4.

¹⁸ *EPS/National City* opinion, p. 7 (footnotes omitted.)

¹⁹ *Id.* at 8-9.

²⁰ *Id.* at 9.

²¹ Former U.S. Assistant Attorney General Charles F. Rule suggested in 1985 that, in analyzing ATM network consolidation, the antitrust division focused more on the economies of ubiquity and the resulting consumer benefits achievable by widespread sharing of ATMs, and he indicated that the division would not challenge shared ATM networks based on size alone. See Charles F. Rule, "Antitrust Analysis of Joint Ventures in the Banking Industry — Evaluating Shared ATMs," Remarks Before the Federal Bar Association and American Association (May 23, 1985), reprinted in Baker and Brandel (2d. ed. 1988), at A-139.

²² Balto, "Payments Systems and Antitrust: Can the Opportunities for Network Competition be Recognized?" speech before the D.C. Bar Association, January 25, 1995.

²³ *The Treasurer, Inc. v. Philadelphia National Bank*, 682 F. Supp. 269 (U.S. District Court for the District of New Jersey 1988), *aff'd mem.*, 853 F.2d 921 (3d Cir. 1988). The court dismissed the suit on the grounds that the plaintiff had suffered no antitrust injury as required under sections 4 and 16 of the Clayton Act and hence lacked standing to sue.

²⁴ Decision of Oct. 3, 1994, at 8.

permit banks to choose lower cost networks if the merged network attempted to raise prices.

Then, in the even more recent *EPS/National City* order, the Board seems to abandon regional network competition as an important factor, even where the network rules were open to more serious competitive questions. In this decision, the Board said:

It has been recognized that MAC has a significant position in ATM network access services in certain states in the Mideast region. However, the significant position of a regional ATM network is not, standing alone, contrary to the public interest. Network externalities, such as the economies of ubiquity, tend to promote consolidation of regional ATM networks. As a result, in various geographic areas, like the Mideast region, dominant ATM networks have been emerging throughout the EFT industry. One recent study indicates that the ten largest regional networks now account for 80 percent of all regional ATM network transactions in the United States. In this light, the Board believes that, as a result of economic and market structure conditions, regions are likely to have one dominant ATM network.²⁵

Inaction by the DOJ and the regulators appears to have been driven by two factors: (1) recurring doubts over whether *branded network service* is, in fact, a relevant market; and (2) uncertainty about the economics of ubiquity—which loosely translated means, the more coverage the better. Under this concept, a merger between ATM systems seemed procompetitive because it increased the number of cardholders and ATMs in a network, improving accessibility for consumers. They do so at the price of eliminating competition for institutions that issue cards and deploy ATMs and creating a risk of monopoly pricing and market cornering.

In many regions, all this merger activity

leaves only the national ATM networks (PLUS and CIRRUS) as possible challengers to regionally dominant networks. Although the national networks offer a degree of coverage comparable to a dominant regional network, they depend for coverage on the same regional leaders which control the regional network and hence may be unlikely to be seen as vigorous competitive alternatives. The competitive impact statement in the *EPS/National City* case noted that national ATM networks are “by design networks of the last resort.”

De facto Mergers Resulting From Boycott Claims

Threats of private litigation based on “boycott” theories have also tended to reduce the differentiation of ATM networks. A member of one network may attempt to join a competing network, perhaps to gain some sort of competitive advantage. If it and others are admitted, the result may be a *de facto* merger between the two networks and a concomitant loss of inter-system competition. Because the antitrust standards have never been very clear and private litigation possess the threat of treble damages, these cases usually end up with the admission of the complaining nonmember—followed by similarly situated competitors.

This reality is well illustrated by what happened in Texas in 1982—when DOJ deferred action based on uncertainty. At the time, there were two separate, very competitive ATM networks in Texas: PULSE and MPACT. PULSE was a nonprofit joint venture and MPACT was a shared propriety network owned by Mercantile Texas Corporation. A large thrift institution, First Texas Savings and Loan Association, was an MPACT member and wanted to join PULSE, which had an exclusive membership rule. PULSE resisted this, and counsel for the parties eventually agreed that the issues would be resolved through the DOJ business review procedure, rather than litigation. PULSE asked whether the division would take enforcement action if it: (1) admitted as a

²⁵ *EPS/National City* opinion, at 17 (footnotes omitted).

²⁶ See Baxter, Cootner and Scott (1977).

member First Texas; (2) generally admitted members of competing networks; or (3) barred its members from participating in a competing network such as MPACT. U.S. Assistant Attorney General William F. Baxter, a leading author in the field, answered only the first question.²⁶ He said that the incremental consumer convenience that would result from admitting the savings and loan association appeared to outweigh the restraint on rivalry that might occur between the two competing networks.²⁷ The other two questions were not answered because DOJ did not consider them ripe for review. Thereafter, PULSE admitted virtually all the depository institutions in Texas, and DOJ did not do anything about it. Thus PULSE became the universal network in Texas, and MPACT became a substantial competitive participant in it.

Similarly in 1986, BayBanks, at the time operator of one of the largest proprietary ATM networks in the United States, sued Yankee 24, a new joint venture ATM network, when it was denied access to Yankee 24.²⁸ At the time, competition between the established BayBanks and the nascent shared network was very active. Yankee 24 offered an aggressive pricing structure to attract banks, and both networks offered low fees to consumers to attract accounts. The parties settled; BayBanks was admitted, and Yankee 24 eliminated its incentive pricing structure.²⁹

The recent, high-visibility *Dean Witter/Visa* decision by the 10th U.S. Circuit Court of Appeals may provide much needed guidance in this area.³⁰ The case involved a boycott challenge to a Visa bylaw that denied membership to any institution that issues Discover cards, American Express cards "or any other card deemed competitive by the Board of Directors." After long pretrial sparring, the case went to trial in fall 1992 and the plaintiff prevailed before the jury. In September 1994, the appellate court reversed because it determined that Visa lacked market power in a properly defined market (in which Visa was treated as separate from MasterCard) and because

the Visa rule promoted intersystem competition in card issuance. If followed, this decision should reduce the likelihood that a competitor can use the threat of a boycott claim to reduce the ability of competing networks to differentiate themselves. This message may be a little late in the branded ATM network markets where only one alternative exists.

EMERGENCE OF MONOPOLY NETWORKS PRODUCES A BIGGER REGULATORY ROLE FOR ANTITRUST ENFORCERS AND COURTS

Modern antitrust analysis of joint ventures since *Broadcast Music* has tended to turn very heavily on market power considerations under the rule of reason.³¹ In simplest terms, this means that a small network without market power should be able to do things that a big network with market power would be prohibited from doing. The message has great practical importance as fewer and fewer ATM networks are becoming ever more dominant in their regional markets.

The message was reemphasized last year when, after more than a generation of silence, the antitrust division reentered the *EFT network enforcement* market with a suit against the largest ATM network in the United States—MAC, operated by EPS.³² Originally started by Philadelphia National Bank (the most famous antitrust defendant in the financial sector), EPS had become a joint venture of four leading Pennsylvania and Ohio bank holding companies. It had approximately a 90 percent market share in Pennsylvania and a strong position in adjacent mid-Atlantic states (as a result, in part, of prior mergers that DOJ had not challenged). The DOJ complaint alleged that EPS barred banks that belonged to its network from buying data processing service from third parties and used its control over ATM processing to prevent member banks from connecting with competing networks. It alleged violations under both sections 1 and 2 of the Sherman

²⁶ See also letter from William F. Baxter, assistant attorney general, antitrust division, to Donald I. Baker (Aug. 3, 1983), discussed in Baker and Brandel (1995) ¶ 24.06 [3].

²⁷ See *BayBanks, Inc. v. New England Network, Inc.*, No. 86-3532-K (U.S. District court for the District of Massachusetts) filed Dec. 9, 1986). I was one of the defendants' attorneys in this proceeding.

²⁸ Similar access issues have been raised by nonbank banks such as Merrill-Lynch, American Express and Sears, seeking access to ATM networks. These cases were settled with the admission of the nonbank banks to the network. See *Household Bank, F.S.B. v. Cirrus System, Inc.*, No. 87C2353 [filed U.S. District Court for the Northern District of Illinois, Mar. 2, 1987]; *Household Bank, F.S.B. v. Money Station, Inc.*, No. C-2-88-0274 [filed U.S. District Court for the Southern District of Ohio, Mar. 2, 1988].

In 1993, BuyPass Corp., the owner of the MAC ATM network, sued the NYCE ATM network seeking access for its processing subsidiary. The case was settled with an agreement that both MAC and NYCE could act as a third-party processor in each other's network. See *BuyPass Corp. v. New York Switch Corp.*, No. 93-CV-3201 [U.S. District Court for the Eastern District of Pennsylvania filed June 15, 1993].

²⁹ *SCFC ILC, Inc. v. VISA U.S.A.*, 36 F.3d 958 (10th Cir. 1994).

³⁰ *Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979).

³¹ *United States v. Electronic Payments Services, Inc.*, No. 94-208 (D. Del. Apr. 2),

Act. The tying violation alleged that regional ATM network access and ATM processing were separate products and that MAC's rules and practices effectively forced its customers to purchase ATM processing from EPS. The monopolization claim alleged that EPS "willfully has maintained its monopoly power in the market for regional ATM network access in the affected states through exclusionary practices."

The consent decree required EPS to open its network to independent ATM processors on a nondiscriminatory basis. EPS was permitted to provide volume discounts for processing, but these must be provided on a nondiscriminatory basis. EPS was also required to sell its network services "at prices that will not vary with the processor selected" and to provide a more open environment for third-party processors.

The ATM driving rule was only one of a series of EPS rules that seemed to be clear restraints on competition both by third-party processors and other networks, including the national networks. The parallel of the challenged rule to the Supreme Court's decision in *Eastman Kodak v. Image Technical Services, Inc.* is obvious.³³ There Kodak tied equipment servicing to its sales of new equipment but provided an exception for those who did self-servicing internally. The Supreme Court sustained the plaintiffs' tie-in claim against the defendants' summary judgment motion. Thus what we see in *EPS/National City* is DOJ singling out one particular restraint and securing its elimination by consent decree in the context of substantial monopoly power in the branded ATM network access market that the government alleged.

One can anticipate more of this type of litigation from the DOJ, private parties and probably the state attorneys general. Any dominant network rule that discriminates against a particular class of market participants (for example, third-party data processors) is an obvious target, as are price discriminations and restraints by a monopoly network on participants using

competitive networks. All of these would seem to be classic actions of the types punishable under sections 1 and 2 of the Sherman Act when undertaken by a dominant firm.

Major Antitrust Conflicts Among Networks

The potential for conflict between (1) a dominant network; and (2) network participants, network competitors, network users or government enforcers falls into a variety of categories. They include the following:

1. interchange fees and routing rules;
2. direct customer charge on network transactions, acquirer surcharges and issuer foreign fees;
3. routing rules;
4. switch fees in for-profit networks;
5. trademark usage rules and fees;
6. processing rules (including those related to third-party processors);
7. use of nonbank cards and ATMs on a network; and
8. scope of network services.

Let us look at each of these in turn.

Interchange fees. ATM networks, like other payment systems, have traditionally provided an interchange fee set by the network to encourage activities that the network believes need subsidizing. In an ATM network, the interchange fee is paid by the card issuer to the ATM owner. Otherwise the ATM owner has no incentive to allow a foreign card in its machine, and the card issuer has no guaranteed outlet for its cards. Stated more generally, the ATM network interchange fee is designed to encourage acquirers to commit their ATMs to the network. ATM network interchange fees have been challenged at least once by a private antitrust plaintiff in the 1988 *First Texas-PULSE* arbitration as horizontal price fixing or a card issuers' cartel. The arbitrator, however, held that the fee was not illegal as long as the individual ATM

1994), 59 Fed. Reg. 24711 (May 12, 1994).

³³ 504 U.S. 451 (1992).

³⁴ *First Texas Savings Assn./Financial Interchange, Inc.*, 55 Antitrust & Trade Reg. Rep. 340 (1988) (Thomas E. Kauper, arbitrator).

³⁵ *Valley Bank of Nevada v. Plus Systems, Inc.*, 749 F. Supp. 223 (U.S. District Court for the District of Nevada (D. Nev.) 1989) affirmed 914 F.2d 1186 (9th Cir. 1990) (Commerce Clause litigation).

³⁶ *Southtrust Corporation v. PLUS System*, CV-93-P-2291-S (U.S. District Court for the Northern District of Alabama 1994).

owner was free to levy surcharges or offer rebates.³⁴

Regulating direct customer charges for network transactions—ATM surcharges and issuer fees. Any ATM network has a legitimate (but not necessarily unlimited) interest when participants levy any transaction fees that may substantially reduce network volume. These fees fall into two categories: *surcharges* charged by ATM owners and *foreign fees* charged by card issuers. A network prohibition on individual pricing by participants is certainly subject to a price fixing claim and must be defended by the network on the *Broadcast Music* ground that uniform pricing is necessary to make the joint network service work. Interestingly, many ATM networks have sought to restrict surcharges, but apparently no network has yet dealt with the parallel subject of issuer fees. The two seem to fall logically in tandem. Higher issuer fees may cause issuance of additional cards, whereas surcharges may encourage deployment of additional ATMs. They may or may not generate additional network volume (or may reduce it) depending on the level of the fees and consumers' response to them. To prevail in a challenge to a surcharge or issuer fee prohibition and to pass muster under *Broadcast Music*, the network will have to make a reasonable showing that the prohibited (or regulated) fee is likely to reduce network volume substantially or reduce the value of the network trademark substantially. Litigation to date has been indecisive.³⁵ We anticipate, however, that more is to follow.³⁶

Routing rules. ATM networks have also developed compulsory routing rules that tell acquirers (and sometimes the issuer, too) how to route every transaction. These two subjects are closely related because if both the ATM and the card are eligible to participate in two separate networks, then the *acquirer* has every incentive to send the transaction back home by whichever network has the higher interchange fees. This is not necessarily a

form of competition that antitrust law should seek to encourage because the ultimate effect may be higher charges to consumers. By contrast, an *issuer* routing rule gives the card issuer, which pays the switch and interchange fees, freedom to designate the routing in such circumstances, presumably based on both fees and efficiency.

In any event, serious antitrust concerns are raised if a monopoly network—or even a very strong one—insists that all transactions be routed by it wherever possible. This makes the creation of a new network competitor very difficult indeed and should probably be illegal on a tie-in or boycott theory.³⁷ The lower courts have also generally applied the rule of reason in cases involving boycott challenges to compulsory routing rules. The most illuminating is a D.C. Circuit decision by Judges Robert Bork and Ruth Bader Ginsberg, who applied a rule of reason analysis to routing rules in the household moving industry. In this case the defendant had a clear free riding problem and lacked market power.³⁸

Although ATM routing rules have generated considerable controversy, only one private case, *BayBanks, Inc. v. New England Network, Inc.*, has challenged a network routing rule on antitrust grounds.³⁹ In that case, BayBanks, the operator of the XPress 24 network in Massachusetts, sued the Yankee 24 network and several New England banks that were instrumental in organizing the network. Bay Banks challenged a compulsory routing rule that required the major organizing banks to run all the transactions between them through the network switch, rather than a subswitch. In March 1988, the parties settled the case, thus leaving these interesting antitrust issues unresolved.

Switch fees. Obviously a network switch has to be supported, and therefore a reasonable switch fee is easily within the *Broadcast Music* standard. In the context of a nonprofit joint venture, any switch fee presents little problem for antitrust. The situation is quite different where there is a proprietary network with market power that is owned

³⁷ See Baker and Brudel (1988) §23.07[3][6] (*Bypass and Routing*).

³⁸ *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 710 [U.S. Court of Appeals for the District of Columbia Circuit (D.C. Cir. 1986) petition for certiorari denied 479 U.S. 1033 (1987)]. This case involved a rule of Atlas Van Lines that required that any Atlas order received by one of its carrier agents be transported under the operating authority of Atlas. The rule was generated by deregulation of the moving industry in 1979 that made it easier for the local carrier agents to obtain their own interstate authority and compete against the national van lines (such as Atlas). Thus carrier agents could free-ride on Atlas' efforts 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. Applying the rule of reason, the D.C. Circuit 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. 792 F.2d at 229.

³⁹ No. 86-3532-K (D. Mass. filed Dec. 9, 1986). As discussed below, the complaint also challenged the trademark license fee that Yankee 24 proposed to levy on transactions that could have been routed to the Yankee 24 switch.

by a few major banking institutions (or even a single one) but necessarily used by everyone. In this context, the switch may look like a monopoly toll bridge, and the switch fee may be characterized as *opportunistic gouging*, or at least an important revenue source for the shareholder-owners. In these circumstances, a very high switch fee could be credibly attacked by nonowner users or DOJ under a horizontal price fixing, monopolistic price squeeze or essential facility theory under the Sherman Act.⁴⁰ Similarly, a fee that discriminated strongly against some group (for example, small banks or out-of-state issuers) could also be subject to a monopolistic abuse theory under section 2 of the Sherman Act. As more regional ATM networks become monopolies, their switch fees are likely to create a more pressing antitrust issue.

Trademark usage rules and fees. An ATM network has to create a consumer product and establish the organization and infrastructure necessary to make it work. It is logical therefore for the network to view its principal asset—namely, its service mark—as a device for supporting the promotional costs of the network.⁴¹ Several service mark licensing approaches have been tried, including a royalty on (1) every card accessing the network, (2) every ATM accessing the network and (3) every network transaction, regardless of whether it uses the network switch.

The per-transaction royalty fee has had an uneven history. When Connecticut Switch expanded in 1986 to become the New England Network and adopted a service-mark licensing fee of several cents per transaction, BayBanks promptly sued, challenging this fee as price-fixing and monopolization.⁴² By contrast, in the *EPS* consent decree, DOJ allowed the defendant to reserve the right to charge a per-transaction trademark fee that was as high as its switch fee—a right that would obviously deter routing of transactions to other switches and thereby deter entry of a new network.

Even if a high per-transaction fee constitutes an unreasonable restraint when

imposed by a *monopoly* network bent on deterring new entry, a *competitive* network with a valuable trademark should be able to charge license fees on any of a variety of bases. Competition from another network should ensure that such fees would not be exorbitant.

Processing rules. A network needs to have detailed specifications and rules to operate. As long as these are objective or technically defensible, there should be no antitrust problems. However, the processing rules can raise the kinds of issues that arise in standards-making cases under the antitrust laws. From time to time, certain products have been arbitrarily excluded from certification or the certification process has been skewed to favor certain enterprises over others.⁴³

Moreover, a processing rule that requires all ATM transactions to be driven by the network switch is plainly bad if imposed by a monopoly (or even a very powerful) branded ATM network. This is exactly what DOJ ordered eliminated in the *EPS/National City* consent decree on tie-in and monopolization theories.

Nonbank ATMs. Increasingly, supermarkets and third-party processors are deploying ATMs, and a variety of merchants are deploying POS arrangements with cash back features that function similarly to ATMs. Attempts by traditional banking organizations controlling a joint venture network to exclude nonbank ATM deployers from the network will raise serious boycott questions, if the network has a significant degree of market power in its market.⁴⁴ In a monopoly network situation the compulsory access principles of *St. Louis Terminal Railroad* and its progeny may come into play, as we shall see shortly.⁴⁵

Scope of network services. In the network joint venture context, intense disputes can exist over expansion of a joint venture's network services. Often, the joint venture offers small institutions certain things that large institutions can offer alone. This type of dispute is most likely to occur

⁴⁰ See *Delaware & Hudson Ry. Co. v. Consolidated Rail Corp.*, 902 F.2d 174, 179-80 (2d Cir. 1990), cert. denied 500 U.S. 928 (1991) (high rate treated as an access issue).

⁴¹ See Baker and Brandel (1995) ¶ 24.07[4](c).

⁴² This practice was abandoned apparently as part of the *BayBanks* settlement.

⁴³ See *Radiant Burners, Inc. v. Peoples' Gas Light & Coke Co.*, 364 U.S. 656 (1961).

⁴⁴ See *Associated Press v. United States*, 326 U.S. 1 (1945) and its progeny. I have a lot of difficulty with the sweep of the *Associated Press* rule. See Baker (1993), hereinafter *Compulsory Access*.

⁴⁵ *United States v. Terminal Railroad Assn.*, 224 U.S. 383 (1912).

openly in a nonprofit joint venture in which different sizes and types of institutions have board representation. It has occasionally turned into an antitrust dispute. (My favorite example was Citibank's mid-1970s case against the MasterCharge joint venture to enjoin it from issuing traveler's checks, a market in which Citibank—a leading MasterCharge issuer—was a major player. The case never went to trial.)

Antitrust conflicts of the types just outlined are inevitable in an environment where diverse competitive interests must depend on a facility for which there are no clear alternatives—especially when it is controlled by a small group of competitors. The dominant network is necessarily subject to stricter antitrust rules when aggrieved competitors have fewer network alternatives. By allowing dominant regional ATM networks, the DOJ and the Federal Reserve have simply created a larger field of antitrust risks for more networks. More business disputes have been taken out of the market and will be switched—potentially—to the courthouse, where treble damages and attorneys' fees under the Clayton Act will encourage private plaintiffs to frame their claims in antitrust terms whenever possible. We have seen this in a good many private antitrust cases challenging ATM network practices during the past decade—including cases brought by large and aggressive banks against networks. In such an environment, antitrust planning is a prudent exercise for any important ATM network and its major participants. Most major ATM networks are largely controlled by their leading institutions, which issue the bulk of the network cards and deploy the bulk of ATMs. In some instances (for example, EPS), the network is a profitable enterprise owned by a few of its largest members, which, as shareholders, elect all the directors and collect all the profits. In others (for example, Pulse), the network is a nonprofit entity with election of directors on a town meeting basis,

but with guaranteed seats for certain founding members.

Advance Planning by Networks to Reduce Antitrust Risks

My suggestions for antitrust planning by a dominant network fall into three general areas:

- More representative corporate governance arrangements;
- Greater flexibility in use of the network facilities or competitive alternatives by participants; and
- Use of alternative dispute resolution procedures for handling antitrust disputes among network participants.

None of these steps depends on the others, but they work well as a package.

Corporate Governance. Whenever a network board of directors (or the management that it has elected) is obliged to make a decision that affects different network participants in different ways, the decision becomes easier to defend if all affected interests were represented in the decision making process. Thus, in principle, it is advisable to have small institutions represented on the board or even to have public directors elected from outside the ownership or network participants.⁴⁶

Operational Flexibility. A dominant network should be careful that its technical standards are technically justifiable—and not more restrictive of competition among users than technically necessary. The network needs to be especially careful that technical justifications are not just a guise for what is really a monopoly rent enhancement scheme.⁴⁷ Giving members operational flexibility to route transactions over alternative networks is likely to be a particularly important operational issue in the case of regional monopoly ATM

⁴⁶ See Baker and Brandel (1995) ¶ 24.08. Interestingly, when the New York Stock Exchange (a very dominant network) came under heavy antitrust and political fire for its rate fixing on broker commissions in the late 1960s, the exchange began appointing distinguished public directors, who did not represent NYSE firms.

⁴⁷ See *United States v. Electronic Payments Services Inc.* (1994) and generally Baker and Brandel (1995) ¶¶ 24.07 [2] and [3].

networks. This is an issue of not only computer programs and switches, but also fee structures for gateways and trademark usage on bypass transactions.

Alternative Dispute Resolution. In 1985, the Supreme Court opened the door to arbitration of antitrust cases between those in a contractual relationship.⁴⁸ As a result, an ATM network—even a monopoly—can institute a reasonable arbitration program as part of its membership and participation arrangements; it can even appoint a particular arbitrator or panel to hear cases. As long as the arbitrator or panel is neutral, industry expertise can be injected into the process—and some greater certainty can be generated in the context of proceedings that have a limited time for decision. The process is likely to be successful in reducing the cost and uncertainty of disputes only if a lot of care goes into designing the process and selecting arbitration panels.⁴⁹

Of course, arbitration only provides assistance where the antitrust dispute is among a network and its participants.⁵⁰ By contrast, if the charge is discrimination against an outsider (for example, a nonmember financial institution, another network or a third-party processor) then the antitrust case will go to the federal courthouse. The same is true if the practice is being challenged by DOJ or a state attorney general.

To conclude, any dominant ATM network faces a real antitrust exposure; it should do everything possible to avoid being arbitrary in its decisions or the way it goes about making them.

CONCLUSION: THE PAST AS PROLOGUE?

It is fitting—and indeed almost Biblical—that we should come to St. Louis for today's discussion. For it is out of your history here that the next chapter of the ATM network antitrust history may yet be written.⁵¹

When the railroads came west, they came to St. Louis, and this crucial crossing

point on the Great River became a vital bridgehead and terminal. Some 24 railroads connected here. Through a series of acquisitions, a smaller group of presumably richer railroads extinguished the competing ferry service and acquired all the rail links to the two big bridges across the Mississippi. Their joint venture company (owned by 14 railroads) monopolized the East St. Louis traffic that had no alternatives, while being competitive for traffic that could use the bridges upriver at Alton, Illinois or downriver at Memphis. The Terminal Railroad Association of St. Louis (Terminal Company) discriminated against nonowner railroads. Into this thicket charged President William Howard Taft's Department of Justice and urged that the monopoly Terminal Company be broken up into competitive pieces. It was a simpler age, and the DOJ probably proceeded without economic counsel, let alone expert witnesses armed with intriguing regression analyses.

The two district judges who heard the evidence here in St. Louis could not decide what to do and issued no opinion or findings. The government appealed.

The U.S. Supreme Court thus became the court of first (as well as last) resort in the case. In its celebrated *Terminal Railroad Assn.* decision of 1912, the court decided that breaking up the monopoly (as DOJ had urged) would be inefficient given the local terrain. Instead, the court decided that the Terminal Company should be restructured so that all market participants could become owners—or, if they preferred, could be offered access to the terminal, as the Court said, “on as nearly an equal plane as may be with respect to expenses and charges” as the owners.⁵²

The *Terminal Railroad Assn.* principle has been applied to a variety of regional monopoly facilities—including a fish market, several tobacco markets, sports stadiums, and even a couple of Fed-supported regional automated clearinghouse facilities.⁵³ It remains a vital principle in today's world of ever more sophisticated networks. Yet it is a second best principle: competition

⁴⁸ *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985).

⁴⁹ See, *Baker and Stabile* (1993).

⁵⁰ There is one famous example of an antitrust arbitration of a major ATM network dispute. *The First Texas/Financial Interchange, Inc. Arbitration*, 55 ATRR 420 (1988). I worked on it for the respondent network.

⁵¹ See *Baker* (1993) at 1020-25, discussing *United States v. Terminal Railroad Assn.*, 224 U.S. 383 (1912).

⁵² 224 U.S. at 409.

⁵³ See *Baker and Brandel* (1995), ¶ 22.03[4] [c], discussing *U.S. v. Rocky Mountain Automated Clearing House Assn.*, C.A. No. 77-391 (U.S. District Court for Colorado 1977); and *U.S. v. California Automated Clearing House Assn.*, C.A. No. 77-1463-ITZ (U.S. District Court for the North District of California 1977).

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among networks is generally preferable to having a federal court sit as a public utility commission to restructure and supervise the terms of access to a network.⁵⁴

Terminal Railroad is still the best principle that we have to deal with the situation where natural monopoly economics or government decisions based on natural monopoly assumptions have created a joint venture monopoly for which there is no likely substitute. Because the Board of Governors now seems to assume that regional monopoly is a way of life in ATM networks, we can expect to hear a lot more about *Terminal Railroad*—as those who have been excluded from ownership in the monopolies seek ownership rights or a position “on as nearly an equal plane” with those whom the Fed and the DOJ have authorized to own these vital electronic bridgeheads.

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⁵⁴ See Baker (1993), especially 1076-8.