

Antitrust Enforcement and the Two-sided Market Theory: EU Payment Card Cases

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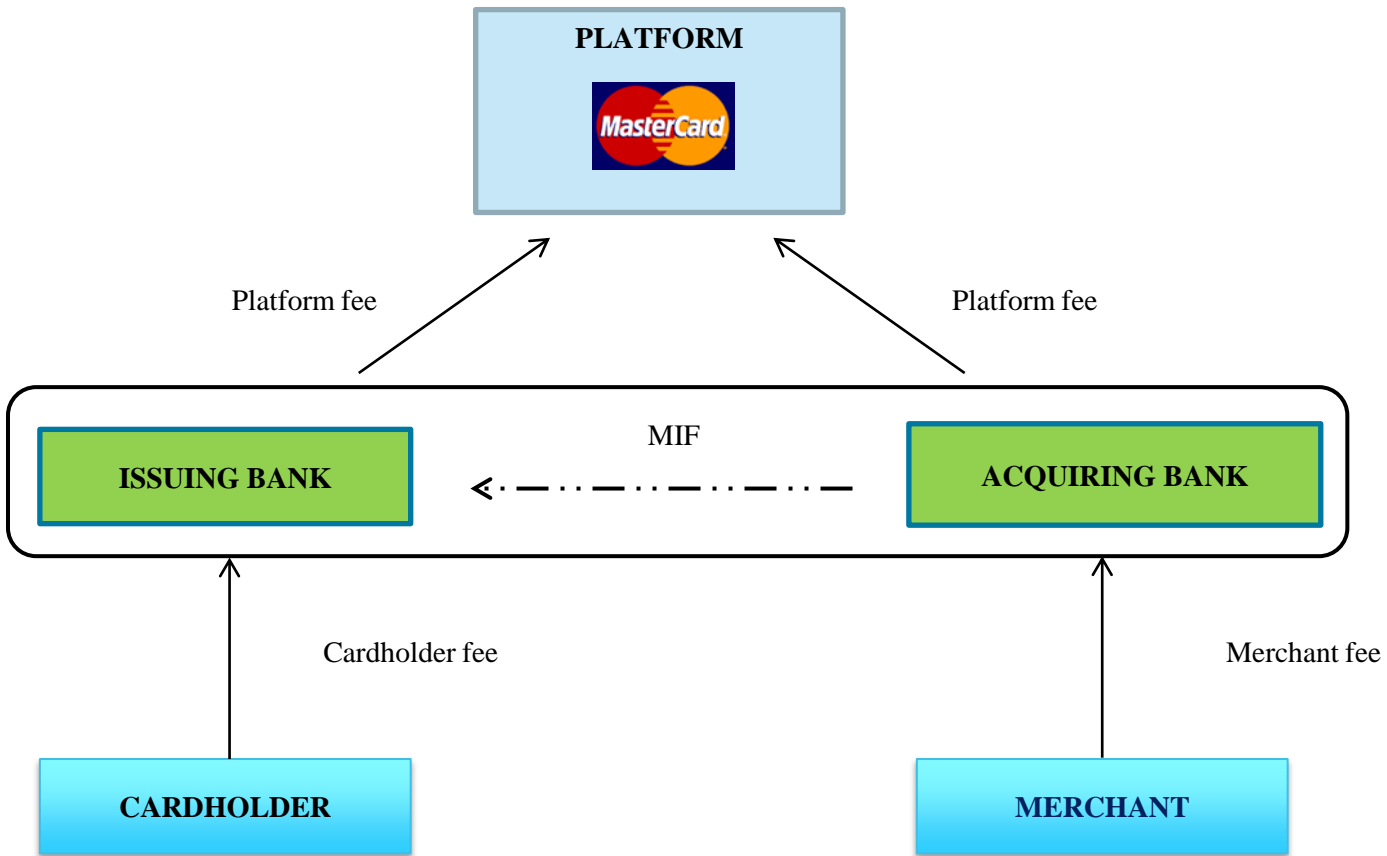
The Theory: Payment card platforms as two sided markets

- Credit card platforms need to attract merchants and cardholders
- There are network externalities between the merchants and consumers
 - How attractive the platform is to the merchants depends on the number of customers using the credit card and vice-versa
- The pricing structure must be balanced in a way to attract both merchants and cardholders

Platform competition in the payment card industry

- Payment card platforms need to compete on both sides of the market
 - An efficient fee structure does not necessarily reflect the relative costs
- The ability to raise prices on one side of the platform does not confirm the existence of market power
 - Regulating pricing is not competitively neutral

Multilateral Interchange Fees (MIFs)



Relevance for antitrust analysis

□ In theory:

- Relevant market definition
- Effect of competition on pricing
- Analysis of efficiencies

□ In practice:

“Invoking a two-sided nature of the business will not get one off the hook in an antitrust case and, in some situations may make the predicament even worse.” (Ordover, 2007)

EU Visa II (2002)

- Initial acceptance of the two-sided market theories
- The setting of MIFs restricts competition (by effect), but could be exempted under Article 101(3) provided that the MIFs are:
 - Public (so that merchants know the level of MIFs and are able to better negotiate their own fees)
 - Linked with cost of specific services provided by issuing banks to the benefit of acquiring bank.

EU Visa II (relevant markets)

- The Commission identified the following markets:
 - Upstream inter-system market (different payment card schemes);
 - Downstream intra-system markets (in which financial institutions compete with respect to card-related activities, i.e. issuing cards and “acquiring” merchants for card payment acceptance)
- (Commission Decision, ¶ 43)

EU Visa II (infringement)

- Visa argued that MIF is not a price paid for services, but a means of transfer between banks cooperating to deliver the payment services:
 - The MIF serves as a financial adjustment to the imbalance between the costs associated with issuing and acquiring and the revenues received from cardholders and merchants
 - The purpose of MIF is to increase the demand for and use of the payment service

EU Visa II (infringement)

- *“the **Commission does not accept that the MIF is a transfer of costs between undertakings**” [...] “**the MIF is an agreement between competitors, which restricts the freedom of banks individually to decide their own pricing policies.**”*
- *“The Commission does accept that a four-party payment scheme is characterised by externalities [...], but **not that there is joint supply of a single product.** Visa card issuers and acquirers each offer a distinct service to a distinct customer.”*

(Commission Decision, ¶¶65-66)

EU Visa II (infringement)

*“However, **the Commission does not consider the MIF agreement to be a restriction of competition by object**, since a MIF agreement in a four-party payment system such as that of Visa has as its objective to increase the stability and efficiency of operation of that system, and **indirectly to strengthen competition between payment systems by thus allowing four-party systems to compete more effectively with three-party systems.**”*

(Commission Decision, ¶69)

EU Visa II (efficiencies)

- MIFs have an important balancing role:
 - *The Visa network will provide greater utility to each type of user the greater the number of users of the other type [...]. The maximum number of users in the system will be achieved if the cost to each category of user is as closely as possible equivalent to the average marginal utility of the system to that category of user. **The Commission accepts that this is not necessarily achieved with each bank simply charging its own customer,** since [...] the card issuing bank provides specific services to the benefit of the merchant, via the acquiring bank. (Commission Decision, ¶83)*

EU MasterCard I (2007-2014)

- Return to the “traditional” analysis
- Turn to a stricter approach to MIFs: MasterCard MIFs violate Article 101(1) and not eligible for an exception under Article 101(3)
- MIFs may be permitted only when they produce sufficient and proven benefits for merchants:
 - MasterCard ultimately capped MIFs at levels linked with merchants’ transactional benefits (based on merchant indifference test); same was required in the 2010 *Visa Commitments* case

EU MasterCard I (market definition)

- Narrower market definition:
 - Upstream market where card scheme owners compete to persuade financial institutions to join their schemes and in which they provide services to such institutions (Commission decision, ¶ 281)
 - Downstream markets: acquiring and issuing markets (“The product characteristics of acquiring services are fundamentally different from those of issuing services.”) (Commission decision, ¶¶282-283)

EU MasterCard I (market definition)

□ The Commission:

- “[...] **interdependence** of demand in a vertically structured industry is **not** as such **an obstacle to defining distinct product markets**.” (Commission decision, ¶263)
- “MasterCard’s concept of market definition is also inconsistent with the Commission’s long standing case practice in industries with two-sided demand.” (Commission decision, ¶ 266)

EU MasterCard I (market definition)

- Market Definition confirmed by the General Court (2012)

*“It is indeed the case that there are certain forms of interaction between ‘issuing’ and ‘acquiring’ sides [...] However, [...] despite such complementarity, **services provided to cardholders and those provided to merchants can be distinguished, and, moreover, cardholders and merchants exert separate competitive pressure on issuing and acquiring banks respectively.**” (GC Judgment, ¶¶ 176-177)*

EU MasterCard I (infringement)

- The Commission stopped short of asserting that MIFs restrict competition “by object”
 - “[...]MasterCard MIF may by its very nature have the potential of fixing prices.” (Commission decision, ¶405)

- Agreements on MIFs **restrict competition between the acquiring banks to the detriment of merchants:**
 - Customers bear the cost of MIF irrespective of the form of payment they use (Commission decision, ¶¶ 410-411)

EU MasterCard I (infringement)

- The General Court broadly confirmed this analysis:
 - [...] with regard to the **criticism concerning the failure to take the two-sided nature of the market into consideration**, it must be pointed out that that, in that context, the applicants highlight the economic advantages that flow from the MIF. [...] Such criticism have **no relevance in the context of a plea relating to infringement of Article [101(1) TFEU]** [...] it is only within the specific framework of Article [101(3) TFEU] that the pro and anti-competitive aspects of a restriction may be weighed (General Court, ¶¶181-182)

EU MasterCard I (efficiencies)

- The Commission focused on whether the MIF specifically creates efficiencies to the benefit of merchants
 - The Court of Justice confirmed that the efficiencies must arise specifically from the MIF and not from the than on whether a broader payment scheme creates efficiencies)
- The Commission required detailed, robust and compelling analysis that relies on empirical data (Commission Decision, ¶680 and following)

EU MasterCard I (efficiencies)

- Court of Justice noted the relevance of the considerations relating to the two-sided nature of the credit card industry:
 - [...] *the General Court was, in principle, required, when examining the first condition laid down in [Article 101(3) TFEU], to take account of **all objective advantages flowing from the MIF, not only on the relevant market, namely the acquiring market, but also on the separate but connected issuing market.*** (Court of Justice, ¶240).

EU MasterCard I (efficiencies)

- ... but held that the benefits must be in the relevant market where the infringement takes place:
 - [...] where [...] restrictive effects have been found on only one market of a two-sided system, **the advantages flowing from the restrictive measure on a separate but connected market** also associated with that system **cannot, in themselves**, be of such a character as to compensate for the disadvantages resulting from that measure **in the absence of any proof of the existence of appreciable objective advantages attributable to that measure in the relevant market**, in particular, [...] where the consumers on those markets are not substantially the same.
(Court of Justice, ¶243)

Impact beyond the payment card industry

- Two sided-markets after *MasterCard I*
 - Market definition – Hard to argue one market if different services delivered to distinct groups of users
 - Analysis of the infringement – A narrow market definition leaves little scope for considering the effects of a practice on other users
 - Analysis of the efficiencies – At best, a very high burden of proof
- ...and separately the Commission publically voiced doubts about the soundness of the two-sided markets theory