IN RE VISA CHECK/MASTERMONEY ANTITRUST LITIGATION: A STUDY OF MARKET FAILURE IN A TWO-SIDED MARKET

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I. INTRODUCTION

In the wake of landmark antitrust litigation in the high technology and payment systems industries, antitrust commentators and economists have increasingly focused on the unique issues raised by two-sided markets. This

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attention intensified following the merchant class action against Visa and MasterCard, *In re* Visa Check/MasterMoney Antitrust Litigation (*"In re Visa Check"*),[1] in which the defendants unsuccessfully contended that the merchants could not prove antitrust injury because their damage theory supposedly did not account for the two-sided nature of the payment card market. Visa and MasterCard argued that to assert a damage claim in a two-sided market, buyers must show an overcharge impacting both sides of the market, regardless of which side they are on. According to Visa and MasterCard, the merchants had not done so and, therefore, their claims should have been dismissed on summary judgment.[2]

This paper explains why, contrary to Visa's and MasterCard's spin, *In re Visa Check* provides an example of a strong antitrust damages claim in a two-sided market. In fact, the case demonstrates that subverting competition on one side of the market can facilitate and exacerbate the cartelization of the other. Consequently, buyers on either side of the market have suffered antitrust injury and need not prove an overcharge affecting both sides to prevail. Before examining *In re Visa Check* in more detail, this article will explain the characteristics of two-sided markets and outline why these markets sometimes raise unique issues.

II. WHAT IS A TWO-SIDED MARKET?

A "two-sided market" is a market in which two seemingly distinct groups of customers need each other in some way, such that each group's demand for a product is dependent on the other group's demand for the same (or a related)

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[1] 297 F. Supp. 2d 503 (E.D.N.Y. 2003), *aff'd sub nom.* Wal-Mart Stores, Inc. v. Visa U.S.A., Inc., 396 F.3d 96 (2d Cir. 2005), *cert. denied sub nom.* Leonardo's Pizza by the Slice, Inc. v. Wal-Mart Stores, Inc., 125 S. Ct. 2277 (2005).

[2] *In re Visa Check*, No. 96-CV-5238, 2003 WL 1712568, at *8 (E.D.N.Y. Apr. 1, 2003); Defs.' Mem. Supp. Mot. Summ. J. or Partial Summ. J. at 61-63, *In re Visa Check*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003) (No. 96-CV-5238) [hereinafter Visa/MasterCard Summ. J. Br.].

product.[3] One example of a two-sided market is the market for dating services. There, men and women have interdependent demand as neither will be interested in such services if members of the other group do not participate.

Payment card system markets have similar features. In these markets, the buyers with interdependent demand are consumers and merchants. Consumers need merchants from whom to purchase goods, and merchants need consumers to whom they can sell their goods. Their respective demands are interdependent because the consumer can only make a purchase with a payment card that the merchant accepts, and the merchant can only make a sale if she accepts the payment form proffered by the consumer.[4] The Supreme Court has observed two-sided market features in the newspaper market: "[E]very newspaper is a dual trader in separate though interdependent markets; it sells the paper's news and advertising content to its readers; in effect that readership is in turn sold to the buyers of advertising space."[5] Other examples of two-sided markets include television (viewers and advertisers),[6] video games (players

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[3] *See* Marc Rysman, An Empirical Analysis of Payment Card Usage 1-2 (May 11, 2004) (working paper, *available at* http://econ.bu.edu/rysman/research/DeterminantsOfPaymentCardUsage.pdf); Jean-Charles Rochet & Jean Tirole, *Platform Competition in Two-Sided Markets*, 1 J. EUR. ECON. ASS'N 990, 990 (2003).

[4] *See* Rysman, *supra* note 3, at 1-2.

[5] Times-Picayune Publ'g Co. v. United States, 345 U.S. 594, 610 (1953). *See also* Cmty. Publishers, Inc. v. DR Partners, 139 F.3d 1180, 1184 (8th Cir. 1998) ("[T]he local daily newspaper market . . . [is] in fact two markets: one for readers and one for advertisers."); Berlyn, Inc. v. Gazette Newspapers, Inc., 157 F. Supp. 2d 609, 616-17 (D. Md. 2001) (quoting *Cmty. Publishers*, 139 F.3d at 1184; *Times-Picayune*, 345 U.S. at 610).

[6] Courts have also addressed the two-sided nature of the television market. *See* Chicago Prof'l Sports Ltd. P'ship v. NBA, 95 F.3d 593, 600-01 (7th Cir. 1996) (stating "buyers" of televised basketball games could be understood as either viewers or advertisers); Lerma v. Univision Commc'ns, Inc., 52 F. Supp. 2d 1011, 1017-18 (E.D. Wis. 1999); N.Y. Citizens Comm. on Cable TV v. Manhattan Cable TV, Inc., 651 F. Supp. 802, 807 (S.D.N.Y. 1986); Action Publ'ns, Inc. v. Panax Corp., No. M80-177, 1984 WL 2268, at *7 n.7 (W.D. Mich. Nov. 30, 1984).

and designers),[7] and computer operating systems (end-users and applications developers).[8]

Two-sided markets are characterized by "network effects," which are present when customers on both sides of the market benefit from having their demands coordinated.[9] In the dating services market, for example, women benefit from having their desire for romance coordinated with men desiring the same. In the payment systems market, consumers benefit from having their interest in using a particular payment method coordinated with merchants' need to accept payment forms that consumers carry. As a result of this coordination, the extent to which a customer on one side values a product or service increases the value of that product or service to customers on the other side.[10] For example, in the market for video games, game developers value consoles more when they have more users, and users value consoles more when they have more games.[11]

A. Getting Both Sides on Board: The "Chicken and Egg" Problem

The interdependence of demand between the customers on the two sides of the market creates a dilemma for firms that provide the platforms on which they meet. In the payment systems market, for example, consumers will not demand payment cards that merchants do not accept, and merchants are reluctant to accept cards that consumers generally do not carry.[12] Similarly, in the dating services market, neither men nor women would use a service in which the other was not involved. This is known as the "chicken and egg" problem.[13] In order to be successful, firms

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[7] *See* Rochet & Tirole, *supra* note 3, at 1015-16.

[8] *Id.* at 1017.

[9] *See* Marc Rysman, *Competition Between Networks: A Study of the Market for Yellow Pages*, 71 REV. ECON. STUD. 483, 483 (2004).

[10] *See* Rysman, *supra* note 3, at 1-2.

[11] *See* Rochet & Tirole, *supra* note 3, at 990-91, 992 tbl.1.

[12] *See id.* at 990.

[13] *Id.*

competing in a two-sided market must figure out how to "get both sides on board."[14] Doing so requires determining the optimal pricing level that balances the relative demands of the two customer groups involved.[15]

Most firms that operate in two-sided markets set prices in a manner that skews the costs toward one side.[16] That is, they set their pricing so that the majority of their revenue comes from one group of customers. For example, real estate brokers derive most of their earnings from sellers by charging commissions.[17] Some two-sided firms confront the chicken and egg problem by investing heavily in one side of the market, thereby lowering the costs for customers on that side.[18] This strategy not only benefits the groups whose costs are lowered, but also encourages the unsubsidized group to participate. For example, when Microsoft invests in companies that write applications, the resulting increase in the quality and quantity of its software entices end-users to buy Microsoft's products.[19]

B. Multihoming

Another characteristic prevalent in two-sided markets is "multihoming," or the simultaneous use of several competing platforms.[20] Multihoming is evident in the payment systems market, as most merchants accept several different payment cards and most consumers carry cards from more than one issuer.[21]

Economists contend that multihoming has an effect on both pricing levels and structures. In their view, prices tend

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[14] *Id.*

[15] *See* Julian Wright, *The Determinants of Optimal Interchange Fees in Payment Systems*, 52 J. INDUS. ECON. 1, 2-4 (2004).

[16] *See id.* at 3-4.

[17] *See* Rochet & Tirole, *supra* note 3, at 991-92.

[18] *See id.*

[19] *See id.* at 992 tbl.1.

[20] *See* Rysman, *supra* note 3, at 6-7.

[21] *See id.* at 6.

to drop in markets with multihoming.[22] In contrast, Visa and MasterCard have repeatedly raised their interchange rates, even though merchants accept, and consumers carry, other forms of payment.[23] Economic apologists consistently ignore this powerful evidence of Visa's and Mastercard's individual and joint market power when they analyze the payment systems industry.

III. IMPLICATIONS FOR ANTITRUST ANALYSIS

Because two-sided markets possess unique features, some economists have suggested that aggressive antitrust enforcement in these industries can lead to false positives and actually harm competition.[24] In their view, certain fundamental aspects of these markets must be considered in determining the consumer welfare effects of any purported antitrust violation.

For example, these commentators contend that prices charged on each side of the market do not necessarily correspond to the respective costs or demands of each side. They also assert that any change in demand or cost on either side might affect prices on the other side of the market. As a result, they contend that one cannot determine the overall effect of a price change without also considering its "crossover effects," or the effects that it has on the other side

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[22] *See* Rochet & Tirole, *supra* note 3, at 992-93.

[23] *See* United States v. Visa U.S.A., Inc., 344 F.3d 229, 239-40 (2d Cir. 2003), *cert. denied*, 125 S. Ct. 45 (2004) ("Visa U.S.A. and MasterCard, jointly and separately, have power within the market for network services . . . . Indeed, despite recent increases in both networks' interchange fees, no merchant had discontinued acceptance of their cards.").

[24] *See* David S. Evans, *The Antitrust Economics of Multi-Sided Platform Markets*, 20 YALE J. ON REG. 325, 379-80 (2003); *see generally* Mark Armstrong & Julian Wright, Two-Sided Markets, Competitive Bottlenecks and Exclusive Contracts (Nov. 2004) (working paper, *available at* http://ssrn.com/abstract=654187); Richard Schmalensee, *Payment Systems and Interchange Fees*, J. INDUS. ECON., June 2002, at 103; Joshua S. Gans & Stephen P. King, *The Neutrality of Interchange Fees in Payment Systems* (Melbourne Business School, Working Paper No. 3, 2001), *available at* http://ssrn.com/abstract=276228.

of the market.[25] Finally, they emphasize the fact that two-sided platforms cannot exist unless both sides participate in the arrangement. Thus, they claim that business strategies commonly used in two-sided markets might appear anticompetitive when considered in a different context.[26] They assert, for example, that one side of a two-sided firm might have an "efficient" price that is below its marginal cost, and that it would be a mistake to condemn that condition as predatory pricing.[27]

Some of these arguments appear to be nothing more than economic pretexts to legitimize anticompetitive conduct that occurs in a two-sided market. For example, if an increase in price on one side of a market will necessarily have crossover effects on the other side, the arguments above would make it virtually impossible for a buyer to assert an overcharge theory due to supracompetitive prices on one side of the market. As *In re Visa Check* demonstrates, however, there is no reason to assume a crossover or offset effect simply because the overcharge has been imposed on one of the two sides. Also, *In re Visa Check* demonstrates that supracompetitive pricing on one side of the market can facilitate the cartelization of the other side.

A. A Case Study of Antitrust Injury in a Two-Sided Market: *In re Visa Check*

1. The Merchants' Antitrust Injury and Damages Theory

In *In re Visa Check*, the defendants used tying arrangements in a two-sided market to foreclose competition, and, in the process, caused an inferior product to dominate the market at great cost to consumer welfare. The inferior product in question was Visa/MasterCard signature debit (commonly known as the Visa Check Card and Debit

[25] Evans, *supra* note 24, at 329, 355.

[26] *Id.* at 355-56.

[27] *Id.* at 328.

MasterCard), which utilizes the inefficient dual-message processing system and is prone to fraud because it is typically authenticated with a signature.[28] The superior product is PIN debit, which uses the more efficient single-message system and is much more secure because transactions are authenticated with a personal identification number ("PIN").[29]

The lynchpin of Visa's and MasterCard's strategy to dominate the debit card market was their Honor All Cards rules ("HAC" or "tying" rules), which forced merchants to accept Visa/MasterCard signature debit transactions as a condition of accepting Visa/MasterCard dominant credit cards. This tie gave Visa and MasterCard the ability to charge credit card-style interchange rates for their signature debit products. Numerous merchants complained that the prices they paid for Visa's and MasterCard's signature debit products were substantially greater—in many cases ten to twelve times greater—than the prices they paid for the superior PIN debit products. But since virtually all merchants needed to accept Visa's and MasterCard's dominant credit cards in order to remain competitive, they had no choice but to accept Visa/MasterCard debit transactions at supracompetitive prices.

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[28] In a dual-message system, transactions are authorized, settled, and cleared in separate electronic messages that can be days apart. In a single-message system, authorization and settlement take place in a single electronic message.

[29] The *In re Visa Check* record included evidence that signatures are virtually worthless as an authentication device because sales clerks are not handwriting experts and signatures are rarely checked in any event. By contrast, a PIN provides a much more secure means of authentication. *See* Expert Report of James Brown at 9, *In re Visa Check*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003) (No. 96-CV-5238) (quoting deposition testimony of MasterCard CEO that signature identification has "very limited value[] . . . [b]ecause a 19-year-old clerk is not someone you could count on to make an intelligent judgment around whether a signature looks like the other signature that is presented on the back of the card"). *See id.* at 9-18 for a discussion of the various risks and inefficiencies associated with signature debit.

The evidence in the *In re Visa Check* case supported the merchants' position that, but for the tying rules, Visa and MasterCard could not have charged credit card-style interchange fees for their debit products. For instance, Visa's longstanding debit consultant, Andersen Consulting, warned Visa in 1997 that if the HAC rules were eliminated, approximately 80% of Visa's debit volume would be at risk; in such event, Visa would have to reduce its signature debit interchange fees to PIN debit levels in order to preserve debit card acceptance.[30] A 1997 study prepared by industry analysts Dove Associates came to essentially the same conclusion:

> If the merchants win the suit, and the tying arrangement is removed, then practically all retailers would abandon off-line debit under its present pricing structure. The card associations would be forced to rethink their interchange fees, and come up with a new pricing schedule that could compete with on-line [PIN] debit....[31]

Notably, all shoppers, including those who did not use Visa and MasterCard signature debit cards, were forced to pay these overcharges in the form of higher retail prices.

The evidence also indicated that the supracompetitive interchange fees, enabled by the tying rules, distorted the development of debit in the United States by motivating

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[30] Andersen Consulting, Report Prepared for Visa Regarding the HAC Rules, at 10, Ex. 820 to Decl. G. Schnell Supp. Pls.' Opp'n Defs.' Mot. Summ. J., *In re Visa Check*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003) (No. 96-CV-5238) [hereinafter Andersen HAC Report]. The *In re Visa Check* Court made this document public when it unsealed substantial portions of the record.

[31] Dove Associates Inc., The Future of Use of ATMs: An Examination of the Current and Future State of the ATM Business, at 84 (1997) (report prepared for the PULSE EFT Association, a nationwide electronic funds transfer network), Ex. 1 to Decl. G. Schnell Supp. Pls.' Opp'n Defs.' Mot. Summ. J., *In re Visa Check*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003) (No. 96-CV-5238). An online summary of this report is available at http://www.doveconsulting.com/article_download/RS1997FutureUseATM.pdf (last visited Nov. 6, 2005).

banks to suppress the superior PIN debit product. To illustrate the full consumer welfare effects of this distortion, it is helpful to recount briefly the history of debit products in the United States.[32]

Visa and MasterCard created their signature debit products in the mid-to-late 1970s and immediately employed their HAC rules to require merchants that accepted their credit cards to accept their debit products as well.[33] Despite this instantaneous and widespread acceptance by merchants, the HAC rules had little effect on the debit market in those years.[34] Banks were reluctant to issue Visa's and MasterCard's signature debit products because of their inherent inefficiency and security risks.[35]

In the mid-1970s, the first regional automated teller machine ("ATM") network emerged.[36] Regional ATM networks proliferated throughout the United States in the 1980s,[37] and, in an effort to generate a large base of PIN debit cardholders, many of them adopted mandatory participation rules that automatically converted "vanilla"

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[32] For a more detailed overview of the history of debit products in the United States, see FUMIKO HAYASHI ET AL., FEDERAL RESERVE BANK OF KANSAS CITY, A GUIDE TO THE ATM AND DEBIT CARD INDUSTRY 12-15, 41-68 (2003); DONALD I. BAKER & ROLAND E. BRANDEL, THE LAW OF ELECTRONIC FUND TRANSFER SYSTEMS ¶ ¶ 1.01-1.03[9], 1-1 to 1-29 (2d ed. 1988).

[33] *In re* Visa Check/MasterMoney Antitrust Litigation, 192 F.R.D. 68, 73 (E.D.N.Y. 2000) (granting plaintiffs' motion for class certification), *aff'd*, 280 F.3d 124 (2d Cir. 2001), *cert. denied sub nom.* Visa U.S.A., Inc. v. Wal-Mart Stores, Inc., 536 U.S. 917 (2002).

[34] *See* BAKER & BRANDEL, *supra* note 32, ¶ 7.02[1][b], at 7-5 to 7-6; public version of Expert Report of Kenneth J. Morrison at 22, *In re Visa Check*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003) (No. 96-CV-5238) [hereinafter Morrison Report]; *see also In re* Visa Check/MasterMoney Antitrust Litigation, 192 F.R.D. at 73.

[35] *See* Morrison Report, *supra* note 34, at 10-11.

[36] *See* BAKER & BRANDEL, *supra* note 32, ¶ 7.02[1][b], at 7-4; Kerin E. Coughlin, Note, *ATM Surcharges Violate the Public Policies that Underlie the Antitrust Laws*, 35 COLUM. J.L. & SOC. PROBS. 217, 223 (2002).

[37] *See* BAKER & BRANDEL, *supra* note 32, ¶ 7.02[1][b], at 7-5; Coughlin, *supra* note 36, at 224.

ATM cards into point of sale debit cards.[38] During this time, PIN debit blossomed as many banks were attracted to its safety and efficiency.[39] PIN debit also flourished because the regional networks priced it at par (i.e., merchants paid no interchange fee), thus maximizing merchant incentives to install the PIN pads that they needed to accept PIN debit transactions.[40]

By the early 1990s, Visa (and later MasterCard) recognized that the continued success of the regional networks' at-par pricing model threatened to destroy their signature debit products and to undermine their credit card interchange fees.[41] To blunt this threat, Andersen recommended that Visa "contain" PIN debit by, among other things, using its HAC rule to encourage the issuance of the slower, more fraud prone, and more expensive signature debit products.[42]

This strategy worked. The vast pricing gap between signature and PIN debit completely distorted the incentives of banks in their debit issuance and promotion practices.[43] After initially preferring PIN debit, many banks performed an about face and aggressively pushed signature debit

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[38] Public version of Rebuttal Expert Report of Franklin M. Fisher at 35 n.130, *In re Visa Check*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003) (No. 96-CV-5238); *see also* public version of Pls.' Mem. Law in Opp'n Defs.' Mots. Summ. J. and Partial Summ. J. at 50, *In re Visa Check*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003) (No. 96-CV-5238) [hereinafter Pls.' Mem. Opp'n]; public version of Supplemental Mem. Law Supp. of Pls.' Mot. for Summ. J. and in Opp'n to Defs'. Mot. for Summ. J. at 35, *In re Visa Check*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003) (No. 96-CV-5238) [hereinafter Pls.' Supp. Summ. J. Mem.].

[39] *See* Morrison Report, *supra* note 34, at 10.

[40] *See id.* at 32.

[41] *See* Andersen Consulting, Financial Impact of Direct Debit Evolution, at 1018583-612 (prepared for the Product Development and Marketing Committee of the Visa U.S.A. Board of Directors), Ex. 299 to Decl. G. Schnell Supp. Pls.' Opp'n Defs.' Mot. Summ. J., *In re Visa Check*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003) (No. 96-CV-5238) [hereinafter Anderson Debit Report]; Morrison Report, *supra* note 34, at 33.

[42] *See* Andersen Debit Report, *supra* note 41, at 1018613-15.

[43] *See* Morrison Report, *supra* note 34, at 38-39.

products.[44] Not only did they now favor the riskier, more costly, slower and less efficient signature debit product, but they also took active steps to suppress PIN debit altogether. They relegated PIN debit marks to the back of debit cards and did virtually nothing to promote PIN debit's superior features. In addition, they imposed financial penalties on their cardholders who made PIN debit transactions, and they adopted rewards programs—such as prize sweepstakes, airline miles, and cash rebates—for which only signature debit transactions qualified and from which PIN debit was excluded or even vilified (e.g., Commerce Bank's "Skip the PIN, Sign and Win!" campaign).[45] As if that were not enough, banks also sent their cardholders materials directing them only to sign for their debit purchases. One issuer, Fifth Third Bank, even put a sticker on its debit cards warning cardholders to "not input your PIN."[46]

Unsurprisingly, these tactics had a profoundly negative impact on PIN debit's share of the debit card market. Between 1993 and 2001, PIN debit declined from a 61% share of debit transactions to a 36% share. At the same time, signature debit grew from a 38% share to a dominant 64% share.[47] This massive market share shift occurred even though most industry observers believed that PIN debit was a superior product.[48] As a result, merchants (and their customers) were forced to pay substantial overcharges for signature and PIN debit transactions.

2. Visa's and MasterCard's Counterarguments

Visa and MasterCard countered the merchants' damage theory by, among other things, asserting that it did not account for the two-sided nature of the payment systems market. In their view, as a matter of law, the court could not

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[44] *See id.*

[45] *See* Pls.' Supp. Summ. J. Mem., *supra* note 38, at 10, 20.

[46] *See id.* at 20.

[47] *See id.* at 11.

[48] *See* HAYASHI, *supra* note 32, at 43; *see also* Morrison Report, *supra* note 34, at 10.

find antitrust injury in the merchant side of the market without also examining prices in the cardholder side of the market. They also asserted that the merchants' damages case was really about competing business models and not antitrust injury.[49]

This line of reasoning can be summarized as follows. Visa and MasterCard used the HAC rules to solve the chicken and egg problem by minimizing, if not eliminating, the cost of building a merchant acceptance network. When Visa and MasterCard introduced signature debit in the late 1970s, their credit cards were already widely accepted.[50] By applying the HAC rules to signature debit products, these cards immediately gained widespread acceptance among merchants, thereby surmounting one aspect of the chicken and egg problem.[51] This merchant acceptance could then be used to solve the other half of the problem, as it attracted issuers and cardholders. According to Visa and MasterCard, it would be inefficient to prevent them from leveraging their installed base of merchants, as that would force them to rebuild a merchant acceptance network each time they introduced a new product.[52]

To further buttress their argument, Visa and MasterCard compared their HAC rules with the ATM networks' mandatory participation rules as a means of promoting PIN debit.[53] Unlike Visa and MasterCard, which had massive merchant acceptance but few debit cardholders, the ATM networks had millions of cardholders but few merchants. To solve their chicken and egg problem, the regional networks used mandatory participation rules to turn ATM cards into point of sale debit cards with PIN debit functionality.[54] They

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[49] Visa/MasterCard Summ. J. Brief, *supra* note 2, at 61; Morrison Report, *supra* note 34, at 10.

[50] Visa/MasterCard Summ. J. Brief, *supra* note 2, at 61-62; Morrison Report, *supra* note 34, at 8-9.

[51] Visa/MasterCard Summ. J. Brief, *supra* note 2, at 61-62; Morrison Report, *supra* note 34, at 9.

[52] Visa/MasterCard Summ. J. Br., *supra* note 2, at 61-63.

[53] *Id.* at 62-63.

[54] *Id.* at 62.

then used their cardholder base and low merchant pricing to gain merchant acceptance.[55] In short, Visa and MasterCard asserted that their use of the HAC rules to address the chicken and egg problem was, from a consumer welfare perspective, no different from the regional networks' use of mandatory participation rules to generate a large cardholder base.

3. Why Visa's and MasterCard's Counterarguments Are Wrong

Visa's and MasterCard's arguments cannot withstand factual or legal scrutiny. As an initial matter, their contention that the merchants ignored the two-sided nature of the market is not credible. While the merchants asserted massive overcharges affecting one side of the market, their damages theory was premised on the two-sided nature of the market. That is, they asserted that the supracompetitive interchange fees for signature debit distorted the evolution of debit on the issuer/cardholder side of the market, which resulted in the suppression of the safer, cheaper, and more efficient PIN debit product.[56] This theory was supported by substantial evidence that the U.S. banking industry had shifted its emphasis from PIN to signature debit, even though most banks recognized that PIN debit was superior.[57]

The merchants also marshaled evidence that the overcharges enabled by the HAC rules facilitated the cartelization of the issuing side of the market. For example, Visa hired Andersen Consulting to prepare an analysis for Bank of America designed to convince it to remove regional PIN debit marks from its debit cards. Bank of America, notably, did not object to this analysis being shared with its

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[55] *See id.*

[56] *See* Pls.' Mem. Opp'n, *supra* note 38, at 49-50.

[57] *See* Pls.' Supp. Summ. J. Mem., *supra* note 38, at 20-22, 34-35.

competitors, who were also entertaining strategies to suppress PIN debit.[58]

Moreover, to show the extent to which the HAC rules distorted the development of debit payment systems in the United States, the merchants highlighted the tremendous success of PIN debit in Canada.[59] The Canadian banks did not tie debit acceptance to credit acceptance, and thus PIN debit has flourished north of the 49th parallel with no interchange fees. Even though debit was introduced in Canada a decade after it first emerged in the United States, per capita debit card usage in Canada greatly exceeds that in the United States.[60] In fact, debit card use has far surpassed the use of checks in Canada,[61] whereas check use has remained strong in the United States (even in light of recent declines).[62] Largely because of these differences, retail banking prices are generally lower in Canada than they are in the United States.[63]

Visa's and MasterCard's argument that *In re Visa Check* was simply about two competing business models also is baseless. The HAC rules externalized the cost of surmounting the chicken and egg problem by forcing merchants, and ultimately all consumers, to bear those costs. By contrast, the mandatory participation rules internalized this cost by imposing it on the regional networks' own

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[58] *See* public version of Pls.' Mem. Law Supp. Pls.' Mot. Summ. J. at 45 n.87, *In re Visa Check*, 297 F. Supp. 2d 503 (E.D.N.Y. 2003) (No. 96-CV-5238).

[59] *See* Morrison Report, *supra* note 34, at 24-29. Mr. Morrison, the merchants' expert on payment systems and the Canadian market, provides a detailed comparison of the development of debit in Canada and the United States. These reports are in the *In re Visa Check* record, and their relevant portions have been unsealed by the Court in that action.

[60] In 1998, Canada had more than double the per capita debit transaction rate of the United States: 44.6% compared to 21.2%. *Id.* at 49 tbl.4.

[61] In 1998, 31% of Canadian consumers preferred to pay with debit, while only 5% preferred to pay with checks. *Id.* at 47 tbl.2.

[62] In 1997, checks were still used for 73% of non-cash payments in the United States, down from 82% in 1990. *Id.* at 50 tbl.5.

[63] *Id.* at 50-51.

members. Visa's and MasterCard's argument completely ignores this crucial economic distinction. It also ignores the fact that several PIN debit networks, including the two leading PIN debit networks, STAR and Visa's Interlink network, did not even employ mandatory participation rules.

Further, the use of HAC rules to propel signature debit was inefficient. Visa and MasterCard admitted that if they could not have used their HAC rules to launch signature debit, then they would not have offered the product at all.[64] In doing so, they essentially conceded its inferiority. Stated differently, if Visa and MasterCard were forced to reduce the interchange fees associated with signature debit in order to attract merchants, the banks would have declined to issue the cards because of their high fraud rates and relative inefficiency. This reinforces the conclusion that the tying rules enabled the success of an inferior product, while motivating the suppression of a superior product. Visa's consultant, Andersen, apparently shared this conclusion. It stated, in an analysis of the impact of rescinding the HAC rules, that the rules created a "major competitive advantage," erected a "significant entry barrier for new players," and weakened the "relative position" of the PIN debit networks.[65]

Finally, Visa's and MasterCard's argument fails as a matter of law. In *Times Picayune Publishing Co. v. United States*,[66] the Supreme Court was faced with a two-sided market—newspapers—featuring two sets of interdependent consumers, readers and advertisers.[67] The Court held that both sides represent "separate though interdependent markets" and that the case before it "concern[ed] solely one

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[64] *See* Visa/MasterCard Summ. J. Br., *supra* note 2, at 24.

[65] Andersen HAC Report, *supra* note 30, at 9.

[66] 345 U.S. 594 (1953).

[67] *See also* Action Publ'ns, Inc. v. Panax Corp., No. M80-177 CA2, 1984 WL 2268, at *7, *7 n.7 (W.D. Mich. Nov. 30, 1984) ("'[A]dvertising is the economic mainstay of the newspaper business[]' . . . . [M]any people may purchase a paper in order to have a copy of the advertisements and coupons contained therein.") (quoting *Times-Picayune*, 345 U.S. at 604).

of these markets."[68] Simply put, the argument advanced by Visa and MasterCard—that one cannot show antitrust injury by reference to only one side of a two-sided market—has been squarely rejected by the Supreme Court.[69]

Given the factual and legal support for the merchants' damages theory, Visa's and MasterCard's arguments were rejected by the *In re Visa Check* court, which found "that the merchants have presented a sufficiently compelling (and factually supported) theory of damages to warrant a trial of the issue."[70]

IV. CONCLUSION

Visa's and MasterCard's "two-sided market" argument was nothing more than an attempt to distract the court from the powerful antitrust injury narrative in *In re Visa Check*. This case demonstrates how the elimination of competition on one side of a market can cartelize and subvert competition on the other. The merchants' case was premised on the two-sided characteristics of the market because it demonstrated how a tying arrangement can foreclose competition on both sides of the market. Specifically, it showed how the HAC rules enabled supracompetitive interchange fees that prevented debit network competitors from fairly competing for (i) merchant acceptance (as merchants would have dropped PIN debit or declined to install PIN pads if the fees were too high), and (ii) bank issuance and promotion (as

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[68] *Times-Picayune*, 345 U.S. at 610.

[69] *See also* Cmty. Publishers, Inc. v. DR Partners, 139 F.3d 1180, 1183 (8th Cir. 1998) (increase in advertising rates constituted antitrust injury as a result of combination of newspapers); Berlyn, Inc. v. Gazette Newspapers, Inc., 157 F. Supp. 2d 609, 618 (D. Md. 2001) (claim that newspapers' "numerous acquisitions, and . . . improper undercutting of advertising rates, have damaged competition for advertisers" was sufficient allegation of antitrust injury); N.Y. Citizens Comm. on Cable TV v. Manhattan Cable TV, Inc., 651 F. Supp. 802, 807 (S.D.N.Y. 1986) ("[A] distinct injury to competition has been alleged, the injury to consumers resulting from the improper exclusion of all but one pay television service.").

[70] 2003 WL 1712568, at *8.

banks favored the higher signature debit fees), resulting in both the massive foreclosure of a superior product and substantial overcharges to merchants and, ultimately, consumers.