MULTILATERAL INTERCHANGE FEES UNDER E.U. ANTITRUST LAW: A ONE-SIDED VIEW ON A TWO-SIDED MARKET?

Luc Gyselen*

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* Partner, Arnold & Porter LLP since July 2004. Previously, the author was a European Commission official. Between 1994 and 1999, he was the Head of the unit in charge of Financial Services at the Commission's Directorate General for Competition. Arnold & Porter LLP represents VISA USA in numerous matters, including those involving interchange fees.

I. INTRODUCTION

Many payment systems, whether set up for the purpose of handling remote payments (e.g., debit or credit transfers) or for face-to-face payments (e.g., debit, charge or credit card transactions), contain interchange fee arrangements. In card payment systems, the merchant/creditor's bank often must pay a uniform fee to the cardholder/debtor's bank for handling the payment. In addition, cardholders frequently encounter interchange fees when withdrawing cash from automated teller machines ("ATMs") operated by another bank. In this three-party situation, the cardholder's bank pays the fee to the ATM-operating bank. An interchange fee arrangement is multilateral when all banks participating in a given payment system—often hundreds or thousands of them—have agreed upon an interchange fee *ex ante* (i.e., when they join that system).

The European Commission ("Commission") has consistently taken the view that multilateral interchange fees ("MIFs") restrict competition because they produce a "knock-on" effect in the bank-customer relationship.[1] According to the Commission, this occurs because the bank that pays the interchange fee typically passes this cost along to its customers. In a credit card system like Visa International's ("Visa"), the merchant's bank (hereinafter the "acquiring bank") will pay the MIF to the card-issuing bank and pass the cost along to the merchant. In its *Visa International* decision, the Commission concluded that, due to this "knock-on" effect, Visa's original MIF for cross-border card payments restricted competition within the meaning of the first paragraph of Article 81 of the European Community ("EC") Treaty ("Art. 81-1 EC").[2] However, pursuant to the

[1] For a historic overview of the cases concerning MIFs, see Luc Gyselen, *EU Antitrust Law in the Area of Financial Services—Capita Selecta for the Cautious Shaping of a Policy*, *in* FORDHAM CORPORATE LAW INSTITUTE, 23[RD] ANNUAL CONFERENCE ON INTERNATIONAL ANTITRUST LAW AND POLICY 329 (Barry Hawk ed., 1997).

[2] Commission Decision of 24 July 2002 Relating to a Proceeding under Article 81 of the EC Treaty and Article 53 of the EEA Agreement (Case No

third paragraph of Article 81 of the EC Treaty ("Art. 81-3 EC"), the Commission permitted Visa's amended MIF because it: (i) contributed to "technical and economic progress;" (ii) enabled consumers to receive a "fair share of the resulting benefit;" (iii) was "indispensable to the attainment of these objectives;" and (iv) did not afford banks "the possibility of eliminating competition in respect of a substantial part of the products in question."[3] Put another way, the Commission believed that the amended MIF did not substantially lessen competition.

In Section II, this Article attempts to explain the Commission's legal reasoning in *Visa International* against the somewhat idiosyncratic, dualist structure of Article 81 of the EC Treaty ("Art. 81 EC"). Next, Section III comments on the Commission's theory of harm. Finally, Section IV concludes that this theory is a narrow one, but that the Commission may develop, refine, or revise it following further fact-finding, which is currently underway within the framework of its sector inquiry. One point of clarification should be made explicit: while the Commission seems to accept that "interdependent *demand* from merchants and cardholders" exists within four-party card systems, it has denied that there is a "joint *supply* of a single product" to them.[4] In other words, the Commission has not adhered to the economic theory of two-sided markets. Irrespective of the merits of its theory of harm, this is the fundamental premise that underpins the Commission's legal reasoning for assessing MIFs under Art. 81 EC.

II. THE VISA INTERNATIONAL DECISION: SUMMARY OF THE LEGAL REASONING

The *Visa International* decision provisionally ended a twenty-five year old saga that concerned Visa's MIF for

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COMP/29.373—Visa International—Multilateral Interchange Fee), 2002 O.J. (L 318) 17 [hereinafter *Visa Int'l II*].

[3] Treaty Establishing the European Community, Dec. 24, 2002, 2002 O.J. (C 325) 81 [hereinafter *EC Treaty*].

[4] *Visa Int'l II*, ¶ 65 (emphasis added).

cross-border card payments within the European Economic Area ("EEA").[5] Visa has consistently argued that it is entitled to use an MIF as cost allocation device in order to optimize the two-sided demand of cardholders and merchants for its credit card.[6] However, consistent with earlier decisions, the Commission did not consider the MIF as a legitimate cost transfer device.[7] As a matter of fact, it objected to Visa's MIF under Art. 81-1 EC precisely because it shifted costs from the debit side of the market to the credit side and produced a "knock-on" effect on merchants.[8] Nevertheless, the Commission ultimately accepted Visa's amended MIF under Art. 81-3 EC because it reflected the actual costs that issuing banks incurred in providing services to those merchants that suffered from the MIF's "knock-on" effect.[9] The Commission approved this cost-based MIF for a limited period of time,[10] so as to afford it the opportunity to "re-examine the practical impact of the modified Visa scheme on the market, and in particular its expected effect on merchant fees."[11]

A. The Prelude to the *Visa International* Decision

Prior to the *Visa International* case, the Commission had already identified the cost-based nature of MIFs as a key issue in analyzing Art. 81 EC. First, in its 1995 *Notice on the Application of the EC Competition Rules to Cross-Border Credit Transfers*, the Commission accepted MIFs for so-called OUR-transfers (remote payments for which all costs

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[5] Visa sought to obtain the Commission's approval of the MIF and other possible restrictions on competition in 1977.

[6] *Id.* ¶ 61 n.2.

[7] *Id.* ¶ 65 n.35.

[8] *Id.* ¶ 68.

[9] *Id.* ¶ 92.

[10] The amended MIF will remain in effect until December 31, 2007. *See id.* ¶ 35 (Art. 1 for point of sale transactions and Art. 2 for mail and telephone transactions).

[11] *Id.* ¶ 109.

are imposed upon on the sender),[12] provided that: (i) the recipient of the MIF, i.e., the beneficiary's bank, would carry out one or more services linked to the cross-border nature of the credit transfer; and (ii) the MIF would reflect the average cost of these services as supplied to all beneficiary banks involved in the system.[13]

Second, in *Accept-Giro*, a case concerning a Dutch domestic remote payment system, the Commission issued a notice announcing that credit banks could permissibly pay an MIF to the debit banks because this fee was based on the cost of processing the payment as incurred by the most efficient debit bank.[14] Incidentally, the MIF covered only half of these costs, as debit banks themselves bore the other half. In other words, in *Accept-Giro*, the MIF allocated costs equally between the two sides of the market, as in a SHARE-transfer.[15]

B. The *Visa International* Decision

To gain a complete understanding of the Commission's decision, one must bear in mind the dualistic structure of Art. 81 EC. In 1957, the EC's founding fathers drafted Art. 81 EC to embody this dualism. In essence, Art. 81-1 EC prohibits any agreement whereby parties restrict their

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[12] SHARE-transfers, in which the sender and beneficiary share all costs, are compared with BEN-transfers, in which the beneficiary incurs all costs.

[13] *See* 1995 O.J. (C 251) 3 ¶¶ 53-56. For a commentary, see H. Piffaut & C. Williams, *Financial Services, in* THE EC LAW OF COMPETITION 635 (Faull & Nikpay eds., Oxford Univ. Press 1999). Although it focuses on OUR-transfers, this notice was never meant to imply that the Commission would only accept MIFs that shifted costs to the debit side. As a matter of fact, in most cases the MIF shifts costs to the credit side. The notice focused only on OUR-transfers because it accompanied a draft Council directive that qualified these transfers as the (preferred) default situation.

[14] *See* 1997 O.J. (C 273) 12 ¶¶ 20 & 24. In the end, the Commission concluded that Art. 81-1 EC did not even apply to the *Accept-Giro* agreement because it did not affect trade between Member States to an appreciable extent.

[15] *Id.*

commercial freedom in the marketplace.[16] However, under Art. 81-3 EC, parties may avoid the prohibition of Art. 81-1 EC if their agreement satisfies four criteria: (i) the agreement must contribute to technical or economic progress; (ii) consumers must get a fair share of the resulting benefit; (iii) the restriction on competition must be necessary to secure the attainment of these objectives; and (iv) the restriction must not lead to a substantial lessening of competition.[17]

A lot of ink has already been spilled over this dualism. Was Art. 81-3 EC the EC's equivalent of the American "rule of reason," whereby antitrust enforcers must balance the procompetitive and anticompetitive effects of an agreement? Or, could Art. 81-3 EC serve as a basis for clearing anticompetitive agreements on grounds unrelated to orthodox antitrust policy (e.g., employment, environmental or industrial policy grounds)? Recently, the Commission has clarified that under Art. 81-3 EC, it will assess agreements by balancing their procompetitive and anticompetitive effects.[18] Although this proposition sounds like a "rule of reason," the results may play out differently on the ground. Under Art. 81-1 EC, the Commission usually examines the extent to which agreements may distort the *process* of competition between suppliers in one or more relevant markets.[19] Agreements that distort this process to an appreciable extent are, in principle, prohibited. However, these agreements will escape this prohibition pursuant to Art. 81-3 EC if they give rise to *efficiencies* that outweigh the distortion of the competitive process.[20]

To fully appreciate the dichotomy between Art. 81-1 EC's process-oriented view of competition and Art. 81-3 EC's result-oriented view of competition, one should consider the

[16] *See* Communication from the Commission, Guidelines on the Application of Art. 81(3) of the Treaty, 2004 O.J. (C 101) 97.

[17] *Id.* ¶ 34.

[18] *Id.* ¶ 33.

[19] *Id.* ¶ 15.

[20] *Id.* ¶ 43.

following passage from the Commission's notice that contains guidelines on the application of Art. 81-3 EC ("Guidelines on Art. 81-3"):

> Agreements that restrict competition may at the same time have pro-competitive effects by way of *efficiency* gains. . . . When the pro-competitive effects of an agreement outweigh its anti-competitive effects the agreement is on balance pro-competitive and compatible with the objectives of the Community competition rules. The net effect of such agreements is to promote the very essence of the *competitive process*, namely to win customers by offering better products or better prices than those offered by rivals. This analytical framework is reflected in Article 81(1) and Article 81(3). The latter provision expressly acknowledges that restrictive agreements may generate objective economic benefits so as to outweigh the negative effects of the restriction of competition.[21]

1. The Commission's Three-Tiered Reasoning

The *Visa International* decision reflects the dualism that is embedded in Art. 81 EC. At the outset, the Commission stated that Visa's original MIF was not critical to the operation of the Visa system. Moreover, in applying Art. 81-1 EC, the Commission explained that the MIF restricted competition because it caused a "knock-on" effect between acquiring banks and merchants. Next, the Commission assessed Visa's amended MIF under Art. 81-3 EC. Like the original MIF, the amended MIF did produce a "knock-on" effect on merchants. However, the Commission allowed the amended MIF because it was cost-based, and therefore, mitigated the impact of this "knock-on" effect. The following sections examine each step of this three-tiered reasoning.

[21] *Id.* ¶ 33 (emphasis added).

a. The Original MIF is Not Necessary for the Operation of the Visa System

As a matter of principle, the Commission concedes that Art. 81-1 EC does not apply to ancillary restraints, i.e., restrictive practices "directly related and *necessary* to the implementation of a main non-restrictive transaction and proportionate to it."[22] Regardless, it refused to grant Visa's original MIF "ancillary restraint" status under Art. 81-1 EC.[23] The Commission rejected Visa's argument that its MIF contributed to the scale of its operations, and thus, to its commercial success.[24] Rather, the Commission observed that such an argument should "be considered under Art. 81-3 EC and not under Art. 81-1 EC; where the question is whether the clause is *technically* necessary for the operation of the Visa payment system."[25]

In the Commission's view, the only restrictions that are absolutely necessary for the proper functioning of Visa's payment system are: (i) technical arrangements for processing the card payments; (ii) the acquiring banks' obligation to accept all payments validly entered into the system; and (iii) the issuing banks' obligation to decide *ex ante* how they will recoup their costs.[26] The issuing banks do not need to set an MIF *ex ante* in order to honor the latter obligation and to refrain from engaging in what the Commission describes as "*ex post* pricing."[27] Indeed, issuing banks may charge cardholders directly, in whole or in part, for these costs.[28] However, the Commission does not examine

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[22] *Id.* ¶ 29 (emphasis added).

[23] *Visa Int'l II*, ¶ 60.

[24] *Id.* ¶ 59.

[25] *Id.* (emphasis added). Later in the decision, the Commission actually concedes that the MIF contributes to the proper functioning of Visa's payment system. *Id.* ¶ 69.

[26] *Id.* ¶ 59.

[27] *Id.*

[28] *Id.* ¶¶ 59, 79 (indicating that "[t]he absence of some sort of default rule on the terms of settlement could lead to abuse by the issuing bank, which is in a position of monopsony as regards the acquiring bank for the

whether direct charging is *commercially* feasible. This recognition illustrates the Commission's tendency to adopt a rather formalistic approach under Art. 81-1 EC. Ultimately, the Commission actually conceded that direct charging is unlikely to be commercially feasible under Art. 81-3 EC.[29]

It is difficult to reconcile the Commission's focus on the technical, as opposed to the commercial, necessity of the alleged restriction on competition with the European Court of Justice's ("ECJ") judgment in *Gottrup Klim*.[30] In this case, the ECJ held that a contract clause falls outside the scope of Art. 81-1 EC if it is *commercially* indispensable for the operation of a given type of legitimate business. In the ECJ's view, a provision in the bylaws of a cooperative purchasing association, which forbids its members from participating in any other organized cooperation that directly competes with it, is not rendered unlawful by the prohibition set forth in Art. 81-1 EC "so long as the above mentioned provision is restricted to what is necessary to ensure that the co-operative functions properly and maintains its contractual power in relation to producers."[31]

b. The Original MIF Restricts Competition Within the Meaning of Art. 81-1 EC

The Commission accepts that the MIF is not a *per se* unlawful price cartel. In "Eurospeak," it "does not consider the MIF agreement to be a restriction of competition *by object*."[32] Thus, the Commission concedes that Art. 81-1 EC applies only if the MIF somehow produces anticompetitive *effects*. Although it acknowledged the existence of "interdependent *demand* from merchants and cardholders"

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settlement of an individual payment transaction. Thus, some kind of default arrangement is necessary, but the question of whether it qualifies for exemption or not will depend on the details of the arrangement.").

[29] *Id.* ¶ 102.

[30] Case C-250/92, Gottrup-Klim e.a. Grovvareforeninger v. Dansk Landbrugs Grovvareselskab AmbA, 1994 E.C.R. I-5641.

[31] *Visa Int'l II*, ¶ 45.

[32] *Id.* ¶ 69 (emphasis added).

in four-party card systems, the Commission takes the view that "Visa issuers and acquirers each *offer* a distinct service to a distinct customer."[33] Accordingly, the Commission concluded that the MIF "distort[ed] the conditions of competition on the Visa issuing and acquiring markets."[34]

In the acquiring market, the MIF represents about 80% of the so-called Merchant Service Charge ("MSC") that merchants pay to their banks. Consequently, the MIF "effectively impos[es] a floor to the MSC."[35] In the Commission's eyes, the problem is, therefore, that the MIF significantly reduces the margin within which acquiring banks compete on price with each other.

In the issuing market, the MIF "may discourage innovation and efficiency . . . and may lead to the oversupply of cards."[36] The Commission probably assumes that oversupply is inevitable if issuing banks do not charge cardholders to use their credit cards, but shift most of their costs from the debit side to the credit side. In addition, the Commission appears to assume that the lack of price competition will also lessen competition for innovation.

In sum, the Commission concludes that Visa's MIF produced anticompetitive effects in two distinct *intrasystem* markets. However, it acknowledged that the MIF "has as its objective to increase the stability and efficiency of operation of [its payment] system and indirectly to strengthen competition between payment systems by thus allowing four-party systems to compete more effectively with three-party systems."[37] It is remarkable that the Commission does not examine whether the procompetitive effects of the MIF at the

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[33] *Id.* ¶ 65 (emphasis added). *See also id.* ¶ 82 (describing the interdependent nature of the demand in observing that each type of consumer—cardholders and merchants—"would prefer the costs of the system to be paid by the other user").

[34] *Id.* ¶ 66.

[35] *Id.* ¶ 71. *See also id.* ¶ 68 (Commission is more cautious when stating that the MIF "is *likely* to constitute a *de facto* floor" for the MSC (emphasis added)).

[36] *Id.* ¶ 71.

[37] *Id.* ¶ 69.

level of *intersystem* competition between four-party and three-party payment systems outweigh the anticompetitive effects at the level of *intrasystem* competition between banks.

c. The Amended MIF Meets the Conditions Set Forth in Art. 81-3 EC

Under Art. 81-3 EC, the Commission maintained the distinction between intrasystem acquiring and issuing markets. Although the amended MIF did not differ fundamentally from the original MIF, the Commission concluded that it met the conditions of Art. 81-3 EC.[38] According to the Commission, the amended MIF *contributes* to economic or technical progress for the benefit of consumers solely because its cost-based nature *mitigates* the negative "knock-on" effect that the original MIF had on merchants in the acquiring market.[39] In fact, the sole benefit of the amended, cost-based MIF is that it causes less harm to the merchants than the original MIF.

The Commission also admitted that the amended MIF was *indispensable* to achieving this benefit.[40] Bilateral interchange fee arrangements are not an option.[41] In addition, in the absence of an MIF, issuing banks would have to either cross-subsidize their card issuing activity or charge their cardholders directly for using their cards.[42] In fact, the Commission's reasoning is valid for all MIFs, whether or not they are cost-based.

2. Contribution to Progress (First Condition of Art. 81-3 EC): The Impact of the Amended MIF on Competition in the Acquiring Market

The Commission first developed its argument under Art. 81-1 EC, by contending that Visa's original MIF produced a

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[38] *Id.* ¶ 91.
[39] *Id.*
[40] *Id.* ¶ 103.
[41] *Id.* ¶ 101.
[42] *Id.* ¶ 102.

negative "knock-on" effect on competition in the acquiring market. It observed that merchants have no effective power to negotiate the MSC with the acquiring banks for several reasons. First, the original MIF is "a business secret."[43] Second, most issuing banks are members of both the Visa and Eurocard/MasterCard systems, and therefore, are "likely to issue whichever of the two brands had the higher MIF."[44] Third, merchants are better off if they incorporate the MSC in the retail prices of their goods than if they cease accepting Visa cards because Visa's MSC is too high.[45]

The Commission then acknowledged that Visa's proposal to link the MIF to the cost of three services supplied by the issuing banks to the merchants "mitigated" its concerns over the lack of competition in the acquiring market.[46] These services include: (i) processing the card payment; (ii) guaranteeing the card payment; and (iii) offering a free funding period. The Commission acknowledged that the amended MIF would not exceed the costs of these services,[47] and that the services "can all be said today to be, *at least in part*, to the benefit of the merchant."[48] However, the Commission adapted its language for each service. With regard to the first service, the Commission stated that "there is no doubt that the merchant benefits" from the processing fee. On the other hand, regarding the two other services, the Commission recognized that guaranteeing the card payment is a service for which "[n]o evidence has been provided . . . to suggest that . . . insurance against fraud and credit losses linked to international card payments would be widely

[43] *Id.* ¶ 80.

[44] *Id.*

[45] *Id.*

[46] *Id.*

[47] *Id.* ¶ 92. Note that the Commission demonstrates a deferential attitude in trusting that the amended MIF will not exceed the cost of these three services. It also points to a cost study using a representative sample of Visa members audited by an independent expert in order to guarantee such a result.

[48] *Id.* ¶ 85 (emphasis added).

available to retailers." [49] In this respect, it observed that the likelihood of fraud is much higher for cross-border than for domestic transactions.[50] With regard to the free funding period, the Commission also focused on the benefits to merchants for international card payments and added that it "might conceivably reach a different conclusion" in the case of domestic card payments.[51]

3. Indispensable Contribution to Progress (Third Condition of Art. 81-3 EC): The Impact of the Amended MIF on Competition in the Issuing Market

The Commission began by stating credit card companies may not use bilateral interchange fee arrangements. With several thousand banks operating in Visa's EU region, such arrangements would increase the "negotiation and transaction costs" and "result in higher and less transparent fees."[52] However, the Commission added that this conclusion does not necessarily apply in a domestic context "where the number of banks may well be far fewer and the efficiency gains of a multilateral agreement vis-à-vis bilateral agreements may not outweigh the disadvantage of the creation of a restriction of competition."[53]

In focusing on the issuing market, the Commission submitted that "in the absence of an interchange agreement, the issuing banks would have to absorb the costs of such services or charge them directly in whole or in part to the cardholder."[54] In the case of cost absorption, the absence of an interchange fee "would probably lead to them being recovered by higher fees for unrelated services (cross-subsidi[z]ation)."[55] Direct charges "might destabili[z]e the

[49] *Id.* ¶ 86.
[50] *Id.*
[51] *Id.* ¶ 89.
[52] *Id.* ¶ 101.
[53] *Id.* ¶ 101 n.45.
[54] *Id.* ¶ 102.
[55] *Id.*

Visa system because cardholders could make less use of their Visa cards, considering the price now to be excessive," and "this reduction in the use of Visa cards could in turn make the card less attractive to merchants, thus setting off a downward spiral in the use of the Visa system."[56]

Clearly, the Commission's reasoning on indispensability is not limited to cost-based MIFs alone. It also applies when issuing banks charge a zero MIF[57] or an MIF that only partly covers the cost of the respective services.

III. THE *VISA INTERNATIONAL* DECISION: APPRAISAL OF THE THEORY OF HARM

Recall that the Commission objected to Visa's original MIF because it caused a "knock-on" effect in the relationship between acquiring banks and merchants by raising the costs to merchants. However, the Commission's theory of harm is deficient for a number of reasons. First, the Commission accepted that the MIF did not substantially lessen the inter-system competition between Visa and its competitors, particularly Europay.[58] By assessing the MIF under the fourth condition of Art. 81-3 EC, it eschewed the European merchants' suggestion that Visa formed a near duopoly with Europay and that collusion existed between the two card payment systems.[59] According to the Commission, there was no evidence of any such collusion.[60] It follows that, whatever harm the original MIF might have caused to intrasystem competition at the acquiring side, the Commission acknowledged that it did not restrict, either alone or in combination with the MIF of another competitor, intersystem competition.

Second, the Commission recognized that the cost-based MIF would merely mitigate its concerns about the original MIF's "knock-on" effect in the relationship between the

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[56] *Visa Int'l II*, ¶ 102.

[57] In "interchange" jargon, they charge an MIF "at par."

[58] *Visa Int'l II*, ¶ 106.

[59] *Id.*

[60] *Id.*

acquiring bank and the merchant. However, the Commission failed to explain how a cost-based MIF, as opposed to the originally proposed MIF, contributed to consumer welfare.

Third, the Commission did not explain its concern about the merchants' practice of incorporating the MSC (including the MIF) into their general overhead costs. Does the Commission suggest that non-card paying customers cross-subsidize the merchants' acceptance of Visa cards? If so, it is far from clear whether this theory is correct because every means of payment imposes costs on merchants. For example, when consumers pay with cash, large merchants will pay security agents to collect the cash several times a day. Thus, they may even accept card payments for an amount higher than the cost of the purchased goods and pay out the excess in cash to customers. This practice indeed reduces the security risk of carrying too much cash. As a result, merchants usually incorporate all costs related to the various payment methods into their general retail prices.

The Commission has failed to demonstrate that the incorporation of costs related to the acceptance of Visa cards diminishes consumer welfare. If cross-subsidization is the issue, it should have examined whether these cards are more expensive than other means of payment. More generally, there seems to be only one remedy that would directly address a cross-subsidization problem: giving merchants the freedom to charge a fee to customers who use an "expensive" means of payment or to offer rebates to customers that use a less expensive means of payment. However, the Commission cleared Visa's no-discrimination rule (or "ban on surcharging") in a separate proceeding under Art. 81-1 EC.[61]

Fourth, and more fundamentally, there is a "positive story" for all MIFs that shift costs to the credit side, whether

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[61] Commission Decision of 9 August 2001 Relating to a Proceeding under Article 81 of the EC Treaty and Article 53 of the EEA Agreement, (Case No COMP/29.373)—Visa International, 2001 O.J. (L 293) 24 [hereinafter *Visa Int'l I*]. Here, the Commission acknowledged that this rule did not appreciably restrict competition.

they are cost-based or not. The Commission explicitly recognized that "*without* some kind of MIF arrangement, it would not be possible for issuers to recover from merchants the costs of services which are provided ultimately to the benefit of merchants, and this would lead to negative consequences, *to the detriment of the entire system and all of its users.*"[62]

Because issuing banks will cross-subsidize the costs of cards by raising the tariffs on its other banking services or by charging cardholders each time they use their cards, it follows that there may be a "positive story" about the *presence* of an MIF, whether cost-based or not. MIFs avoid cross-subsidization by the issuing banks, and consequently, may offset the "evil" of cross-subsidization perpetrated by the merchant. MIFs also avoid direct charges to cardholders, and thus, may offset the "knock-on" effect of MIFs in the acquiring market. The Commission seems to acknowledge this result in stating that the Visa MIF avoided "a downward spiral in the use of the Visa system" that would otherwise result from direct charging.[63] By accepting that such direct charges "might destabili[z]e the Visa system,"[64] the Commission really suggested that the MIF was indispensable both for the achievement of technical and economic progress within the meaning of Art. 81-3 EC and for the operation of the Visa system. If this analysis is correct, the Commission implicitly admitted that the MIF was an ancillary restraint that falls outside the scope of Art. 81-1 EC.

Fifth, the Commission did not pretend that its theory about the cost-based nature of Visa's MIF is particularly refined. Indeed, it only referred to services that were "*at least in part,* to the benefit of the merchant."[65] Also, "given

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[62] *Visa Int'l II*, ¶ 98 n.2 (emphasis added).

[63] *Id.* ¶ 102.

[64] *Id.*

[65] *Id.* ¶ 85 (emphasis added). *See also id.* ¶ 92 (stating "the cost of services which issuing banks provide wholly or partly to the benefit of merchants").

the difficulties of measuring the average marginal utility of a Visa card payment to each category of user," the Commission's sole ambition was to find "some acceptable *proxy* for this."[66] Therefore, the Commission seemed to concede implicitly that its theory about specific services for the benefit of a distinct category of customers (i.e., the merchants) was rather futile. All in all, the Commission drew limited lessons from the concept of "interdependent demand from merchants and cardholders."[67] Had the Commission accepted that issuing and acquiring banks jointly supply a single product, it could have permitted the MIF as a cost allocation device under Art. 81-1 EC on the ground that it was either an ancillary restriction or a non-restrictive price arrangement. Instead, the Commission conducted a needless cost analysis and ultimately acted as a mere price regulator by dictating the level at which the MIF becomes a legitimate cost allocation device.

IV. CONCLUSION

In sum, the Commission's exemption of Visa's amended MIF represents a piece of rather interventionist, and by its own admission, unsophisticated price regulation. On the other hand, the Commission recognized the utility of MIFs (cost-based or not) as devices that shift costs from the debit to the credit side of the market in view of the elastic nature of cardholders' demand. Indeed, the Commission acknowledged that direct charging of cardholders "might destabili[z]e the Visa system."[68] Nevertheless, the Commission tried to regulate the level of the MIF in view of the inelastic nature of the *merchants'* demand. Consequently, the Commission acknowledged that "the possibility of merchants ceasing to accept Visa cards if the Visa MIF was too high, was not sufficiently strong to constrain [the] upward pressure [on the level of that MIF]."[69]

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[66] *Id.* ¶ 83.

[67] *Id.* ¶ 102.

[68] *Id.*

[69] *Id.* ¶ 80.

On balance, the Commission did not grant Visa the discretion to allocate costs between the two sides of the market as it sees fit. Rather, it reallocated these costs on the basis of a sense of fairness towards the merchants. Optimization of demand was not its concern. Thus, the analysis returned to the starting point. While the Commission accepted that the two sides of market are interdependent, it did not accept that Visa members jointly supply a single product to cardholders and merchants. In addition, it did not explain why market forces, at the level of intersystem competition, are unable to correct the misallocation of costs that the MIF might cause.

The Office of Fair Trading ("OFT"), the competent United Kingdom competition authority, has recently issued objection statements against both MasterCard's and Visa's MIFs for *domestic* card transactions.[70] By and large, the OFT follows the Commission's theory of harm on intra-system competition. In its view, the domestic MIFs should be a cost-based price for services supplied to the merchants, but they are not.[71] However, the OFT also mentioned harm to inter-system competition. In essence, it suggested that the issuing banks use the MIF revenue to offer loyalty discounts that distort competition between the cards in question and other means of payment. [72]

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[70] *Compare* Press Release, Office of Fair Trading, MasterCard Agreement Anti-Competitive, Rules OFT (Sept. 6, 2005), *available at* http://www.oft.gov.uk/ News/Press+releases/2005/168-05.htm [hereinafter *MasterCard Press Release*] *with* Press Release, Office of Fair Trading, OFT Issues Statement of Objections on Visa Agreement (Oct. 19, 2005), *available at* http://www.oft.gov.uk/News/Press+releases/2005/195-05.htm [hereinafter *Visa Press Release*].

[71] *See MasterCard Press Release* (noting that "recovering extraneous costs through [MasterCard's MIF] resulted in merchant acquirers paying a higher interchange fee to card issuers than if the [MIF] had been used just to recover the costs of the payment transmission mechanism").

[72] *See MasterCard Press Release* (indicating that "[t]he inclusion of extraneous costs in the [MasterCard MIF] provided a large flow of revenue to card issuers and the incentive to induce customers to hold and use MasterCard cards, for example, through loyalty schemes . . . [t]his distorted competition between the MasterCard scheme and alternative

The Commission is likely to challenge MasterCard International's MIF for cross-border credit card transactions on grounds similar to those expressed in its Visa International decision.[73] However, the Commission may develop a theory of harm that refers to inter-system competition. In this respect, one should recall that in June of 2005, the Commission launched an EU-wide sector inquiry into the payment cards business.[74] We might have to await the outcome of this inquiry to find out whether the Commission will develop, refine, or revise the theory of harm that focuses on intra-system competition and underpins its *Visa International* decision.

methods of payment such as debit cards, cheques or cash").

[73] *See EU May Accuse MasterCard of Overcharging Customers, People Say*, Bloomberg, Oct. 27, 2005, http://www.shanghaidaily.com/art/2005/10/28/208476/MasterCard_faces_fee_charges.htm.

[74] *See* Press Release, European Commission, Competition: Commission Opens Sector Inquiries into Retail Banking and Business Insurance (June 13, 2005), *available at* http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/05/719&format= HTML&aged=0).