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The European Commission's *MasterCard* Decision of December 19, 2007[1] (the Decision) concerns fallback multilateral interchange fees (MIF) set by MasterCard, which issuing banks charge acquiring banks for cross-border payment card transactions within the European Economic Area (EEA) and which are applied where there is no bilateral agreement between the banks concerned. The Decision marks the end of an investigation that originated with a complaint to the Commission in 1992 by retailers concerning cross-border interchange fees and with the notification shortly thereafter by the predecessor of MasterCard of its network rules. The Commission's first Statement of Objections relating to MasterCard's Intra-EEA fallback interchange fees was issued in September 2003.

In its Decision, the Commission found that MasterCard infringed Article 81 over the course of a 15-year period by "in effect setting a minimum price merchants must pay to their acquiring bank for accepting payment cards in the European Economic Area, by

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[1] Commission Decision 19/XII/2007 of 19 December 2007, Cases COMP/34.579 MasterCard, COMP/36.518 EuroCommerce, and COMP/38.580 Commercial Cards (not yet reported) [hereinafter Decision], *available at* http://ec.europa.eu/comm/competition/antitrust/cases/decisions/34579/provisional_nc_decision.pdf (provisional non-confidential version). The author has access only to the non-confidential version of the Decision published by the Commission.

means of the Intra-EEA fallback interchange fees." MasterCard has been ordered to bring this infringement to an end and to refrain from repeating it through any act or conduct having the same or equivalent object or effect. MasterCard has been ordered to repeal not only the Intra-EEA fallback interchange fees, but also the SEPA/Intra-Euro zone fallback interchange fees, established recently in anticipation of the creation of the Single Euro Payments Area (SEPA). The Commission has granted MasterCard a six-month period in which to repeal these interchange fees and to modify its network rules. Daily penalty payments at a rate of 3.5 percent of MasterCard's global daily turnover (70 percent of the permitted maximum) will be imposed in the event of failure to comply. MasterCard has announced that it has filed an appeal against the Decision with the Court of First Instance and has confirmed its intention to comply with the Decision while the appeal proceeds.

The history behind the Commission's Decision is significant. Both domestic and cross-border MIF have been under investigation, or the subject of regulatory intervention, in several jurisdictions in recent years. In Australia, for example, the Reserve Bank took action in 2001 to regulate interchange fees. The effects of such intervention and the inferences to be drawn from it were debated in the course of the proceedings before the Commission. In the United Kingdom, the Office of Fair Trading (OFT) issued an infringement decision with regard to MasterCard's domestic MIF in 2005. The decision was appealed and the OFT decided in the course of the appeal that it should be withdrawn (technically, the OFT's decision was set aside by the Competition Appeal Tribunal). Most pertinently, in 2002 the Commission granted an exemption under Article 81(3) with respect to Visa's cross-border MIF within the EEA for a period expiring on December 31,

2007. Visa reduced its MIF progressively during the period of the exemption. Following the expiry of the exemption, on March 26, 2008 the Commission announced the initiation of formal antitrust proceedings against Visa with regard to its cross-border MIF within the EEA, stressing that the initiation of proceedings implied no proof of infringement. In doing so, the Commission explained that the intervention was based on Article 11(6) of Council Regulation 1/2003, which has the effect of preventing national competition authorities within the European Union from applying EC competition law to the matter. Finally, as noted by the Commission when announcing the Decision, the Commission's sector inquiry into retail banking in 2005 and 2006 found that interchange fee arrangements might stand in the way of a more cost-efficient payment cards industry and the creation of SEPA.

The Decision displays a fundamental divergence between the Commission’s and MasterCard’s approaches to the analysis of the competitive effects of open payment card schemes. To summarize briefly, MasterCard's position (which appears from the Decision to have changed considerably over the course of the proceedings) is that MasterCard, together with its acquirers and issuers, provide payment card services simultaneously to cardholders and merchants. The MasterCard payment service is defined as a "co-operation enabling service" or "demand co-ordinating service" to cardholders and merchants. According to MasterCard, interchange fees are not a payment for costs incurred by issuers, but a tool to allocate revenues between issuing and acquiring banks in order to balance properly the demands of cardholders and merchants. On this basis, there is an interchange fee that maximizes system output.[2] Consistent with this analysis, MasterCard contended that the relevant market is that in which different payment card systems' services compete with each other and with all other forms of payment.[3]

The Commission essentially rejected MasterCard's analysis and all of the consequences that flowed from it. In the Commission's view, two-sided demand does not imply the existence of a single "joint product" and the relevant product is not merely payments, but also separate acquiring and issuing services. The MasterCard platform is a vehicle for issuers and acquirers to offer distinct services to two groups of customers, which have different responses to final prices.[4] The Commission defined the relevant product market for assessing the MIF as the market for acquiring payment card transactions, which remain national in scope for the time being.[5]

MasterCard accepted the Commission’s view that it was an association of undertakings within the meaning of Article 81(1) EC, until the initial public offering (IPO) of MasterCard Incorporated took place in May 2006. Thereafter, MasterCard argued that it had become an independent undertaking pursing its own commercial interests for the benefit of its stockholders. The Commission disagreed, finding that the changes in governance of MasterCard in Europe, brought about by the IPO, did not fundamentally alter its cooperative and representative character. Since the IPO, "the MIF

[2] *See id.* at paras. 148-152.

[3] *Id.* at para. 250

[4] *See id.* at paras. 257-74.

[5] *Id.* at paras. 307, 317 & 329.

remains to be the faithful expression of the association's resolve to co-ordinate the commercial conduct of its members."[6]

The Commission reached the view that MasterCard's MIF restricted competition between acquiring banks by inflating their cost base and thereby placing a price floor on the acquiring fees charged to merchants, a conclusion based in part on quantitative surveys. The Commission did not accept MasterCard's argument that intersystem competitive pressures constrained interchange fees to an optimum efficiency-enhancing level and was particularly concerned that the MIF had become an artificial element of intersystem competition. According to the Commission, there was a risk of inflating merchant fees in countries in which MasterCard replaced domestic card schemes that operated without a MIF. Clearly, having taken the view that issuing banks generally have the incentive to choose or promote a scheme with a MIF over one without (or one with a higher MIF over one with a lower)[7] and perceiving that banks in a number of Member States appear to be using this opportunity to switch domestic payment card schemes to MasterCard in preparation for SEPA, the Commission feared that this process could lead to an overall increase in interchange and merchant acquiring fees in the Euro zone.

The fundamental difference between MasterCard's and the Commission's arguments can almost be encapsulated in three paragraphs of the Decision. MasterCard says that it is in the interests of the MasterCard system, its members, cardholders, and merchants and competition in the payments market to set a MIF at an output-optimizing level. As output maximization equals competition maximization, intervention is

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6 *Id.* at para. 397.

7 *Id.* at para. 471.

unnecessary. The Commission, however, concludes that market forces do not sufficiently constrain the MIF and that all banks share a common interest that merchants pay a higher price than they would in a fully competitive market.[8] It cannot be presumed, therefore, that output optimization and profit maximization within the MasterCard scheme produce a fully competitive outcome.

The discussion of whether a MIF is necessary for the operation of the scheme is interesting. Based on *Gottrup-Klim* and *Wouters*, the Commission advances the principle that restrictive clauses that are desirable for the commercial success of an operation, but not necessary for its viability, do not escape Article 81(1) but must be assessed under the exemption criteria of Article 81(3).[9] The Commission concludes that the only provisions necessary for the operation of an open payment card system are the obligation on the creditor bank to accept any payment validly entered into by the debtor bank and a prohibition on ex-post pricing by one bank to the other. A mechanism such as the MIF that shifts costs and revenues between issuing and acquiring banks is not necessary for the banks' cooperation under the system. A series of open payment card schemes operating at a national level within the European Union without a MIF are described in some detail. The Commission's analysis of the effects of the Australian Reserve Bank's intervention mentioned earlier (which reduced, but did not eliminate MIF) was that it had not prevented MasterCard from continuing to grow, in contrast with the "death spiral" that MasterCard had said would be the result. A MIF and its restrictive effects on price

[8] *Id.* at paras. 497-99.

[9] *Id.* at para. 527. *See* Case C-250/92, Gottrup-Klim, Grovvareforeninger v. Dansk Landbrugs Grovvareselskab AmbA, 1994 E.C.R. I-5641 and Case C-309/99, Wouters, Savelbergh, Price Waterhouse Belastingadviseurs v. Algemene Raad van de Nederlandse Orde van Advocaten, 2002 E.C.R. I-1577.

competition between acquiring banks were therefore concluded not to be objectively necessary.[10]

The analysis in the Decision of whether the Article 81(3) exemption criteria are satisfied is rather brief for a set of issues that might have been expected to be at the heart of the Decision.[11] It may be that the premises adopted by the Commission and MasterCard were so far apart that it was difficult to engage in constructive debate on these matters. The Commission accepted that a payment card scheme such as MasterCard could as such represent economic and technical progress and that it may be efficient for there to be cost reallocation between companies in two-sided industries in order to make use of network effects.[12] It did not dispute that, in principle, in a payment card system characterized by indirect network externalities, interchange fees can help to optimize the utility of the network to its users.[13] There is nevertheless repeated emphasis placed on the need for "convincing" or "robust empirical" evidence to support the specific contribution of the MIF in this respect. The Commission did not accept without evidence that increasing MasterCard's system output contributed appreciable objective advantages, in the absence of evidence that parties other than MasterCard's member banks benefited. The Baxter pricing framework that MasterCard relied on was regarded as a theoretical construct, not based on realistic assumptions. The level at which a MIF should be set to enhance scheme output could not, in the Commission's view, be determined in a general

[10] Decision, *supra* note 1, at paras. 555-648.

[11] The discussion of whether the Article 81(3) exemption criteria are satisfied consumes 20 pages out of a total of 210.

[12] Decision, *supra* note 1, at paras. 680 & 682.

[13] *Id.* at para. 729.

manner by economic theory alone. Overall, the existence of objective appreciable efficiencies is to be assessed in relation to the MIF, the effects it produces on the market, and the manner in which it is set.[14]

With respect to consumers, the Commission's position appears to be that a fair share of the benefits of the scheme must be guaranteed to all customers, both cardholders and merchants, not only to customers on the issuing side.[15] The Commission treated the indispensability criterion as unproven, observing that MasterCard had not provided empirical evidence of actual effect of the MIF on the market regarding system output.[16] According to the Commission, MasterCard did not demonstrate that its MIF fulfills the first three conditions of Article 81(3).

Where does the Decision leave MasterCard and, indeed Visa, following the expiry of its exemption and the Commission's initiation of proceedings described earlier? There are suggestions in the Decision that circumstances have changed since the Commission's Visa exemption decision in 2002. With regard to its appeal, MasterCard has said that its objections to the Decision include:

- the Commission's failure to recognize that four-party payment card systems cannot operate without default settlement terms, which requires the setting of an interchange fee;
- the Commission's failure to recognize the efficiencies that such systems create and the fairness of MasterCard's MIF; and

[14] *Id.* at para. 731.

[15] *Id.* at para. 740.

[16] *Id.* at para. 751.

- the Commission's conclusion that MasterCard continues to be an association of undertakings following the IPO.[17]

The type and strength of empirical evidence that the Commission says is necessary in order to exempt a MIF, however, appears to pose great challenges for both systems, particularly given the scant weight placed on the economic evidence that MasterCard has presented so far. The Commission's press statement, Q&A, and Commissioner's announcement of the decision all emphasize the need for convincing proof of the benefits of a MIF, using phrases such as "empirical proof that the MIF creates efficiencies", "objectively verifiable methodology", and "detailed robust and compelling analysis that relies in its assumptions and deductions on empirical data and facts." Are these criteria that the payment card systems will be able to satisfy? Has the force with which the Commission's conclusions been expressed made it harder to reach settlements with both MasterCard and Visa? The complex data needed to analyze fully the effects of schemes on all classes of participants and customers is scarcely available. Are decisions by competition authorities that regulate MIFs, but are based on data that is incomplete or out of date (or both), likely to be genuinely beneficial to cardholders and merchants alike?

The Commission's Q&A suggests that a "new generation" of MIFs is being developed that will be detached from the concept of network externalities and could more clearly contribute to technical and economic progress. In reviewing such schemes, the Commission says that it will pay particular attention to promoting more efficient means

[17] Press Release, MasterCard Worldwide, MasterCard Files Appeal of European Commission Decision (Mar. 3, 2008), *available at* http://www.mastercard.com/us/company/en/newsroom/pr_EC_Decision_Appeal.html.

of payment and helping to win the "war on cash". This "war" is scarcely acknowledged in the Decision[18] and it is not self-evident that the Commission should place great weight on this matter in a strict competition analysis. It might be thought that the best evidence of whether the war on cash has been “won”, is whether payment card schemes have achieved output maximization—the very factor that the Commission refused to acknowledge as competition- or efficiency-enhancing. Furthermore, is ignoring network externalities good economics and is it likely to lead to decisions about interchange fees that enhance consumer welfare?

[18] *See* Decision, *supra* note 1, at para. 726, where the Commission says that none of the evidence provided shows that the MIF was causal for the replacement of cash and checks in Europe.