When Market Definition Trumps Competitive Effects Analysis: *First Data/Concord* versus *In Re Visa Check*

BY JEFFREY I. SHINDER

THE INFLUENCE OF ANTITRUST enforcement can be felt in many parts of the U.S. economy. One noteworthy example in recent years is in consumer payment systems, in which several major private cases and government enforcement actions have caused serious reverberations throughout the payment industry. A significant recent antitrust development affecting the industry occurred in early 2003, when the merchant class action against Visa and MasterCard settled on the eve of trial, after the district court entered partial summary judgment in favor of the merchants on significant aspects of their antitrust claims.[1] The year closed with the Antitrust Division and certain state attorneys general (collectively "the agencies") challenging the First Data/Concord merger, ultimately forcing First Data to agree to sell its majority interest in the NYCE network as a condition of clearing the transaction.[2]

The similarities and differences between these cases raise many interesting issues of antitrust law and economics. This article focuses on the stark contrast between relevant product markets asserted in each case. In *Visa Check*, the merchants asserted—and the district court accepted—a relevant product market in debit cards that included both forms of debit card transactions, i.e., those authenticated with a signature (called signature debit) and those authenticated with a personal identification number (called PIN debit). In First Data/Concord, the agencies alleged a narrower product market limited to PIN debit.

The difference between these two conceptions of the relevant market raises the question of whether the agencies premised their merger challenge on an improperly narrow market definition and thereby justified the abandonment of a transaction that could have created a necessary counterweight to Visa in a broader debit card market. It also raises the issue of whether the agencies, in defining a narrow product market, walked into a new version of the "*Cellophane* fallacy" by failing to account for Visa and MasterCard's market power in a broader debit card market. If they did, the case provides a cautionary tale for future antitrust enforcement. Unlike the traditional setting, in which the "*Cellophane* fallacy" may unduly broaden the relevant market and (all else being equal) weaken the case for antitrust enforcement, the agencies' mistake in First Data/Concord had the opposite effect by lending support to a merger challenge that may prove to be misguided. Either way the lesson is the same: Do not put too much stock in the definition of relevant markets, and don't use market definition as a substitute for a thorough analysis of past or future competitive effects.

Market Definition in Debit: *In re Visa Check*

Retail merchants in *Visa Check* challenged the Honor All Cards rules of Visa and MasterCard, which required merchants to accept all Visa and MasterCard branded payment cards, including debit cards at allegedly inflated prices. The merchants contended (1) that these rules constituted per se unlawful tying arrangements because, among other things, the merchants could not do business without accepting Visa and Master Card credit cards, and (2) that Visa and MasterCard used the tying rules and other exclusionary conduct to dominate the market for debit card services.

In their tying claims, the merchants argued that credit and debit card services are distinct services to merchants and that they constitute separate relevant product markets. The merchants contended that, because credit cards generate incremental (or extra) sales for merchants and debit cards do not, these products are not substitutes. Visa and MasterCard countered that all forms of payment compete for merchant acceptance because consumers constantly shift between various forms of payment based on their individual circumstances and the type of store and purchase being made. The district court, in granting partial summary judgment in favor of the merchants, credited evidence that other forms of payment do not constrain the prices merchants pay for accepting general purpose credit (or credit and charge) cards.[3]

The district court also addressed the merchants' claim that debit cards constitute a separate relevant product market comprised of the two forms of debit card services that are prevalent in the United States: PIN debit and signature debit. If accepted, this market would include Visa and MasterCard's signature debit services; the Visa Check Card and Debit MasterCard; and the services offered by several PIN debit

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networks, including Visa's Interlink network and the "regional" networks that also compete for merchant acceptance and bank participation.[4] The merchants contended that, under the umbrella of the supracompetitive fees that Visa and MasterCard forced merchants to pay for signature debit, the PIN debit networks had consistently increased the price of PIN debit without losing acceptance, and that cash and checks did not discipline the price of debit card acceptance to merchants.

Visa and MasterCard countered that the relevant product market should at least include all forms of consumer payments that access or utilize the funds consumers hold on deposit, including cash and checks. In their view, because consumers tend to use debit cards instead of cash and checks for everyday purchases like groceries, cash and checks also should be included in the market. The merchants responded that this position improperly conflates consumer substitution with merchant substitution, in that merchants could not use cash and checks as a substitute for debit card services, even if some consumers may use those payment methods interchangeably. The merchants also introduced evidence of price increases for PIN debit to show that consumers use of cash and checks did not discipline the pricing of debit card services to merchants.

After weighing these arguments, the district court granted the merchants partial summary judgment on the issue of relevant product market definition, finding that "debit card services is a well-defined submarket characterized by an inelasticity of demand and universal recognition by the public, the parties, and the industry as a whole."[5] The court did not cite to the voluminous factual record submitted by the parties, but much of the evidence now has been unsealed after Dow Jones successfully petitioned the court for access to the record, and portions are discussed below.

The merchants relied on a 1990 analysis prepared by Andersen Consulting (Visa's longstanding consultant), that outlined a strategy for debit services to merchants that Visa allegedly used to dominate the debit market.[6] Andersen predicted at the time that, if Visa did not act to "contain" the growth of PIN debit, the PIN debit networks would grow tremendously by continuing to utilize a zero interchange ("at-par") pricing model to attract widespread merchant acceptance. To understand the implications of that model for the growth of debit, a brief description of interchange and how it influences prices to merchants and the decisions of banks in payment card networks is needed.

Interchange is a fee that is collectively set by networks and their member banks. In the credit card network model, this fee constitutes the vast majority of the charges merchants pay for accepting Visa/MasterCard credit card transactions. In that model, these fees are ultimately paid to the banks that issue payment cards to consumers. Many merchants contend that the credit card interchange model—which Visa and MasterCard extended to debit through their tying arrangements—results in a perverse competitive dynamic in which networks compete for bank issuance by raising interchange rates to merchants. By contrast, in the 1980s the PIN debit networks developed and thrived without interchange. Under this approach, interchange fees were set at zero ("at-par"), and merchants were not forced to pay interchange to issuing banks.

According to Andersen, the continued success of PIN debit with zero interchange or at-par pricing threatened Visa and MasterCard in two ways. First, their signature debit services would be eliminated. Second, their credit card interchange structures would be undermined. To blunt these threats, Andersen recommended that Visa "contain" PIN debit by tying debit to credit (and thereby supporting a credit-style percentage of the transaction interchange for off-line or signature debit), and by acquiring a leading PIN debit network and setting a high interchange fee for its transactions.

The problem with the agencies' analysis is that, by adopting a narrow market definition, it walked into the "*Cellophane* fallacy."

This strategy was designed to give banks supracompetitive revenue on signature debit and PIN debit interchange services, which would force smaller PIN debit networks into a self-defeating competition to raise the interchange they charged to merchants so that higher interchange payments could be made to banks to attract their loyalty.[7] The merchants asserted that Visa followed Andersen's advice and that the strategy worked. To show that, the merchants introducing evidence that (1) in 1991, Visa bought the then-leading PIN debit network—Interlink—and over time raised Interlink's fees to unprecedented levels for PIN debit; and (2) these price increases forced the PIN debit networks to raise their prices to merchants under the umbrella of the high fees dictated by Visa and MasterCard. The merchants argued that the success of this strategy supported the conclusion that the relevant market should include both signature debit and PIN debit services to merchants.

Developments in merchant usage of debit services following the settlement in *Visa Check* reinforced the conclusion that the relevant product market should include both forms of debit. As the merchants predicted in their damages methodology, the high interchange rates associated with signature debit could not be sustained without the Honor All Cards rules. After the settlement, Visa and MasterCard announced new interchange rates for signature debit transactions that were significantly below the rates that prevailed before the settlement, and large merchants—particularly those with PIN pads—have been offered substantially lower signature debit interchange rates that are likely to be comparable to PIN debit rates.

Wal-Mart, for example, reportedly now pays the same rate for Visa signature and PIN debit services.[8] This trend should intensify as increasingly savvy merchants take advantage of their enhanced bargaining position following the elimination of the Honor All Cards rules, by installing PIN pads and declining to accept signature debit, or by steering high-priced signature debit transactions to PIN debit networks.[9] David Robertson, publisher of the industry publication *The Nilson Report*, described this trend as follows: "[Visa and MasterCard] have made sure to have complete ubiquity in their merchant acceptance network. And to maintain that, they are offering low prices. The merchants have leverage that they never had in the history of the bank card industry."[10]

The most powerful evidence of this leverage was Wal-Mart's treatment of MasterCard's signature debit service. Following unsuccessful negotiations with MasterCard, Wal-Mart stopped accepting Debit MasterCard as of February 1, 2004. According to Wal-Mart, this change neither inconvenienced its customers nor affected its bottom line because customers who were not allowed to use Debit MasterCard simply made PIN debit transactions instead. Faced with Wal-Mart's determined stance, MasterCard relented and likely dropped the price that Wal-Mart pays for MasterCard signature debit transactions to levels at or below PIN debit rates.[11]

Wal-Mart's ability to implement such a strategy has not been lost on other merchants, who now may bargain for lower fees for accepting Debit MasterCard. Against this backdrop, it is hard to see how MasterCard can maintain substantially higher prices for signature debit services than for PIN debit services without jeopardizing its widespread and nearly ubiquitous acceptance.

Visa's conduct in the post-settlement world further reinforces the view that the relevant product market, from the standpoint of merchants and banks, should include both signature debit and PIN debit services. Since the settlement, Visa has intensified its effort to lock in large debit issuers—including First Union/Wachovia, Wells Fargo, and others—to long-term contracts with Interlink as their de facto exclusive PIN debit network. Visa used substantial cash payments, including a reported payment of over $100 million to Wells Fargo, to entice these banks to remain with Visa. Because these payments appear to vastly exceed the near-term value of incremental business that these banks can bring to Interlink, their real purpose may be to maintain Visa's market position and ability to impose supracompetitive interchange fees on merchants for both signature debit and PIN debit processing services. As one analyst put it:

> Visa's CAP payments, that are likely to have exceeded $100 million for Wells in addition to the purported $70 million for Wachovia, do not make sense if PIN debit revenues . . . are considered in isolation of the broader benefit to Visa of obtaining price leadership in PIN debit and hence the ability to set a rising floor under signature debit interchange.[12]

However these moves and countermoves play out, they show that signature debit and PIN debit are reasonably interchangeable for networks, issuers, merchants and consumers, and that price disparities between the two forms of debit are diminishing.

First Data/Concord: PIN Debit and the *Cellophane* Fallacy

During the time that the merchants were settling their claims against Visa and MasterCard, First Data and Concord—the owners of the largest and third-largest PIN debit networks—announced their intention to merge. This transaction appears to have been motivated by a desire to achieve greater scale and geographic scope to compete with Visa for the loyalty of large national banks. By purchasing Star (the leading PIN debit network), and combining it with NYCE (the third-largest PIN debit network), First Data would have created a network that could better withstand the competitive onslaught that Visa unleashed both before and after the merchants' settlement. This arguably procompetitive rationale for the transaction did not find a receptive audience at the agencies, however, which sued to block the transaction and ultimately forced First Data to divest NYCE as a condition of allowing the deal to close.

Citing much of the same industry data that the merchants used to support an all-debit market, the agencies premised their case on a relevant product market limited to PIN debit services. The agencies relied on a "SSNIP test," arguing that a hypothetical PIN debit monopolist could profitably impose a small but significant and nontransitory increase in the price of PIN debit services.

The agencies' complaint (at ¶ 26) described the basis for their narrow PIN debit-only market definition, as follows:

> PIN debit networks would remain substantially less expensive than signature debit or credit card networks even after a small but significant nontransitory increase in price. Merchants would continue to purchase and promote the use of PIN debit network services because of the low fraud rate, corresponding lack of charge-backs, speed of execution at the register, and the cash back feature that consumers demand.

It is hard to argue with any of the facts detailed in this allegation. Signature debit has been substantially more expensive even though PIN debit is superior in many respects, as the agencies alleged. Throughout the 1990s—while the Honor All Cards rules were in effect—the PIN debit networks repeatedly raised their interchange rates under the high-price umbrella for debit services created by Visa and MasterCard, without losing merchant acceptance or causing merchants to steer PIN debit transactions to other forms of payment.

The problem with the agencies' analysis is that, by adopting a narrow market definition, it walked into the "*Cellophane* fallacy."[13] In its traditional form, this fallacy occurs when the relevant market is inappropriately broadened to include purported substitutes merely because, when a price

increase is imposed upon already supracompetitive prices, some consumers will switch away from the dominant product to a functional, but higher-priced, substitute. When this mistake is committed during a merger investigation, the agencies run the risk of clearing an anticompetitive transaction merely because they defined an unduly broad market.

A less common manifestation of the *Cellophane* fallacy occurs when products that are close functional substitutes are placed in separate relevant markets merely because one is substantially more expensive than the other, and the difference is the result of the historic exercise of market power. In this context, the fallacy causes the market to be improperly narrowed due to the historic exercise of market power and the resulting distortion in relative prices for the functional substitutes. When this mistake is committed during a merger investigation, the agencies may challenge a merger that is benign or procompetitive when analyzed in a relevant market that includes other services that are functional substitutes. Such an enforcement stance also may have a chilling effect upon similar transactions in the future.

But would competition have been better served by permitting First Data/Concord to merge, given the extreme concentration of the market?

The agencies appear to have walked into this trap in *First Data/Concord.* The substantial difference between prices for signature debit and PIN debit services was caused by Visa and MasterCard's historic market power over merchants.[14] This conclusion is apparent from the *First Data/Concord* complaint, which details the many ways in which PIN debit is superior to signature debit—it is cheaper, safer, more efficient, and virtually chargeback free. Yet signature debit has been substantially more expensive. A vastly inferior product usually must be offered at lower prices to compete. That the opposite occurred in this market—with Visa and MasterCard charging rates up to ten times higher than the rates charged by the PIN debit networks—can only be explained by Visa and MasterCard's substantial market power over merchants.[15]

Moreover, developments following the *Visa Check* settlement further support the conclusion that the Honor All Cards rules underpinned Visa and MasterCard's substantial market power in debit card services. As discussed earlier, after the Honor All Cards rules were abolished by the settlement, prices for signature debit services rates fell substantially for most merchants, and appear to be declining even further for many large merchants that have PIN debit processing capabilities. Moreover, this trend likely will intensify after Wal-Mart's decision to drop MasterCard debit, as more merchants install PIN pads and successfully steer transactions to PIN debit networks. Even though the DOJ/FTC Horizontal Merger Guidelines (at § 1.12) suggest that markets be defined by using "future prices . . . when changes in the prevailing prices can be predicted with reasonable certainty," the agencies' narrow relevant market allegations do not appear to have accounted for the emerging effects of the merchants' settlement in *Visa Check* on prices for off-line signature debit processing.

Implications of the *Cellophane* Error in *First Data/Concord*

To be fair, the agencies' enforcement stance may simply reflect the difficulty of predicting future prices in a dynamic and volatile market. Visa and MasterCard did not announce their 2004 signature debit rates until mid-December 2003, and MasterCard adjusted its rates to match Visa's in January 2004.[16] In October 2003, when the agencies filed their complaint in First Data/Concord, they may have been unable to reliably predict that prices for signature debit services would begin to fall to PIN debit levels. Even after these rates were announced, many confidential deals between individual merchants and Visa or MasterCard were (and are being) negotiated. Thus, the extent of price declines for signature debit services relative to price levels for PIN debit services may not have been fully disclosed or known to the agencies in the months after First Data agreed to divest NYCE.[17]

Admittedly, by narrowing the market to PIN debit services, the agencies may have enhanced their chances of prevailing at trial or extracting concessions from First Data. In a relevant market limited to PIN debit, based on 2003 dollar volumes the merger would have increased the HHI a whopping 1377 points from an already highly concentrated 3321 to a spectacularly concentrated 4698. When the market is defined as all debit, the shares are almost as concentrated, but the change resulting from the merger is much smaller. In that market, the HHIs would have increased from 3833 to 3995, with the delta a comparatively modest 163.[18]

A broader market consisting of signature debit and PIN debit more fully reflects Visa's dominance in the debit industry and diminishes (at least on paper) the competitive significance of the First Data/Concord merger. In the broader market, Visa's dominant 57 percent market share in 2003 would have dwarfed Star/NYCE's combined 21 percent market share. Moreover, as detailed above, Visa has intensified its efforts to lock large banks that issue debit cards into de facto exclusives for debit network services, to protect its market position after the *Visa Check* settlement.[19]

In the context of the broader all-debit market, First Data/Concord still would have had a challenging, but potentially viable, "against giants" defense to the agencies' merger challenge.[20] Had the agencies analyzed the transaction in the broader all-debit market, the case would have presented an interesting test of this defense after the D.C. Circuit's decision in *FTC v. Heinz*,[21] particularly given that, in contrast to *Heinz*, the First Data/Concord merger occurred in a network market that might be tipping to an already dominant firm.[22] The debit services industry is one in which merger-

specific scale efficiencies arguably justify a transaction that could prevent the market from irreversibly tipping to Visa.

But would competition have been better served by permitting First Data/Concord to merge, given the extreme concentration of the market? The answer may be unknowable without market evidence of whether a Star/NYCE combination would have had greater success in competing with Visa. We do know that, since First Data agreed to divest NYCE, Visa has continued its assault on competition in the debit market, and for the most part First Data has been no more successful at countering Visa than was Concord.[23] Lured by large bounties paid by Visa, banks continue to withdraw from Star. In addition to First Union/Wachovia and Wells Fargo, which withdrew from Star while the merger was pending, others banks have followed suit since the merger challenge.[24] Since that time, several PIN debit networks have raised their interchange rates in an effort to compete with Visa's rates for Interlink. As of now, it appears that market forces have not been sufficient to erode Visa's market position as PIN debit inevitably challenges signature debit as the leading form of debit. The First Data/Concord merger appears to have been a prime case for recognition of the "against giants" defense. Unfortunately, the factual underpinnings for the defense were only apparent in the broader relevant market for both signature debit and PIN debit services that the agencies eschewed.

Conclusion

The First Data/Concord merger highlights the difficulty of defining antitrust markets and analyzing competitive effects in a fluid and fast-changing market. After concluding that the merger would significantly enhance concentration in an already concentrated market, the agencies faced a choice. They could clear the merger to create a competitive counterweight to Visa or they could simultaneously challenge Visa's de facto exclusive deals with banks under Section 2 of the Sherman Act and the First Data/Concord merger under Section 7 of the Clayton Act. Because the agencies walked into the *Cellophane* trap and defined an unduly narrow product market, they forced a divestiture that may have thwarted First Data's ability to be an effective counterweight to Visa, without taking full account of the broader market environment in which the merger may have enhanced competition. Although market definition has a key role in antitrust analysis, this case demonstrates that a close analysis is needed of actual industry effects in other potentially relevant markets in which the products or services in question are close functional substitutes. ■

[1] *In re* Visa Check/MasterMoney Antitrust Litig., No. 96-CV-5238, 2003 WL 1712568 (E.D.N.Y. Apr. 1, 2003) (*Visa Check*).

[2] United States v. First Data Corp., No. 03 CV 2169 (D.D.C. filed Oct. 23, 2004) (complaint), *available at* http://www.usdoj.gov/atr/cases/f201400/201400.htm. In another notable decision for this industry, the Second Circuit Court of Appeals affirmed the invalidation of the Visa and MasterCard rules that prohibited their members from issuing cards on competing networks. As of the writing of this article, petitions for certiorari filed by Visa and MasterCard are still pending. United States v. Visa U.S.A. Inc., 163 F. Supp. 2d 322, 340 (S.D.N.Y. 2001), *aff'd*, 344 F.3d 229 (2d Cir. 2003), *cert. denied*, 2004 WL 2049776 (Oct. 4, 2004), and *cert. denied*, 2004 WL 2049840 (Oct. 4, 2004).

[3] *Visa Check*, 2003 WL 1712568 at*3. General purpose credit cards typically have a preset spending limit and they give consumers the ability to choose to repay their outstanding balances over time. Visa and MasterCard credit cards are general purpose credit cards. Charge cards typically have no preset spending limit and they do not give cardholders the opportunity to revolve their balances over time. The traditional American Express card is a charge card.

[4] Many of the PIN debit networks have been traditionally referred to as the "regional networks" because they emerged from the numerous Automated Teller Machine networks that formed in various regions of the United States in the late 1970s and early-to-mid 1980s. This nomenclature is currently dated as many of the "regional networks" including First Data's Star network (which is discussed more fully below) have achieved national dimensions via mergers, and to a lesser degree, internal expansion.

[5] *Visa Check*, 2003 WL 1712568 at *7.

[6] *See* FINANCIAL IMPACT OF DIRECT DEBIT EVOLUTION (June 1990) (prepared by Andersen Consulting for the Product Development and Marketing Committee of the Visa U.S.A. Board of Directors) (filed in support of the merchants' Motion for Summary Judgment).

[7] This perverse competition for banks by raising prices to merchants slowed the growth of PIN debit services by significantly reducing merchant incentives to install PIN pads. As Visa understood, PIN debit would have achieved widespread acceptance, as it did years ago in Canada, if the PIN debit networks were able to maintain their zero interchange pricing strategy. Visa prevented them from doing that and PIN debit now is accepted by roughly 30 percent of the merchant locations that accept Visa and MasterCard credit card transactions. A detailed comparison of merchant acceptance of PIN debit in the U.S. and Canada can be found in the expert reports of Ken Morrison, the merchants' payment systems and Canadian expert. These reports are in the *Visa Check* record, and their relevant portions have been unsealed by the court.

[8] *Visa, Wal-Mart Deal Details Told*, ATM & DEBIT NEWS, Apr. 22, 2004, at 1.

[9] The *Visa Check* settlement will substantially enhance merchants' ability to discipline signature debit pricing by steering high-priced signature debit transactions to cheaper PIN debit networks. Under the settlement, Visa and MasterCard must require their issuers to provide distinct visual and electronic identification for 80% of their debit cards by July 2005, with all such cards having those properties by January 1, 2007. In addition, the settlement requires Visa and MasterCard to make debit card BIN tables available to merchants who want to use them to steer signature debit transactions to lower-cost PIN debit networks. The settlement also prohibits Visa and MasterCard from enforcing or passing any rules to prohibit merchants from attempting to steer. These provisions will give merchants a greater ability to cost-effectively steer signature debit transactions to lower-cost PIN debit networks.

[10] *See* Jennifer Bayot, *Final Pact Approved in Long-Running Debit Card Litigation*, N.Y. TIMES, Dec. 20, 2003, at C8.

[11] *See* David Breitkopf, *Wal-Mart, MasterCard Reach Agreement on Signature Debit*, AM. BANKER, June 22, 2004, at 8.

[12] SANFORD BERNSTEIN RESEARCH, IMPLICATIONS OF WELLS FARGO DECISION TO EXPAND VISA RELATIONSHIP TO INCLUDE INTERLINK (Oct. 21, 2003).

[13] *See* United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377 (1956).

[14] Even the perceived inferiority of signature debit services can be attributed to some degree to Visa and MasterCard's market power. In a competitive market, Visa and MasterCard would have been forced to improve these products by, for example, reducing chargebacks and fraud, to avoid being driven from the market.

[15] A comparison of relative PIN and signature debit interchange rates through the 1990s can be found in the expert reports of Franklin Fisher, the merchants' economist in *Visa Check*. Portions of these reports are in the *Visa Check* record and were unsealed by the court.

[16] *MasterCard Does Not Plan to Change Its Debit Card Interchange*, CARDLINE, Nov. 14, 2003, at 1; *Visa Extends Lower Offline Debit Rates into 2004*, CARDLINE, Nov. 21, 2003, at 1; *Visa/MC Extend Off-Line Debit Interchange into 2004*, CARDFLASH, Nov. 17, 2003, at 2; Lavonne Kuykendall, *Visa Revamps Signature Debit Rates*, AM. BANKER, Dec. 12, 2003, at 20; *Visa Strikes First in Looming Debit-Interchange War*, CARDLINE, Dec. 19, 2003 at 1; *MasterCard Again Matches Visa's Debit Rates*, CARDLINE, Jan. 16, 2004, at 1.

[17] For example, Wal-Mart's deal with MasterCard for signature debit was consummated after the entry of Final Judgment in First/data Concord on May 25, 2004.

On the other hand, the *Visa Check* record, and current developments in the market, strongly suggest that prices for signature debit and PIN debit services will converge over time. Numerous commentators have predicted such convergence once the Honor All Cards rules were repealed. Prominent examples include Dove Associates, U.S. Bancorp's Piper Jaffray, and Andersen (Visa's own consultant), which told Visa that in a world without the Honor All Cards rules, to maintain ubiquitous acceptance it should consider dropping its debit pricing to Regional PIN debit levels. *See* ANDERSEN CONSULTING ANALYSIS FOR VISA (Dec. 3, 1997); *see also* DOVE ASSOCIATES, THE FUTURE USE OF ATMS 84 (June 1997) ("If the retailers 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 debit, or merge the two products."); *see also* PIPER JAFFRAY, THE DEBIT DEBATE 28 (June 2002) (predicting that if merchants win *Visa Check*, Visa and MasterCard would "lower signature-debit interchange prices to compete with PIN-debit prices").

[18] *See also* NILSON REPORT No. 809 (Apr. 2004); and No. 805 (Feb. 2003).

[19] If the agencies were concerned about the issues raised by these deals, the correct response would have been to bring a Section 2 case against Visa.

[20] This limited defense was first suggested by the Supreme Court in *Brown Shoe*: "When concern as to the Act's breadth was expressed, supporters of the amendments indicated that it would not impede, for example, a merger between two small companies to enable the combination to compete more effectively with larger competitors dominating the relevant market. . . ." Brown Shoe Co. v. United States, 370 U.S. 294, 319 (1962).

[21] In *Heinz*, the D.C. Circuit noted that, while the Supreme Court has not sanctioned the use of the efficiencies defense in Section 7 cases, the trend in the lower courts has been to recognize the defense. The court, nonetheless, found that in cases where high concentration levels are present, the defense requires "proof of extraordinary efficiencies," which in most cases will be virtually impossible to prove. FTC v. Heinz, 246 F.3d 708, 720 (D.C. Cir. 2001). *See also* U.S. Dep't of Justice and Federal Trade Comm'n Horizontal Merger Guidelines § 4 (1992, revised 1997) ("efficiencies almost never justify a merger to monopoly or near-monopoly").

[22] If the merger deal had been consummated without a divestiture, the market shares in the broader market would have been: Visa (57%), Star/NYCE (23%), MasterCard (14%), followed by Pulse Pay (2%), Credit Union 24 (.51%), Accel (.50%), Shazam (.45%), and AFFN (.32%). Each of these networks, including MasterCard, is suffering stagnant or declining market shares. Other than Pulse Pay, which has traditionally been dominated by large Visa and MasterCard member banks, none of these networks has a realistic chance of growing into a national competitor. As for Discover and American Express, until the stay of the remedy in *U.S. v. Visa* is lifted, Visa and MasterCard's exclusionary rules will continue to foreclose their entry into the market for debit services. That should happen now that the Supreme Court has denied Visa and MasterCard's petitions for certiorari.

[23] First Data recently announced that it has regained a portion of the Bank of America business that it had lost to Visa. Since this new deal is limited to a "portion" of Bank of America's business, it is unclear whether it represents a significant reversal of Visa's onslaught against First Data's Star network. *See* David Breitkopf, *B of A, Star Have New Debit Pact*, AM. BANKER, Sept. 16, 2004, at 8.

[24] In its Form 10-Q for the period ending March 2004, First Data reported that Star "will experience several deconversions over the next 12 to 18 months." *See* First Data, Form 10-Q (filed May 7, 2004).

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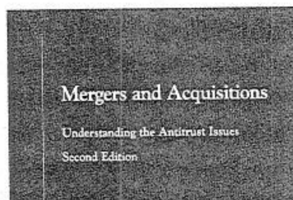

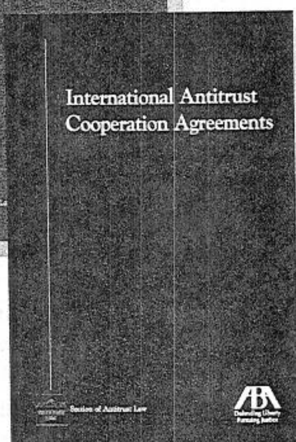

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