Fordham Journal of Corporate & Financial Law

Volume 13, *Number* 4 2008 *Article* 4

The Antitrust Aspects of Bank Mergers - Panel Discussion II: Consumer Issues

Carl Felsenfeld* Duncan MacDonald†
Jeffrey Shinder‡ Robert Manning**

*
†
‡
**

Copyright ©2008 by the authors. *Fordham Journal of Corporate & Financial Law* is produced by The Berkeley Electronic Press (bepress). http://ir.lawnet.fordham.edu/jcfl

SYMPOSIUM

THE ANTITRUST ASPECTS OF BANK MERGERS[†]

PANEL DISCUSSION II:
CONSUMER ISSUES

WELCOME

Carl Felsenfeld[1]
Fordham University School of Law

MODERATOR

Duncan MacDonald[2]
Former General Council, Citigroup Inc.'s
Europe & North American card business

PANELISTS

Jeffrey Shinder[3]
Constantine Cannon

Robert Manning[4]
Rochester Institute of Technology

[†] The panel discussion herein was held at Fordham University School of Law on November 13, 2007, for the first annual Fordham Journal of Corporate and Financial Law Symposium. It has been edited to remove minor cadences of speech that appear awkward in writing and to provide sources and references to other explanatory material in respect to certain statements made by the speakers.

1. Carl Felsenfeld is the Director of the Financial Services Institute and a Professor of Law at Fordham University School of Law.

2. Duncan MacDonald is the former General Counsel of Citigroup's Europe and North America card businesses.

3. Jeffrey Shinder is the Managing Partner of Constantine Cannon's New York office and has a primary area of expertise in antitrust counseling and litigation.

4. Robert Manning is a Research Professor and Director of the Center for Consumer Financial Services at the Rochester Institute of Technology.

PROF. FELSENFELD: As contrasted with this morning's session, this afternoon will be devoted to the effect of bank mergers on consumers. Our moderator this afternoon is Duncan MacDonald, who was the general counsel of Citicorp's international card business.[5]

MR. MACDONALD: Banks, as a matter of statutory law, are very highly regulated institutions.[6] There are both limitations and favoritism in terms of regulation that affect how they behave. That is fairly important.

There is the safety and soundness doctrine that, in effect, says that bank regulators and banks themselves have to be cognizant of stepping over the line and stopping themselves or reversing themselves.[7] They can do it any number of ways.

There are lots of mergers that have taken place over the years.[8] Although there is a broad body of antitrust law that applies to both the regulatory industry, like banking, and unregulated industries, it has not been applied all that much in the last fifteen or twenty years against banks.[9] A good part of the reason has to do with the Justice Department, in particular, paying deference to the so-called expertise of the bank regulators, like the Federal Reserve, the Comptroller of the Currency, and so on.

There is a decision, the *Chevron* decision, that goes back some time.[10] Basically, the Supreme Court of the United States said that the expertise of federal regulatory agencies ought to be given high deference in various kinds of lawsuits.[11] To some extent, that may have had an effect.

In any event, the law, at least as I see it, is not being enforced. There are two ways to enforce antitrust laws: by government and by

---

5. *See* Isabelle Lindenmayer, *MasterCard IPO: Mulling Ripple Effects*, AM. BANKER, Sept. 26, 2005, at 1, 2.

6. *See* Julia P. Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1352 (2006).

7. *See* 12 U.S.C. § 1831p-1(d)(4) (1994).

8. *See* Gabriel Kahn, *Tracking the Numbers/Street Sleuth: Pitfalls May Lurk for Intesa-Sanpaolo if Past Bank Deals are Any Indication*, WALL ST. J., Dec. 19, 2006, at C1.

9. *See, e.g.*, Charles Weller, *Patent Reform by Daubert Litigation*, 2 EXPERT EVIDENCE REP. 232 (2002), *available at* http://www.ftc.gov/os/comments/intelpropertycomments/weller2.pdf.

10. Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984).

11. *See id.* at 865-66.

private action.[12] Outside the United States, there is an enormous amount of antitrust or equivalent activity in various countries around the world with respect to bank cards.[13] There is no public or government action against the bank card industry in the United States, but there has been a ton of litigation involving price fixing, misused market power, et cetera.[14]

The two speakers today are going to discuss both that issue and the consequences of antitrust misbehavior by banks, in particular with respect to joint ventures, like Visa and MasterCard.[15] Banks created these joint ventures back in the late 1960s, and they have thrived ever since.[16] Now suddenly they seem to be stumbling because they allegedly—and determined by courts—have stepped over the line and violated the Sherman Act.[17]

When you talk about a joint venture, one of the things to keep in the back of your mind is that a joint venture is a merger, of a kind. If Citibank or Chase merges with X National Bank of Chicago, that's the standard merger we think of. But sometimes when you create a joint venture—and they are created, very often, by competing organizations—they get together and merge any number of items and processes and operations to achieve a business objective. Visa and MasterCard are of that kind.

---

12. *See* Antitrust Laws, Information on the Law about Antitrust, http://law.jrank.org/pages/11796/Antitrust.html.

13. *See* Barbara Pacheco & Richard Sullivan, *Interchange Fees in Credit and Debit Card Markets: What Role for Public Authorities?*, ECON. REV. (Fed. Reserve Bank, Kansas City, Mo.), First Q. 2006, at 87, 105-07, *available at* http://www.kc.frb.org/PUBLICAT/ECONREV/PDF/1q06pach.pdf (discussing antitrust activity in Canada and Europe).

14. *See*, *e.g.*, Bernard Wysocki, Jr., *FTC Targets Hospital Merger in Antitrust Case—Agency Expects Vigilance on Medical M&A to Help Rein in Health-Care Costs*, WALL ST. J., Jan. 17, 2005, at A1 (discussing an example of the FTC bringing an unusual lawsuit against a hospital for price fixing and market power abuse).

15. *See, e.g.*, Harvey N. Bock, Senior Vice President and Gen. Counsel, Credit Services, Morgan Stanley, Dean Witter, Discover & Co., Remarks at the Hearings on the Federal Trade Commission's Joint Venture Project (June 30, 1997), *available* at http://www.ftc.gov/opp/jointvent/bock.shtm (discussing the need for increased antitrust scrutiny as a result of dominant joint ventures like Visa and MasterCard).

16. *See* David A. Balto, *42 Annual Antitrust Seminar: Distribution & Marketing*, 1355 PRACTISING L. INST. 69, 86 (2003) (stating that "national credit card joint ventures were first formed in the 1960s, their memberships were distinct and there was vigorous network competition").

17. Sherman Anti-Trust Act, 15 U.S.C. §§ 1-7 (2004).

We are going to start with Jeff Shinder. The major lawsuit brought against the bank card industry, when all is said and done—the paradigm—is the Wal-Mart lawsuit that turned into a class action.[18] It was led by Jeff's firm, Constantine Cannon.[19] They won a big settlement.[20] He is going to talk about that. He is an expert on joint ventures, antitrust litigation, retail pricing policies, et cetera.

After he speaks, Robert Manning, a Ph.D and a professor at Rochester Institute of Technology,[21] who wrote a book that is very important to the card industry—because they hate it—called *Credit Card Nation: America's Dangerous Addiction to Credit.*[22] I have written about that topic, too, addiction to credit. So I am somewhat sympathetic to it. But, he is a four-letter word in banking, but otherwise a very honorable and good person. He is very much involved in litigation matters as an expert witness, and he has testified before House and Senate committees.[23] He has a book coming out fairly soon called *Borrowing the American Dream*,[24] which should be out next year and which you should read.

Let's turn to Jeff.

MR. SHINDER: Thank you, Duncan, for that introduction. I am going to speak about joint ventures and antitrust treatment of joint ventures,[25] and then I am going to apply some of the general principles to the experience of Visa and MasterCard. It's important to keep in mind that Visa and MasterCard were formed as joint-venture

---

18. Wal-Mart Stores, Inc. v. Visa U.S.A., Inc., 396 F.3d 96 (2d Cir. 2005).

19. *See* Constantine Cannon, Antitrust Litigation, http://www.constantinecannon.com/practice_areas/litigation.html (last visited Jan. 31, 2008) (describing the details of the high-profile Wal-Mart case).

20. *See id.* (stating that "the case was settled for a record-breaking 3.05 billion in payment from Visa and MasterCard, along with injunctive relief valued in the tens of billions of dollars . . . .").

21. *See* Robert D. Manning, Ph.D.—Biography, Center for Consumer Financial Services, http://centers.cob.rit.edu/cfs/drManning.php (last visited Mar. 7, 2008) [hereinafter Manning Biography I].

22. ROBERT D. MANNING, CREDIT CARD NATION: THE CONSEQUENCES OF AMERICA'S ADDICTION TO CREDIT (Basic Books 2000).

23. *See* Robert D. Manning, Ph.D.—Biography, Credit Card Nation, http://creditcardnation.com/manning.html (last visited Mar. 7, 2008) (stating that Manning frequently testified before the U.S. Senate Banking and Judiciary Committees and the U.S. House Financial Services Committee).

24. *See* Manning Biography I, *supra* note 21.

25. *See* Carl Shapiro & Robert D. Willig, *On the Antitrust Treatment of Production Joint Ventures*, 4 J. ECON. PERSP. 113 (1990).

associations, purportedly nonprofit, by banks that competed both in the issuance of credit and debit cards and in the acquisition of merchants for Visa and MasterCard.

It's ironic; Visa just filed its preliminary prospectus, its S-1 document, to go public, and is about to end its thirty-plus years as a joint-venture association.[26] MasterCard went public a couple of years ago.[27] It may be the case that a lot of the lessons that I am going to go through are in the past. I will address that towards the end.

Before I get to the specifics of Visa and MasterCard, let's outline some general principles about the antitrust treatment of joint venture. First and foremost, it's important to know that the antitrust laws recognize that many, perhaps most, joint ventures are actually pro-competitive. Firms, even competing firms, get together and often produce something that they cannot produce by themselves.[28] Integration is happening. They create something that the individual actors couldn't do themselves.

Visa and MasterCard are an example of this. Before Visa became Visa, there was BankAmericard, and there were restrictions on interstate banking that prevented Bank of America from acquiring merchants or issuing cards across the country.[29] It limited the scope of what was then this emerging payment system. To construct something that BankAmericard could not do by itself, Visa was formed as an association of competing banks that issued cards and acquired merchants around the country and then around the world.[30] All of a sudden, something that not one bank could do by itself was created. It's something we take for granted. You can go anywhere around the world and carry your Visa card and know that it's going to be accepted by the merchant.

---

26. *See* Aaron Lucchetti & Robin Sidel, *Visa Inc. is Moving Ahead on the Biggest IPO in Years*, WALL ST. J., Nov. 10, 2007, at A8.

27. *See* Robin Sidel, *MasterCard Sets IPO Terms, Names Board Members*, WALL ST. J., May 4, 2006, at C4.

28. *See* FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS 5-6 (Apr. 2000), *available at* http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf [hereinafter ANTITRUST GUIDELINES].

29. *See* David S. Evans, *More than Money: The Development of a Competitive Electronic Payments Industry in the United States*, 2 PAYMENT CARD ECON. REV., Winter 2004, at 9, *available at* http://idei.fr/doc/conf/tsm/payment_card_review2.pdf.

30. *See id.* at 9-27.

Antitrust law has recognized, as a general proposition, that joint ventures are often pro-competitive.[31] However, joint ventures also can be a device for anti-competitive activity, particularly when there are competitors involved. This can show up in a bunch of ways. It can show up in what's called a naked restraint of trade, where a joint venture is merely a disguised device to fix prices or allocate markets, where consumers are harmed by virtue of higher prices and less competition, or, in a more subtle example, where a joint venture, a restraint, created for purposes that are arguably pro-competitive, actually has harmful consequences outside the functioning of the joint venture.

Most joint ventures are adjudicated under the so-called rule of reason.[32] In antitrust law, restraints are divided into two categories. *Per se* restraints of trade, which, from longstanding experience, we know that a restraint is almost always going to injure competition.[33] When a *per se* restraint is set forth, no significant injury to competition needs to be shown.[34] Price fixing/market-allocation schemes between competitors are classic examples of *per se* restraints of trade. Everything else is adjudicated principally under the rule of reason.[35] The rule of reason, in the context of a joint venture, often simply comes down to whether or not there is market power at work. Does this joint venture comprise a significant enough portion of the market—the first criterion is, "What is the market?"—that it could harm competition by excluding competitors or raising prices?

Under the rule of reason, if there is a potential for harm to competition along the lines I just described, the joint venture or a restraint within the joint venture will be evaluated under the following criteria:[36] (1) The agreement must be necessary to achieve the purposes of the joint venture;[37] (2) If there is a pro-competitive effect, it must outweigh the anti-competitive harm;[38] (3) The pro-competitive effect

---

31. *See* ANTITRUST GUIDELINES, *supra* note 28.

32. *See* Bruce D. Sokler et al., Practitioner Note, *A Consideration of Dagher and the Antitrust Standard for Joint Ventures*, 1 N.Y.U. J. L. & BUS. 307, 309-17, n.45 (2004) (discussing the antitrust use of the rule of reason).

33. *See* Joseph N. Eckhardt & Andrea L. Hamilton, *U.S. Antitrust Law: Unreasonable Restraints of Trade Under Section I of the Sherman Act*, COMP. L., 2003, at 259, *available at* http://www.mwe.com/info/pubs/complaw0305.pdf.

34. *Id.* (explaining that *per se* restraints are categorically ruled to be unlawful).

35. *Id*.

36. *See* ANTITRUST GUIDELINES, *supra* note 28.

37. *Id*. at 10.

38. *Id*. at 11-12.

that is used to justify the restraint at issue must not be speculative, but something that can actually be verified;[39] and (4) There may not be any significantly less restrictive means to achieve that purpose.[40]

Visa and MasterCard are examples of something that we are seeing more of in the marketplace today: networks—platforms that function to link two sides of a market. In the context of Visa and MasterCard, they link cardholders and merchants. But we see platforms all over the place. Network industries in the marketplace today, from the telecommunications industry to real estate listing services, to dating services, are all networks that link disparate constituencies of consumers.

Networks are often formed through joint ventures, as with Visa and MasterCard. Such network joint ventures can raise significant antitrust issues, particularly in industries where, as with Visa and MasterCard, barriers to entry are high. It's not easy to replicate what Visa and MasterCard did. It would take years. Many examined doing so and decided that the cost and the effort were too daunting. Network industries tend to tip, for example, in software industries, where once a leading firm gets sufficient advantage in the marketplace, the market tends to tip to them, where they become the standard. They can then exercise market power by virtue of being the leading standard. That is a classic example where standardization can have positive benefits, but could also lead to the exercise of market power that could hurt consumers by stifling innovation.

Network industries raise interesting and unique antitrust issues. For example, in a network industry where networks have essentially become the standard, membership rules can raise significant antitrust issues. In the case of Visa and MasterCard, their rules were too inclusive, in that everyone who was a member of Visa was also allowed to be a member of MasterCard. The same banks owned, operated, and controlled both associations,[41] which led to allegations, with some credibility, that their common ownership caused them not to compete.

Membership rules can also be too restrictive. A network that dominates the market and denies access to potential entrants can abuse market power and harm competition by denying something necessary

39. *Id.* at 24.
40. *Id.*
41. *See* Complaint, United States v. Visa U.S.A., Inc., No. 98-civ. 7076 (S.D.N.Y. Oct. 7, 1998).

for effective competition to a would-be entrant. So, membership rules can raise significant antitrust issues in the context of a network.

I didn't discuss ancillary restraints.[42] A naked restraint is a restraint of trade that really has no redeeming justification.[43] It is enacted in the context of a joint venture but is really simply an artifice to fix prices and exclude competition.[44] There is obvious injury to consumer welfare. Most restraints in the context of a joint venture are ancillary restraints, restraints that could have pro-competitive benefits by being reasonably necessary for the functioning of the joint venture and are evaluated under the aforementioned criteria.[45] Weigh the positive aspects of the restraint against the potential harm to competition and see whether there are other means that could have been applied to achieve the pro-competitive benefits.[46]

The experience of Visa and MasterCard is instructive as to the various ways that a network joint venture can get into antitrust hot water. First, its membership rules. A common feature of the payments industry was something called duality, where virtually every member of one of the two leading associations was also a member of the other.[47] That led to an allegation by the Department of Justice, in the late 1990s, that duality or, more properly, dual governance—the fact that the boards of directors were comprised of banks that ran Visa and MasterCard, and that banks sitting on the MasterCard board were leading members of Visa and vice versa—was anti-competitive.[48] That formed part of the

---

42. *See* Gary R. Roberts, *The Evolving Confusion of Professional Sports Antitrust, the Rule of Reason, and the Doctrine of Ancillary Restraints*, 61 S. CAL. L. REV. 943, 993 (1988) (defining ancillary restraints as "agreements that were attached and reasonably related to an otherwise lawful transaction").

43. *See id.*

44. *See id.*

45. *See* ANTITRUST GUIDELINES, *supra* note 28, at 10-25.

46. *See id.* at 24.

47. *See* THE ANTITRUSTSOURCE, THE SECOND CIRCUIT'S DECISION IN UNITED STATES V. VISA/MASTERCARD, http://www.abanet.org/antitrust/at-source/04/05/visa.pdf (last visited Mar. 7, 20008) [hereinafter THE ANTITRUSTSOURCE]; *see also* MICHAEL BAYE & PATRICK SCHOLTEN, VISA AND MASTERCARD'S ASSOCIATION POTENTIALLY ANTICOMPETITIVE, http://highered.mcgraw-hill.com/sites/dl/free/0072983892/256225/ Baye_visa_case_5e.pdf.

48. *See* THE ANTITRUSTSOURCE, *supra* note 47; *see also* BAYE & SCHOLTEN, *supra* note 47.

basis of the DOJ lawsuit against Visa and MasterCard in the late 1990s.[49]

Another aspect of the DOJ suit was various rules of Visa and MasterCard that said every bank in the country can issue cards over our network, but those banks cannot at the same time issue cards over the Discover or American Express networks. Citibank, for example, could issue a Visa card or a MasterCard card, but if it wanted to issue an American Express card or a Discover card, it would do so at penalty of being thrown out of the Visa or MasterCard association.[50] In that sense, the Visa and MasterCard membership rules were too exclusive. They said to their banks, "You have to stay in the club, but if you do business with Discover or American Express, we will throw you out." That comprised the other side.

There were two theories of the DOJ case: one, dual governance; the other, that these rules that prevented banks from doing business with Discover and American Express were anti-competitive.[51] The DOJ lost the dual governance portion of the case, but won on the theory that the rules excluding banks from doing business with Discover and American Express were anti-competitive.[52]

What was the theory of competitive injury? Visa and MasterCard litigated the case all the way to the Supreme Court.[53] Ultimately, the Supreme Court declined to review the decision affirmed by the Second Circuit.[54] They said, all the way up, there is absolutely no consumer harm here, period.[55] Discover and American Express, as issuers, can issue to anyone in the country, and the fact that they cannot distribute through the banks that are members of Visa and MasterCard has not harmed consumers one whit.[56]

---

49. *See* THE ANTITRUSTSOURCE, *supra* note 47 (explaining the opinion of the Visa and MasterCard case); *see also* United States v. Visa U.S.A., Inc., 344 F.3d 229 (2d Cir. 2003).

50. *See* THE ANTITRUSTSOURCE, *supra* note 47; *see also Visa U.S.A., Inc.*, 344 F.3d at 236.

51. *Visa U.S.A., Inc.*, 344 F.3d at 234, 237.

52. *Id.* at 234.

53. *Id.* at 229 (holding that exclusivity rules were anticompetitive and a restriction on innovation), *cert. denied*, 543 U.S. 811 (2004).

54. *Id.*

55. *Id.*

56. *Id.* at 242.

The theory in that case was not the typical consumer welfare, higher prices; this was a lost innovation case.[57] The theory was that Citibank, partnering with American Express or Discover, would be able to offer something that was unique, differentiated, different for consumers, and not deprive consumers of consumer choice; but, the rules said Citi couldn't do that, or any of the other thousands of issuers of Visa and MasterCard.

Private lawsuits continue to be important terrain, and the loss by Visa and MasterCard in the DOJ case has spawned, as you would expect, the typical follow-on cases. American Express and Discover—in the spirit of full disclosure, I represent Discover in this case—have sued Visa and MasterCard for damages for lost profits as a result of those rules.[58] American Express just settled its case with Visa.[59]

There was another important aspect that should be noted in the DOJ case, which was that joint-venture restraints, when they impact competition outside the joint venture, can have significant risk to competition, even if they have some kind of pro-competitive purpose.[60] One of the theories of the DOJ case is that the banks who ran Visa and MasterCard were restraining competition between themselves.[61] The idea was that Chase and Citi basically said to each other, through the rubric of Visa and MasterCard, "I don't want to let you have the advantage of issuing an American Express or Discover card, and so we will all agree not to do that." That impacted competition outside the joint venture in the market to issue credit cards and debit cards.

The various merchant cases provide a different example of how restraint within the Visa and MasterCard joint ventures had anti-competitive consequences—in this instance, outside the joint venture—although the injury to competition outside the joint venture was at the network level. One of them was the so-called Wal-Mart case.[62]

---

57. *Id.* at 241 (describing the case as one in which a chance for a new idea was lost).

58. *See* Discover Fin. Servs., Inc. v. Visa U.S.A., Inc., No. 04 Civ. 7844, 2005 U.S. Dist. LEXIS 13342 (S.D.N.Y. 2005).

59. *See* Eric Dash, *Visa Agrees to Pay Amex $2.1 Billion To Settle Suit*, N.Y. TIMES, Nov. 8, 2007, at C4.

60. *Visa U.S.A., Inc.*, 344 F.3d at 243.

61. *See* BAYE & SCHOLTEN, *supra* note 47.

62. *In re* Visa Check/Mastermoney Antitrust Litig., 280 F.3d 124 (2d Cir. 2001) (affirming district court's order granting merchant's motion for class certification); *In re* Visa Check/Mastermoney Antitrust Litig., 96-CV-5238 (JG), 2003 U.S. Dist. LEXIS 4965 (E.D.N.Y. 2003) (denying credit companies' motion for summary judgment).

What was the Wal-Mart case about? It was about Visa and MasterCard using their honor-all-cards rule, which is the rule that says to every merchant that accepts Visa and MasterCard, "If you accept Visa, you must accept every validly presented Visa card, no matter what you see. You can't choose between different kinds of Visa cards."[63]

This is a classic example of a restraint that was actually necessary for the functioning of the joint venture. When Visa and MasterCard were formed—think about this: You have thousands of banks across the country issuing these cards, thousands of banks acquiring merchants, millions of merchants accepting these cards—you need to have a seamless acceptance experience. We all take it for granted, but you needed to have a rule that ensured to you, as a consumer, that when you proffer the Visa card, the merchant is going to take it. It's not going to say, "I'll take a Chase Visa card, but I don't like Citibank, so I'm going to turn that one down."

The honor-all-cards rule, as applied to one product, which is what Visa and MasterCard were back in 1966—credit cards—was pro-competitive. As Wal-Mart's lawyer, we never argued that, in that guise, it was anything other than pro-competitive. But something very interesting happened to the honor-all-cards rule over the years; it became an instrument to tie two distinct products.

There is a species of antitrust claim called a tying claim, which basically involves leveraging market power from one product to another by forcing the consumer to take an unwanted second product.[64] The argument in the merchant case was that the honor-all-cards rule, when it was applied to debit cards and forced merchants to take debit cards at a very high price, allowed Visa, particularly, but MasterCard as well, to leverage their preexisting power in the credit card market into the distinct and very different debit card market, with anti-competitive effects in the debit market.[65]

The theory that was accepted by the court, in large measure, was that a superior platform for PIN debit—the same PIN that you use at the ATM, that you sometimes use in supermarkets at the point of sale, the platform that everyone thought was going to take off in debit in the early

---

63. *In re Visa Check/Mastermoney Antitrust Litig.*, 280 F.3d at 131.

64. *See* BLACK'S LAW DICTIONARY 1557 (8th ed. 2004) (defining "tying arrangement" as "a seller's agreement to sell one product or service only if the buyer also buys a different product or service").

65. *In re* Visa Check/Mastermoney Antitrust Litig., 2003 U.S. Dist. LEXIS 4965, at *6.

1990s—was cheaper and safer and faster and more efficient, and was suppressed by virtue of the honor-all-cards rule. Thereby, consumers were harmed and competing PIN debit networks, who were not Visa and MasterCard, were suppressed.

That case, like the DOJ case, was largely litigated, although, unlike the DOJ case, we did not go all the way up to the Supreme Court on the liability issues.[66] But, a score of findings emerged from these two cases that can be used against Visa and MasterCard in the future, findings about their market power; in the example of the merchant case, findings that debit cards and credit cards were distinct products for purposes of tying law, which sets up, potentially, future actions, where honor-all-cards policies are used to link distinct products.[67] That precedent can be used. Debit is a market. Visa had market power in debit.

That leads me to the last example, and probably the most nettlesome of the legal issues facing Visa and MasterCard over the years, and that is interchange,[68] a somewhat complex mechanism. Visa and MasterCard, through their boards of directors, have historically set something called interchange. Interchange is a fee that is ultimately paid by merchants as part of the discount they pay when they accept a Visa or MasterCard transaction that flows back to the issuer.[69] If you go to a merchant with a Citibank-issued Visa card and you make a transaction, the merchant pays the interchange fee, and the fee flows back to Citibank as the issuer.[70]

Over time, interchange has become an increasingly critical proposition to the business for the issuance of payment cards, both in debit cards and in credit cards. The antitrust theory challenging interchange is that it is nothing more than a price; it's a price that is paid by merchants to competing issuers. [71] That price is fixed by competing issuers who sit—I should say, sat—on the board of, at least, MasterCard,

66. *See* Visa U.S.A. Inc. v. Wal-Mart Stores, Inc., 536 U.S. 917 (2002) (cert. denied).

67. *See in re* Visa Check/Mastermoney Antitrust Litig., 2003 U.S. Dist. LEXIS 4965, at *8-9.

68. *In re* Visa Check/Mastermoney Antitrust Litig., 280 F.3d 124, 130 (2d Cir. 2001).

69. *Id*.

70. *Id.*

71. *See* James M. Lyon, *The Interchange Fee Debate: Issues and Economics*, THE REGION (Fed. Reserve Bank, Minneapolis, Minn.), June 2006, *available at* http://minneapolisfed.org/pubs/region/06-06/interchange.cfm.

and they may continue, some of them, to sit on the board of Visa.[72] Therefore, that's price fixing.[73] Antitrust 101: price fixing harms consumers by raising price and is usually a *per se* violation of the antitrust laws when engaged in by horizontal competitors.

The first challenge against interchange was the so-called *NaBANCO* case in the mid-1980s.[74] In that case, Visa succeeded to leverage a preexisting Supreme Court opinion—the *BMI* decision—to get the case treated under the rule of reason.[75]

Visa said interchange can't be treated like a normal price.[76] Instead, it's a device that is needed to equilibrate two sides of this network industry.[77] We need interchange for it to function.[78] The side bearing the disproportionate share of the costs and the risks, the issuer, should receive a transfer from the merchant side of the equation.[79] Otherwise, these systems won't exist.[80] You can't evaluate interchange without understanding that this is a network platform with two sides to the market and a need for interchange to basically balance the two sides of the market.[81] The court accepted that argument and Visa prevailed, on appeal, and it was allowed to continue to set interchange.[82] This was in the mid-1980s, when interchange was applied to credit, and debit was a fairly minor part of the payments landscape.[83]

---

72. *See id.*; Eric Grover, *MasterCard's Brave New World, Post-IPO*, DIGITAL TRANSACTIONS, Jan.-Feb. 2006, at 47-48, *available at* http://www.digitaltransactions.net/files/47-48Jan06.doc (discussing MasterCard's changing governance model).

73. *See* Lyon, *supra* note 71 (merchant complaints charge that interchange fees represent "price fixing" by card association "cartels").

74. Nat'l Bancard Corp. v. Visa U.S.A., Inc., 779 F.2d 592 (11th Cir. 1986).

75. *See* Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979); *see also id.* at 603 (stating "[w]e conclude that the district court properly determined that the IRF was not a naked restraint of competition and therefore not per se price fixing proscribed by Section 1 of the Sherman Act").

76. *See* Nat'l Bancard Corp. v. Visa U.S.A., Inc., 596 F. Supp 1231, 1260-61 (S.D. Fla. 1984), *aff'd*, 779 F.2d 572 (11th Cir. 1986) (summarizing Visa's argument that the issuer bears the most costs and should receive transfer payments from the merchant).

77. *Id.*

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.*

82. *See Nat'l Bancard Corp.*, 779 F.2d at 605 (finding as not clearly erroneous district court's holding that IRF ("Issuer's Reimbursement Fee") is pro-competitive).

83. *See* John P. Caskey & Gordon H. Sellon, Jr., *Is the Debit Card Revolution Finally Here?*, 79 ECON. REV. 79, 82 (1994) (stating that the debit card was not in

Going forward, Visa and MasterCard applied their ability to set interchange to debit cards, where they fixed very high credit card interchange to debit cards, a large part of the impetus for the merchant case.[84] It was framed as a challenge to the honor-all-cards rule, but a subtext was that debit card interchange was just a disguised exercise of market power. They have set high interchange for commercial cards, for prepaid store cards, and have raised interchange over and over again, to the breaking point. It's at the breaking point around the world.

Let me note one other thing on this particular slide.[85] Price fixing theory, a traditional antitrust attack, has so far failed in the United States on interchange.[86] Some of the regulatory challenges are not framed on pure antitrust terms. Instead, they are framed that interchange actually funnels too much credit card use and that it leads to a regressive effect, where interchange is paid by merchants, it's too high, it's passed along in the form of higher prices to everyone, including the cash customer who is not paying with a credit card, and it finances all kinds of rewards cards for the very affluent, and too much credit.[87]

That was a large basis for the Australian challenge. I just cannot stress this enough—this was not a pure antitrust attack.[88] Most antitrust lawyers would actually recoil, to some degree, at the analysis. The theory was, there is too much use of credit cards.[89] Interchange is financing something that is socially problematic and something that is

---

popular use in the mid-1980s and was still being tested with consumers).

84. *In re* Visa Check/Mastermoney Antitrust Litig., 280 F.3d 124, 130-31 (2d Cir. 2001).

85. *See* Jeffrey Shinder, Slides (Nov. 13, 2007) (unpublished PowerPoint slides, on file with author).

86. *See* Noah J. Hanft, Gen. Counsel and Corp. Sec., MasterCard Worldwide, Keynote Address at the 2005 Payments Conference: Interchange Fees in Credit and Debit Card Industries: What Role for Public Authorities (May 4-6, 2005), *in Let's Get Real*, Proceedings – Payment Sys. Research Conferences 205, 210 (Fed. Res. Bank of Kansas City, Kansas City, Mo.), *available at* http://www.kansascityfed.org/PUBLICAT/PSR/Proceedings/2005/Hanft.pdf (stating that almost all court decisions hold that interchange is legal).

87. *See* News Release, Food Marketing Institute, FMI Praises Rep. Watt for Speaking Out Against Regressive Interchange Fees and Demanding Solutions (Apr. 27, 2007), *available at* http://www.fmi.org/news_releases/index.cfm?fuseaction=mediatext&id=869 (praising Rep. Melvin Watt for criticizing the regressive impact of interchange fees).

88. *See* Hanft, *supra* note 86 (stating that the Reserve Bank of Australia was simply regulating with the intent of curbing credit card issuance and usage).

89. *Id.*

regressive. We are going to cut interchange down, and so be it if it leads to fewer rewards for the affluent.

This has been an ongoing battle. One of the things that Visa and MasterCard have said repeatedly, including to regulators in the United States, is that this was misguided, that it has had unintended and problematic consequences, and that regulators have no right getting into how much a particular payment form is used at the point of sale; it's not the province of a regulator.[90] The Federal Reserve in the United States has accepted that its mission should not get into some of the things that the Australians were willing to get into.[91]

Europe was different. Europe has taken a more traditional price fixing approach to the issue of interchange, but then has superimposed a somewhat regulatory regime that I don't think an antitrust authority in the United States would ever countenance.[92] They have essentially gotten into negotiations with Visa and MasterCard over what is actually the correct level of interchange.[93] I cannot imagine the Antitrust Division doing anything similar here, getting into the mission of regulating what could be characterized as a price. Here are just some other examples of countries around the world that have looked into or are looking into the issue of Visa and MasterCard interchange.[94]

What about the United States? I went through the history of the *NaBANCO* case.[95] There is another round of cases—this one, I will happily say, I am not litigating—where merchants have brought another

---

90. *See, e.g.*, MasterCard Worldwide, Myths and Facts, http://www.mastercard.com/us/company/en/newsroom/inter_myths_facts.html (last visited Jan. 31, 2008) (stating that government regulated price controls are not the answer to the interchange problem); *see also* Hanft, *supra* note 86 (stating that "regulators and courts should not be substituting their own judgments as to what price should be charged for those determined through market forces").

91. *See* Pacheco, *supra* note 13, at 94-95 (stating that the central bank in Australia is more active than the Federal Reserve in the United States because interchange fees in the U.S. have been rising recently).

92. *See id.* at 101 (stating that European authorities are implementing cost-based interchange in a way that merchants see as more equitable distribution of benefits of the network, and which may be more beneficial for the United States to try).

93. *See id.* at 106 (stating that "Visa proposed a set of remedies which included setting interchange fees based on a benchmark comprised of three cost components of services benefiting merchants: transaction processing, the payment guarantee, and the cost of the free funding period").

94. *E.g.*, Australia, Mexico, the Netherlands, Spain, several countries in the European Union, and the United Kingdom. Shinder, *supra* note 85.

95. Nat'l Bancard Corp. v. Visa U.S.A., Inc., 779 F.2d 592 (11th Cir. 1986).

class action based on a price fixing theory, based on a theory that the *NaBANCO* case and its factual underpinnings have proven to be wrong.[96] That case is winding its way through the federal courts as we speak. If the merchants prevail, the entire system of collectively setting interchange will be rescinded in the United States.

One interesting question that merchant case will raise is whether or not the new corporate forms of Visa and MasterCard fix the problem, or at least fix the problem from the perspective of traditional antitrust analysis. Remember, the issue in antitrust terms is that you have competing issuers sitting on the boards of Visa and MasterCard fixing what could be characterized as a price that they receive, and a key price they receive.

MasterCard reformed itself. It's a public company.[97] It no longer has banks sitting on its board.[98] But one could argue—and the merchants, I assume, will argue—that banks essentially delegated authority to do what was done before to the staff of MasterCard.

The theory—I don't know if it's going to work—is that if you have ten people meeting in a smoke-filled room to fix prices and then decide, "We're not going to do this anymore, because the smoke-filled room is a magnet for antitrust cases; instead, we will designate Duncan as the agent of our price fixing going forward," that's still price fixing if there is an agreement that Duncan will carry forward the will of the banks. The merchants will have to prove that.

My only point is that I am not so sure that MasterCard has insulated itself from antitrust attack and price fixing by changing itself, but it has certainly improved its position and has an argument it didn't have before it restructured. One could argue that one of the main reasons it restructured was to protect itself against the interchange case.

Visa just filed its S-1 document. Visa, though, is going to have banks still on its board, which will make it harder for Visa to make the same argument that MasterCard will be able to make.[99]

On that note, I think I will conclude.

---

96. *See* Temple v. Circuit City Stores, Inc., No. 06 CV 5303 (JG), 2007 U.S. Dist. LEXIS 70747 (E.D.N.Y. 2007).

97. Sidel, *supra* note 27 (stating that MasterCard was moving close to becoming a publicly traded company).

98. *See* Grover, *supra* note 72 (stating that MasterCard is no longer a "consortium of banks" because unlike Visa, it is not keeping its bank association governance model).

99. *Id*. (stating that the banks' presence on Visa U.S.A.'s board will make them a larger target for plaintiffs).

MR. MACDONALD: Thank you. Before we turn to Bob, just to kind of round that out from an insider's perspective—he was the litigator; I was an in-house guy. By the way, all this happened after I left Citibank, but that's beside the point.

If you are an in-house guy, you have to prevent things from happening. You stay ahead of the curve, and you don't get yourself in a mess. You see the risks or the consequences of getting into a private antitrust lawsuit. The government is not ever a private party that can make a profit for themselves, in terms of damages. An antitrust loss in one case can be a disaster, and this has proven to be a disaster for the banking industry.[100]

One of the biggest dangers that came out of this was that everybody was asleep looking at the banking industry, and then all of a sudden there was an enormous knowledge transfer to the private bar about how the insides of banks work and how they collaborate. So firms like Constantine Cannon and others sprung up all over the United States with an enormous amount of knowledge about banking because of discovery, and because of the consequences of these lawsuits they build and create other lawsuits.[101]

What happened in this first loss was a tidal wave of lawsuits that is still tossing them. After they lost to the Justice Department, Wal-Mart was out there, and these guys got a $3 billion settlement.[102] But that doesn't tell the whole story. The consequence of losing to the Justice Department, and then Wal-Mart—the biggest animal in the United States—was probably tens of billions of dollars in damages when it plays itself out.[103]

These lawsuits are not going to go away. Nobody knows how to make them go away. They have caused a reorganization of the industry.[104] They have caused Visa and MasterCard to change. New

---

100. *See, e.g.*, Paul Davis, *Two More Report Visa Case Exposure*, Am. Banker, Nov. 14, 2007, at 13 (discussing the effects of Visa Inc.'s settlement with American Express Co. on the bottom lines of Synovus Financial Corp. and Bank of America Corp.).

101. *See* Constantine Cannon*, supra* note 19 (describing the details of the high-profile Wal-Mart case).

102. *See id.*

103. *See id.*; *see generally* Mara Der Hovanesian & Justin Hibbard, *When the Bill Comes Due*, NEWSWEEK, Dec. 5, 2005, *available at* http:// www.businessweek.com/magazine/content/05_49/b3962112.htm (discussing the potential consequences of Visa's legal challenges).

104. *See generally* Grover, *supra* note 72 (discussing the effects of the massive amount of litigation on the banking industry).

competitors come out of the woodwork. None of this was managed by the banks themselves. They didn't have the foresight. They were macho. They thought they were going to be smart and win, and they didn't win.

One of the little things that came up just recently is the Super SIV, structured investment vehicle.[105] Chase, Citibank, and Bank of America created this joint venture, in effect—I don't think they called it a joint venture—to deal with the subprime meltdown.[106] The minute I saw the headline, I thought of this guy, and I thought of joint ventures and what would have been learned from all these cases. Is there somebody out there with a telescope saying, "Wait a second. These guys are getting together again. Is there any kind of antitrust rubric that will apply to this?"

The key point is if you are a bank and you get into antitrust trouble—just understand the evil that men do lives after them—these things can get very, very big.

With that, I turn to Bob. Take over.

PROF. MANNING: It's a pleasure to be here. I am coming with a little bit different perspective. As Duncan mentioned, my book *Credit Card Nation*[107] did create a bit of a ripple. But I like to think of myself as a voice of prudence. We might not have had quite the subprime crisis if we had started thinking about some of the consumer issues and the exposure that banks have created, not only in terms of the anti-competitive aspects of the industry, but also the insulation of this industry in terms of consumer protections.

---

105. "SIV" is short for structured investment vehicle. *See* Investopedia, http://investopedia.com/terms/s/structured-investment-vehicle.asp (last visited Feb. 1, 2008) (defining "SIVs" as "a pool of investment assets that attempts to profit from credit spreads between short-term debt and long-term structured finance products such as asset-backed securities"); *see also* Frank Partnoy, *The Siskel and Ebert of Financial Markets?: Two Thumbs Down for the Credit Rating Agencies*, 77 WASH. U. L.Q. 619, 672-73 (1999) (stating that "[a] typical SIV is a company which seeks to 'arbitrage' credit by issuing debt or debt-like liabilities and purchasing debt or debt-like assets, and earning the credit spread differential between its assets and liabilities") (footnotes omitted).

106. *See* Liz Moyer, *Citigroup Goes It Alone to Rescue SIVs*, FORBES, Dec. 13, 2007, http://www.forbes.com/business/2007/12/13/citi-siv-bailout-markets-equity-cx_lm_1213markets47.html?feed=rss_business (discussing the attempt to organize Super SIV by Chase, Citibank, and Bank of America).

107. MANNING, *supra* note 22.

First, I would like to make very clear why this is a unique issue. Carl had asked for a particular focus on the *Philadelphia* decision[108] and the Riegle Act.[109] I want to look at the credit card industry as kind of a consequence of the emergence of deregulation in banking and the institutional form that it has assumed, what role credit cards play, and how profound the change really has been.

First, I want to look at the unique aspects of the industry. I come at it as a business school professor. I came in with some different slides.[110] The second aspect is some of the specific negative consumer-related outcomes that have resulted in the era of deregulation, with tremendous consequences.

I have been an expert witness in about twelve class-action federal and civil suits in the last five years. The costs of litigating these suits are just extraordinary. We are not talking about the enormity of the Visa/MasterCard duality or the Wal-Mart suit, but just at an individual level, every single major issuer. There will probably be questions about some of the issues regarding predatory lending,[111] deceptive marketing,[112] and deceptive pricing practices[113]—and I will talk briefly

108. United States v. Phila. Nat'l Bank, 374 U.S. 321 (1963) (holding Section 7 of the Clayton Act applicable to bank mergers).

109. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338 (codified in scattered sections of 12 U.S.C.).

110. Robert D. Manning, Bank Mergers, Industry Consolidation, and Market Competition: The Decline of Consumer Rights in the Era of Soaring Credit Card Profits (Nov. 13, 2007) (unpublished PowerPoint slides, on file with the Fordham Journal of Corporate and Financial Law) [hereinafter Manning Slides].

111. *See* Investopedia, http://www.investopedia.com/terms/p/predatory_lending.asp (last visited Feb. 1, 2008) (defining "predatory lending" as "unscrupulous actions carried out by a lender to entice, induce, and/or assist a borrower in taking a mortgage that carries high fees, a high interest rate, strips the borrower of equity, or places the borrower in a lower credit rated loan to the benefit of the lender"); *see also* Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039, 2043 (2007) (stating that "[p]redatory lending is a syndrome of loan abuses that benefit mortgage brokers, lenders, and securitizers to the serious detriment of borrowers").

112. Deceptive marketing and deceptive advertising are interchangeable terms. The definition of deceptive advertising is "the tortious and sometimes criminal act of distributing an advertisement that is untrue, deceptive, or misleading." BLACK'S LAW DICTIONARY 435 (8th ed. 2004).

113. Deceptive pricing is defined as making "savings claims, price comparisons, special sales, two-for-one sales, factory or wholesale prices" if such claims are false of deceptive (internal quotation marks omitted). American Marketing Association,

about federal preemption and the role that has played, especially in terms of governance. Ultimately, when we talk about our dual banking system, we are talking about, largely, the fact that Congress, with the OCC and directives to the Federal Reserve and the FDIC, is the one setting the tone.[114]

As somebody who testifies to Congress frequently, with access to some discovery documents, the banking industry clearly has been listening to the signals of Congress. They don't want to be regulated. Yet, as soon as the pressure eases off, some of the most egregious policies occur again, and then, ultimately, these have to be settled through some very costly litigation.

I want to emphasize what has changed about this industry. Keep a couple of things in mind in terms of the postindustrial society. Today the most profitable aspect of our economy is financing production, not actually producing things.[115]

Second, in terms of the transformation of the banking system and community banking and the bundling of services at a local issuer and the nature of an expanded national market, the best customer in the banking system—and we are talking retail banking—has gone from someone who could pay off their loans to somebody who will never pay off their loans. When we talk about the issues of securitization and consumer rights, this certainly has an important place, both in terms of how these products are produced and the loss of consumer rights in that process.

We talk so much about competition. It is always striking to me that whenever there is a discussion about pricing and marketing policy, the American Banking Association[116] always comes back and says, "There are 6,000 credit card issuers. This is the most competitive industry in the American economy."[117] As we will see, in terms of the

---

Marketing Terms Dictionary, http://www.marketingpower.com/mg-dictionary.php?Searched=1&SearchFor=claim&Term_ID=&SearchDefinitionsAlso=ON (last visited Feb. 6, 2008).

114. COMPTROLLER OF THE CURRENCY, ADMINISTRATOR OF NATIONAL BANKS, NATIONAL BANKS AND THE DUAL BANKING SYSTEM 1 (2003), *available at* http://www.occ.treas.gov/dualbanking.pdf.

115. ROSEMARY MARCUSS, U.S. DEP'T OF COMMERCE, CORPORATE PROFITS IN THE GDP ACCOUNTS 10 (2004), *available at* http://www.bea.gov/papers/pdf/nabeprofits_fv.pdf.

116. For more information, please visit the ABA website, http://www.aba.com (last visited Feb. 6, 2008).

117. UNITED STATES GENERAL ACCOUNTABILITY OFFICE, CREDIT CARDS: INCREASED COMPLEXITY IN RATES AND FEES HEIGHTENS NEED FOR MORE EFFECTIVE

extraordinary pace of consolidation in this industry, it belies some of the realities that have occurred.

Remember when you would open up a savings account—this certainly isn't the students, but the faculty and the practitioners here—you would get a free toaster? One of the key points to keep in mind as we look at the evolution of this industry is that credit cards were essentially loss leaders to reward the most desirable customers, typically people who paid off their credit cards. This was a customer service to reinforce the use of the other bundle of services. In some cases, of course, in the 1960s and 1970s, the toaster—you can only have so many toasters, for affluent clients. Unlike getting a mortgage—you are only going to get one mortgage—you can get several credit cards. Credit cards then became a real effort to market as a status symbol for people who didn't need credit, but wanted to demonstrate that they had such high credit and such a favorable relationship with their banking institution that they were offered an unsecured loan with a relatively high line of credit.

This is a critically important issue to keep in mind. Until we see deregulation that occurs particularly in the late 1970s, where we are talking about state-regulated interest caps[118]—until the 1978 *Marquette* decision,[119] banks were actually losing money in their efforts to mass-market credit cards.[120] In fact, it's hard to believe today—Citibank was almost insolvent in the early 1990s—but between 1979 and 1981, my estimates are that the company lost at least $400 million in terms of scaling up to the problems of high interest rates and state interest rate caps here in New York City.

So a key issue is, what has happened and what have we done in terms of this industry?

DISCLOSURES TO CONSUMERS 10 (2006) (discussing that more than 6,000 institutions issue credit cards), *available at* http://www.gao.gov/new.items/d06929.pdf.

118. State regulated interest caps were enacted by states through usury laws which forbade companies from charging interest rates above the statutory amount. *See generally* Dianne Ellis, *The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate*, BANK TRENDS (FDIC Div. of Ins., Washington, D.C.), March 1998, at 10, *available at* http://www.fdic.gov/bank/analytical/bank/bt_9805.html.

119. Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299 (1978).

120. Robin Stein, *The Ascendancy of the Credit Card Industry*, FRONTLINE, Nov. 23, 2004, http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/rise.html.

I would argue that, as the national scope of the industry through consolidation occurred, credit cards became a crucial avenue for establishing a national marketing schema, not just in terms of vertical integration, in terms of particular markets, but the fact that the credit card, as we get to the end, in terms of personal consumer privacy issues, becomes an enormous opportunity to collect information for cross-marketing. The problem is that technology has grown and improved so much faster than the protection of consumer rights, to the point that identity fraud and exposure to our personal financial information is an epidemic.

I remember testifying in 2003,[121] with the reauthorization of the Fair Credit Reporting Act.[122] The major banks made it very, very clear that the *quid pro quo* of having a national, standard, uniform credit-scoring system would be the protection of consumer privacy rights. In fact, if there is a price premium that has been passed on to consumers in terms of the national scale of this market, it has been that the burden of compromising personal private information has been passed on to consumers.

If we look just briefly at consolidation, both the number of banking enterprises and their scale have increased dramatically. On the one hand, credit cards as a cash-flow mechanism have helped drive the financing of consolidation, as well as the scale of its national operations. You had hundreds of different marketing associations in different states. There were efforts of franchising, which is essentially what happens with BankAmericard and Visa and MasterCard. But it was a chicken-and-egg phenomenon. You couldn't have a local credit card, because you wouldn't have the scale, if you went out of your town or locality, in terms of using it in another state.

Technology and geographic expansion meant that merchants weren't going to accept a credit card unless consumers were going to use it, and, of course, consumers weren't going to use it unless merchants could use it. Integral to this business plan is that there has to be an economy of scale that is going to be national.

121. *See The Role of FCRA in the Credit Granting Process*: *Hearing on H.R. 2420 Before the Subcomm. on Financial Institutions and Consumer Credit House Fin. Services Comm.*, 108th Cong. 79-82 (2003) (statement of Robert D. Manning, Caroline Werner Gannett Prof. of Humanities, Rochester Inst. of Tech.), *available at* http://financialservices.house.gov/media/pdf/061203rm.pdf.

122. Fair Credit Reporting Act, 15 U.S.C. §§ 1681 to 1681x (2008).

I find this *Life* magazine astounding.[123] This was a cover story in 1970, before any of the major deregulatory decisions—*Marquette*, of course, which allowed, through federal preemption, for nationally chartered banks to move to a state, in terms of its brick-and-mortar operations, and essentially import and then export that interest rate throughout the country.[124] This is in 1970, when the outstanding credit card debt was less than $15 billion.[125] Here, you see that the future of banking is retail banking, and credit cards were really the engine of that expected growth.[126]

There has been long-term planning, part of it, of course, in terms of globalization and the postindustrial economy. I have a chart about social inequality and the growth of credit card usage.[127] Clearly, there was a view that if the cost structure of the labor-intensiveness of retail banking could be brought under control, and with the technology that would enable the scale to go nationally, credit cards were really the major future of retail banking. In 1977, the top fifty banks controlled approximately half of the credit card market.[128] Today the top three banks control about 60% of the market.[129]

When I go back to that earlier comment about 6,000 issuers and it being the most competitive market, this is what those issuers look like. These are all credit cards that have now been purchased by Citibank.[130] What is intriguing is the AT&T Universal Platinum Card that you see to the left.[131] Notice that AT&T was actually losing money before it was

123. *See* Ranan Lurie, *Credit Card Craze*, LIFE, Mar. 27, 1970 (cartoon illustration), *available at* http://www.life.com/Life/cover_search/view?coverkeyword=&startMonth=1&startYear=1970&endMonth=12&endYear=1970&pageNumber=1&indexNumber=9 (cover story dealing with bank regulation).

124. *See Marquette*, 439 U.S. at 301.

125. FEDERAL RESERVE BOARD, FEDERAL RESERVE STATISTICAL RELEASE, CONSUMER CREDIT (2008), http://federalreserve.gov/releases/g19/hist/cc_hist_sa.html (last visited Feb. 28, 2008) (showing that in December 1970 the "net" outstanding revolving (i.e., credit card) debt was just under $5 billion).

126. *See* Manning Slides, *supra* note 110.

127. *See id*.

128. Robert D. Manning, *Thinking Big*, THE BOSTON GLOBE, June 29, 2003, at D12 (stating that in "1977, according to the Credit Card Industry Directory, the top 50 banks accounted for about one-half of the credit card market").

129. FED. DEPOSIT INS. CORP., CREDIT CARD ACTIVITIES MANUAL ch.1 (2007), *available at* http://www.fdic.gov/regulations/examinations/credit_card/index.html.

130. *See* Manning Slides, *supra* note 110.

131. *See id*.

purchased in 1997.[132] Why? It had so many affluent, highly educated "deadbeats"—people who were paying off their credit cards. The price premium paid when Citibank purchased this card was because of the marketing base that it offered.[133] It wasn't making money on credit cards; it could only make it in the one-stop-shopping business model that emerged when Travelers purchased Citibank.[134]

There are some very important issues here that bear on the question about consumer rights. If the profitability of some of these portfolios is driven by access to consumer information, what provisions are there in place to protect privacy and consumer rights?

Just to give you a sense of the evolution of the top ten credit card issuers—you really need a scorecard, because it happens so fast. Clearly, what we are seeing is an industry that will be driven, probably, by about five major players. What is intriguing now is the growth of the debit card industry. Who would have thought that could be such an important, billion-dollar industry, to the point now that even Capital One has created a debit card product that decouples the debit card itself from the bank that you actually have your deposit account with? You can get a Capital One debit card that could access your funds from Citibank, and it will be accepted in a national network.[135]

The evolution of this industry is still continuing, largely technologically driven. It provides new, different opportunities.

I present this particular table in terms of outstanding consumer debt because it shows the shift as the profitability of credit cards became more and more central to retail banking.[136] You see a shift in terms of the proportion of revolving credit card debt versus installment debt. The intriguing thing is, in the 1989-90 recession, we actually see for the first time that revolving credit card debt actually expands.[137] We talked

132. *See generally* Lisa Fickenscher, *Citi Touts Deal for AT&T Unit As 'Partnership'*, AM. BANKER, Dec. 19, 1997, at 1 (stating that AT&T "should have been the one being relieved of carrying the burden of [its] portfolio").

133. *See generally id*. (describing Citibank's purchase of AT&T Universal Card Services, in which it paid a premium, as a marketing partnership).

134. Tara Siegel, *Citi's Move To Spin-Off Travelers Praised By Street*, DOW JONES NEWS SERV., Dec. 19, 2001 (stating that the "merger between the old Citibank and Travelers erected the first mega-one-stop-shop for financial services").

135. Aleksandra Todorova, *Capital One Tests a New Type of Debit Card*, SMARTMONEY, June 13, 2007, *available at* http://www.smartmoney.com/consumer/index.cfm?story=20070613.

136. *See* Manning Slides, *supra* note 110.

137. *See* FEDERAL RESERVE STATISTICAL RELEASE, *supra* note 125 (showing that the

earlier about pricing through credit-scoring systems.[138] Banks were beginning to recognize that there was an opportunity to dilute their risk-averse underwriting standards and begin to expand the debt capacity of individual consumers, which will then lead to other issues about collecting that debt.[139]

Credit card usage is exploding; tack onto this debit cards. Are we headed towards a cashless society? No, but we are certainly talking about a society where all our personal, private information is not only accessible to those that we are not aware of, but there aren't protections for it. They primarily argue that this is going to provide consumer benefits in terms of marketed products that the scoring system will say we are most interested in, but again that belies the fact that there just hasn't been enough investment in terms of protecting that information.

The top ten credit card-issuing banks, along with the two major associations, spent approximately $20 billion last year in marketing.[140] How much has been spent in terms of protecting and upgrading the

---

revolving credit expanded from (in billions) $211,229.83 in 1989 to $238,642.62 in 1990).

138. William Goddard, *Swimming in the Wake of Dehoyos: When Federal Courts Sail Into Disparate Impact Waters, Will State Regulation of Insurance Remain Above the Waves?*, 10 CONN. INS. L.J. 369, 373 (2003).

139. David A. Schulman, *The Effectiveness of the Federal Fair Debt Collection Practices Act (FDCPA)*, 2 BANKR. DEV. J. 171, 171 (1985) ("Consumers usually enter into credit transactions planning to satisfy the obligation when it becomes due. Nevertheless, debtors are often unable to meet these obligations because of poor financial planning or unforeseen circumstances, such as the loss of employment.").

140. American Express Co., Annual Report (Form 10-K), at 70 (Feb. 26, 2007) (marketing expense totaling $6,516,000,000); Bank of America Corp., Annual Report (Form 10-K), at 100 (March 17, 2007) (marketing expense totaling $2,336,000,000); Capital One Services, Inc., Annual Report (Form 10-K), at 66 (Feb. 16, 2007) (marketing expense totaling $1,444,635,000); Citigroup Inc., Annual Report (Form 10-K), at 104 (Feb. 23, 2007) (marketing expense totaling $2,563,000,000); Morgan Stanley, Annual Report (Form 10-K), at 112 (Feb. 12, 2007) (marketing expense totaling $1,247,000,000); HSBC Finance Corp., Annual Report (Form 10-K), at 111 (Mar. 2, 2007) (marketing expense totaling $814,000,000); JP Morgan Chase & Co., Annual Report (Form 10-K), at 90 (Mar. 12, 2007) (marketing expense totaling $2,209,000,000); MasterCard Inc., Annual Report (Form 10-K), at 2 (Apr. 2007) (marketing expense totaling $1,052,000,000); U.S. Bancorp, Annual Report (Form 10-K), at 65 (Feb. 26, 2007) (marketing expense totaling $217,000,000); Washington Mutual, Inc., Annual Report (Form 10-K), at 83 (Mar. 1, 2007) (marketing expense totaling $443,000,000); Wells Fargo & Co., Annual Report (Form 10-K), at 46 (Feb. 20, 2007) (marketing expense totaling $456,000,000); Visa Inc., Final Prospectus (Form 424B4), at 13 (Mar. 25, 2008) (marketing expense totaling $1,075,000,000).

security protocol systems of our private, personal information? The $20 billion—I think we could see a little bit more taken out of that to protect our private information.

Similarly, credit card marketing solicitations exceeded 6 billion in 2005.[141] Notice that the yield is continuing to diminish, all the way down to less than half a percent in 2005, with a slight uptick today.[142] Part of this is reflecting the subprime crisis, people paying off credit cards with their refinancing and home mortgages.[143] Now, they can't sell their homes; they can't refinance; they are now much more receptive to even less desirable credit card offerings.

Who the deadbeat is from the credit card industry is very clear. One of the reasons I want to emphasize this point is, what other banking product is there that is actually offered to lose money, in terms of administrative costs? If you pay off your credit card at the end of the month, you receive customer service and loyalty reward programs, as well as a free loan.

I like to explain the cultural history that underlies our cognitive views that are negative about being in debt. We essentially self-punish, each of us, over our debt because of the negative connotation that it holds. That is one of the arguments for why, if you pay off your credit card at the end of the month, you get rewarded with a free loan. This becomes a real problem to the industry, as we see that so many people were paying off their credit cards through refinancing. We are now seeing that uptick again. The question is, "What is the quality of the debt that is increasing at this point in time?"

Keep in mind, as you look at the statistics—and we are looking at the magnitude, in terms of risk assessment of these portfolios—there has been a big discussion about, "Gosh, the stabilization of credit card debt means that Americans are making better choices. They are more informed," et cetera. The reality is that this temporary plateau is largely based on refinancing of credit card debt into home mortgages and a significant uptick in discharge rates prior to the 2005 Bankruptcy Reform Act.[144]

---

141. David Lazarus, *A Slick Marketing Approach*, S.F. CHRONICLE, Jan. 15, 2006, at D1, *available at* http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2006/01/15/BUGRFGNKP31.DTL.

142. *See* Manning Slides, *supra* note 110.

143. *See id*.

144. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11, 18 and 12 U.S.C.).

Much attention has been paid to information and ease of understanding. Of course, anybody who has actually read their credit card contract knows that it has been written by a risk-averse lawyer. It actually has increased. In the Banking Committee[145] last year, there was a member who brought out some of his old contracts. He pointed out how ten years ago the contract was ten pages; today it's thirty-five pages. The assumption is that consumers are even more knowledgeable and informed than ever. The reality, as we look at the increase in consumer debt, and particularly the penalty pricing that emerges, is that we see a very high statistical correlation between the growth of economic inequality in America and the desperation of financially distressed groups of people that will accept virtually any financial terms for a consumer loan.[146] Some of these deals are quite astounding.

In terms of where the major banks are headquartered today, there is only one major bank—and that's a nice trivia question—that is actually in a state that has an interest rate cap. That is Bank of America, at 36% APR.[147] All the other banks are in states without usury law caps.[148]

This is a table,[149] as we talk about pricing—and I want to show profitability—that is simply looking at the spread between a blue-chip loan,[150] car lending, and credit card lending. It doesn't include fees. You can see how extraordinarily profitable this industry has become, exclusive of fees. The credit card industry became more profitable and became the engine of growth for retail banking. More and more resources were deployed to expand, not only in terms of depth of the average level of credit card debt, but also into less creditworthy

---

145. For more information, please visit the United States Senate Committee on Banking, Housing, and Urban Affairs website, http://banking.senate.gov (last visited Feb. 16, 2008).

146. *See* Manning Slides, *supra* note 110.

147. Bank of America/Direct Merchants is headquartered in Arizona which has an interest rate ceiling at 36%. *See id*.

148. JPMorgan Chase, MBNA, Morgan Stanley (Discover), and HSBC are all headquartered in Delaware; Capital One is headquartered in Virginia; Providian is headquartered in New Hampshire; Citibank is headquartered in South Dakota; and American Express is headquartered in Utah. None of these states have interest rate caps. *See id*.

149. *See id*.

150. A blue chip loan is a loan that has a high probability of repayment. *See generally*, AM. BANKING ASS'N, BANKING TERMINOLOGY 40 (3d ed. 1989) (referencing the definition of "blue chip").

markets—what is often referred to as "the democratization of credit." But, at what cost?

This is really the report card of the credit card industry. If we want to look at where the revenues come—Jeff was talking about interchange fees—you can see how extraordinarily important interchange is to the industry. Interest last year: $75 billion.[151] Interest rate revenues are increasing again as the cost of bank funds continues to fall. Furthermore, what is most striking is the tremendous growth of late and overlimit penalty and cash-advance fees (over $14 billion),[152] along with annual membership fees (over $3 billion)—totaling over $17 billion in 2006.[153] That is just fees alone. I am talking about interchange fees. Transaction fees alone are almost net profits of the industry.

We were talking about information to consumers—if one focuses on interest rates, one is only scratching the surface of what pricing is all about.

One of the interesting subtexts about this discussion was that the credit card industry, for seven years, emphasized how the risk of expanding more and more into less financially strong markets required a much stronger bankruptcy bill. Yet, ironically, the profitability of the industry had its sharpest increase during 2005, when the bankruptcy law was passed.[154] What does this mean to us in terms of issues dealing with consumers?

I am going to focus on the issue of safety and soundness of the banking system. Where is the balance of consumers in this process? For example, there was a lot of discussion by the OCC Advisory about increasing minimum payments.[155] There was a lot of misinformation in the media, that increasing minimum payments was a way to help consumers regain control over their debt situation. The reality is that the intent of federal regulators was to purge unperforming credit card accounts from lender portfolios that were primarily associated with

---

151. *See* Manning Slides, *supra* note 110.

152. *See id*.

153. *See id*.

154. *See* Jeffrey Green, *C&P's 2006 Bank Card Profitability Study and Annual Report*, CARDS AND PAYMENTS, May 2006, at 30, 31.

155. *See* Memorandum from the Comptroller of the Currency Admin'r of Nat'l Banks to the Chief Executive Officers of Nat'l Banks, Dep't and Div. Heads, and All Examining Pers. 5 (Jan. 8, 2003), *available at* http://www.ffiec.gov/ffiecinfobase/resources/retail/occ-bl2003-1_account_manag%20_loss_allow_guid.pdf (discussing the need to increase minimum payments).

financially marginal borrowers that were entrapped in fee-harvesting, subprime credit card programs. Their goal was to cleanse bank debt portfolios so that regulators and potential investors could more accurrately assess the value of these assets.

The consensus that emerged from regulators was that negative amortization was certainly a practice that should be not only frowned upon, but not tolerated. [156] In fact, from my discussion with regulators, three months of negative amortization really becomes the litmus test of when it really smells bad. Yet, we are seeing the emergence of a subprime credit card market that is based almost exclusively on negative amortization.[157]

I have been on cases where top-five card issuers have issued lines of credit for $300, and they would charge $178 in fees.[158] There is another major issuer who has a "multi-card harvesting practice," where as soon as the $300-to-$500 line of credit has been exhausted, largely with fees, then another card is issued.[159] That way, you can have a low-income or distressed consumer with five credit cards, and you could harvest maybe four or five or six different fees each month. That is the way in which this negative amortization process continues.

Some of the other issues I find disconcerting include this effort of binding arbitration. There have been some cases introduced about collusion in arbitration contracts. This limits consumer options in terms of class-action lawsuits.

Federal preemption has focused on, as a national market, that we no longer have personal local relationships, and banks need larger empirical, objective information, like credit scores, to assess the quality of their customer so they can make appropriate risk assessments.[160]

---

156. *See* CREDIT CARD ACTIVITIES MANUAL, *supra* note 129, at ch.9 (stating that "regulators are likely to object to programmatic negative amortization").

157. *See* JURGENS & WU, NAT'L CONSUMER LAW CENTER, FEE-HARVESTERS: LOW-CREDIT, HIGH-COST CARDS BLEED CONSUMERS 9 (2007), *available at* http://www.consumerlaw.org/issues/credit_cards/content/FEE-HarvesterFinal.pdf (describing the increasing subprime credit card market).

158. *See*, *e.g.*, Bonner v. Cortrust Bank, No. 2:05-CV-137 PS, 2006 U.S. Dist. LEXIS 47410 (N.D. Ind. 2006) (discussing the legality of fees so high that they essentially eliminated the balance on a first issued credit card).

159. *See* JURGENS & WU, *supra* note 157, at 3-5.

160. *See National Credit Reporting System: Before the Comm. on Banking, Housing, and Urban Affairs*, 108th Cong. (2003) (statement of Delores S. Smith, Director, Div. of Consumer and Cmty. Affairs, Bd. of Governors of the Fed. Reserve Bank), *available at* http://www.federalreserve.gov/boarddocs/testimony/2003/20030729

Federal preemption limits price competition, because there aren't any kind of regulatory limits; the major states no longer have interest-rate caps. The 1991 *Smiley* decision extended that also to fees.[161]

Most disconcerting to me was the 2002 California *Lockyer* case.[162] I was actually an expert witness on that case. Federal preemption was extended to disclosure.[163] If we are trying to make sure that consumers make informed decisions, the real question is why can't we push for stronger efforts of compliance to improve disclosure at that level?

The last thing I want to emphasize is the rise of predatory lending, deceptive marketing practices, and the emergence of securitization, where servicer and investor relationships mean that when your credit card or other consumer debts have been pooled and resold into asset-backed securities, your consumer rights have dramatically changed, not only from the servicer in terms of who actually holds your debt and is processing your payment, but also in terms of the Class B and C tranches of investors who are now basically taking some fiduciary control over your debt. If you go to court and you are going into a settlement or a bankruptcy, sometimes people find that their debts have been sold into an asset-backed security, and they can't go through that process. It's a whole different ballgame, as more and more consumer debt gets repackaged into asset-backed securities.

Thank you.

MR. MACDONALD: Before we take questions, I come back to some of the points made at the beginning: Keep your eye on regulation. If you look at a timeline here, the woes that both speakers talked about arguably have gone in tandem with the consolidation of the industry. The bigger it has gotten, the more it has approached an oligopoly market, the more the bad behavior seems to come to the fore. That is important.

/default.htm (discussing the current nature of credit scoring); *Credit Scoring: Before the H. Banking and Fin. Servs. Comm., Subcomm. on Fin. Insts. and Consumer Credit*, 106th Cong. (2000) (statement of Peggy Twohig, Assistant Dir., Div. of Fin. Practices, FTC.), *available at* http://financialservices.house.gov/banking/92100ftc.htm (discussing how credit scoring has changed over the years).

161. Smiley v. Citibank, 900 P.2d 690, 707 (Cal. 1995) (holding that the term "interest" in 12 U.S.C. § 85, whereby a national bank is authorized to charge interest at the rate allowed by the laws of the state in which the bank is located, applies to late payment fees).

162. Am. Bankers Ass'n v. Lockyer, 239 F. Supp. 2d 1000 (E.D. Cal. 2002).

163. *Id*. at 1007-08.

Banks have a responsibility, and the regulators have a responsibility, under safety and soundness standards, to protect their reputations. Consumers have to trust that banks are going to look out for them. Trust is important, fiduciary duty is important, and reputation is important. If we have seen anything in the last five years, it is, in fact, harm to all three of those. You should ask yourself, "Why is that happening?"

QUESTION: I have a question for Mr. Shinder about the private litigation surrounding the interchange fee. You mentioned, if the class claims are successful, this will lead to a change in how the interchange fee is set. I was wondering what you think will be the likely result.

MR. SHINDER: If I had to handicap the case, I think they are going to have a hard time getting the class certified. The first big moment in that case is the class motion—having lived this in the Wal-Mart case, where I think the hardest thing we achieved was getting the class certified.[164] That went all the way up to the Supreme Court.[165]

Interestingly, the precedent that we used has been clarified by the Second Circuit.[166] They are in the same courtroom. The standards are a little harder. I think we would have satisfied them—a little bias—but I think this class is going to have a hard time getting certified.

Whether the cudgel of antitrust and blowing the system up is the best way to deal with interchange is unclear to me. I don't like what happened in Australia either.[167] I look at the numbers that Bob put up, and you can see how this industry probably could survive without interchange. It leaps right out from those numbers. The argument that was initially made to defend the system was that interchange is necessary to give issuers incentives. Obviously, it's not anymore. That said, to just eliminate it could have significant effects on the system that are hard to predict.

QUESTIONER: I know one proposal would be to have the issuing banks negotiate individually with the merchants, rather than having it set by Visa and MasterCard—perhaps a consortium of smaller issuers. Do you think that would be a workable solution?

---

164. *In re* Visa Check/Mastermoney Antitrust Litig., 280 F.3d 124 (2d. Cir. 2001) (granting class certification).

165. *Id.*, *cert. denied*, Visa U.S.A., Inc. v. Wal-Mart Stores, Inc., 536 U.S. 917 (2002).

166. *In re* Initial Pub. Offering Sec. Litig., 471 F.3d 24 (2d Cir. 2006).

167. *See* Joseph Farrell, *Assessing Australian Interchange Regulation: Comments on Chang, Evans and Garcia Swartz*, 4 REV. NETWORK ECON. 359 (2005).

MR. SHINDER: You are talking about a system of bilaterals, actually, with the issuers and the large acquirers. That could be the solution. Now you have a situation that you didn't twenty years ago—it sounds like you know something about this industry—where the First Datas of the world and large merchant processors aggregate millions of merchants and perhaps could cut deals where there is equal bargaining power brought to the table. As you have seen, the issuer side has consolidated significantly.

That could be a solution. That's one of the arguments that the merchants, I assume, are going to proffer, that they don't need this system anymore. Back in 1985, they were exchanging paper.

MR. MACDONALD: If I could add a couple of comments. If you are on the defendant's side, and you are the banks, at least as far as prosecution of the case goes, you don't want to class-certify it, because it puts relentless pressure on you. You want to settle maybe at a higher price.

On the other hand, if you want to privately settle with the plaintiffs, you want a class because you want a universal settlement. If there are 200 plaintiffs on the marquee of the lawsuit, you want 6 million plaintiffs when you do the settlement. What good is it for you? That's point number one.

Point number two: In price fixing, it gets back to reputation. I would argue that the central sacrilege in commercial law in the United States is price fixing. With the exception of, maybe, environmental damage, oil spills and what have you, price fixing is the worst thing. If a decision were to come out as a result of a jury in Brooklyn deciding that the banks engaged in price fixing, it is a terrible, terrible headline for the banking industry. You guys are not only scoundrels, you fixed prices.

Which again begs the question: Where the hell were the regulators? Where is safety and soundness? Where is regulation? Is it *laissez-faire* all the way?

And so it ended quietly. The world ends with a whimper, not a bang. Thank you very much.