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Competition and Coordination: The Card Network Balancing Act

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Security is one of the most pressing issues in the payments industry, and a crucial ingredient in achieving security is coordination among industry participants. However, efforts to coordinate this highly concentrated industry have led to claims of anti-competitive behavior in pricing and rules by the payments card industry. Following a variety of lawsuits filed in the last 40 years, new lawsuits that allege such behavior are being filed around payment card security. This *PSR Briefing* reviews these lawsuits, discusses why coordination among card networks raises concerns about anti-competitive behaviors, and considers future implications for payment system security.

Previous Card Network Litigation and Regulation

Payment card networks have been involved in antitrust litigation for nearly 40 years (Wildfang and Marth). For example, in the 1970s, the Worthen suit litigated exclusivity rules.¹ In the 1990s, what is known as the “Walmart suit” litigated “honor all cards” policies. And in the 2000s, both a merchant-led class action suit and a U.S. Department of Justice (DOJ) suit litigated the setting of interchange fees and anti-steering rules. Litigation is a lengthy process, and the ongoing costs and piecemeal solutions have done little to curb allegations of anti-competitive behavior.

Legislation and accompanying regulation occasionally have been pursued as an alternative to litigation. In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act’s Durbin Amendment sought to cap debit card interchange fees and provide merchants a choice in how transactions are routed. Nonetheless, payment card networks still are embroiled in antitrust litigation.

Current Payment Card Network Litigation

The impetus for recent payment card network litigation was the migration from magnetic stripe technology to the Europay, MasterCard, and Visa (EMV) chip standard.² The United States was the last major market in the world to implement EMV, which was adopted after payment card networks announced their own plans to encourage EMV acceptance. Visa, MasterCard, Discover and American Express selected Oct. 1, 2015, as the date for shifting liability for payments fraud from issuers to merchants in situations where consumers were issued EMV cards but merchants were not accepting them. This shift in liability was intended to give merchants an incentive to upgrade their terminals. To address issues that require coordination across payments constituents, the industry formed the EMV Migration Forum, an association designed to facilitate EMV adoption in the United States.³ The migration to EMV, however, still did not go smoothly,

and many merchants were unable to upgrade their terminals by Oct. 1, 2015. Consequently, merchants have called the coordinated effort by card networks anti-competitive and have filed complaints in federal and state courts.

In a class action suit by B&R Supermarket Inc., Milam's Market and Grove Liquors LLC, the litigants claim that "for their own benefit, the networks, the issuing banks through EMVCo conspired to shift billions of dollars in liability for fraudulent, faulty and otherwise rejected consumer credit card transactions from themselves to the Class, without consideration to, or meaningful recourse by, those merchants (the 'Liability Shift')" (B&R Supermarket Inc. et al. v. Visa Inc. et al. Complaint 2016).⁴ Simply put, the liability shift is alleged to have been designed to make merchants liable for payments fraud in circumstances where issuing banks previously had been responsible. Furthermore, the ability to comply with the shift often was out of merchants' control. Even merchants who upgraded terminals to avoid the liability shift still could be liable for fraud because of third-party delays in the mandated EMV certification process. Conversely, the card networks argue they had independent, reputational incentives to encourage the technological upgrade because EMV chips are better at preventing a certain type of payments fraud (B&R Supermarket Inc. et al. v. Visa Inc. et al. Memorandum of Law 2016). Coordinated schedules, the networks claim, simply made the migration less confusing for participants.

Large merchants have filed three additional suits against card networks. Wal-Mart Stores Inc. and The Kroger Co. each filed a complaint against Visa, and Home Depot Inc. filed a complaint against both Visa and MasterCard. These suits arose from card networks preventing merchants from promoting chip and PIN technology, thereby allegedly precluding merchants from exercising the debit card transaction-routing rights afforded to them by the Durbin Amendment.⁵ Though different from concerns about the shift in liability, these claims also allege anti-competitive behavior by the payment card networks as a result of the EMV migration.

The migration to EMV also has piqued the interest of Congress. In March 2016, U.S. Sen. Dick Durbin of Illinois sought information about EMVCo, including its governance structure and the effects its standards may have on competition (Sen. Durbin EMVCo Letter March 2016). He urged EMVCo to incorporate other stakeholders into its governance structure to ensure a meaningful vote by those outside the network in

making decisions and setting standards (Sen. Durbin EMVCo Letter May 2016). In its response, EMVCo stressed that while it facilitates standards regarding security and interoperability, it does not establish rules for their implementation (EMVCo Sen. Durbin Letter April 2016). It explained the shift in liability was the result of assessments by independent networks rather than EMVCo's decision.

Collaboration and Competition: A Delicate Balance

Federal antitrust agencies have tried to help navigate the delicate balance of industry cooperation and market competition. The Federal Trade Commission (FTC) and the DOJ have issued "Antitrust Guidelines for Collaboration Among Competitors" to provide a framework for how they will analyze antitrust issues to encourage pro-competitive collaboration and deter collaboration that may harm competition (Antitrust Guidelines 2000). The framework is meant to help organizations evaluate whether collaboration is likely to face a federal antitrust challenge. When assessing the overall effect of an agreement to collaborate, benefits may be weighed against harms. The pro-competitive benefits of collaboration can include cheaper, more valuable goods or services, better use of existing assets, incentives for new investments, and economies of scale beyond the reach of any single organization. In contrast, the anti-competitive harms of collaboration can include increased prices or reduced output, quality, service, or innovation below what likely would exist absent the collaboration. While following these guidelines may reduce the likelihood of federal antitrust enforcement, it may not dissuade private litigants from going to court.

Implications for Payment Card Security

Determining whether behavior in the payments industry is collaborative or anti-competitive is not always easy. The economics of payment networks is conducive to a concentrated market structure, which may indeed be necessary for the success of the payment method. Moreover, in some cases, allegations of anti-competitive intent could hinder industry progress. In the EMV implementation example, although consumers and merchants raised concerns about the coordinated shift of fraud liability on Oct. 1, 2015, a fractured alternative with uncoordinated timing would have carried its own significant challenges. If each card network had a different standard and timeframe for implementing EMV, it would confuse both

merchants and consumers. In this regard, it's practical for networks to agree to a standard and choose a single date for the shift in liability.

But in the context of antitrust law, is standards-setting by joint ventures an attempt to improve U.S. payment card security or, as merchants allege, a means by which to conspire?⁶ This is a critical issue to examine as more industry collaborations may be necessary to improve security and counter fraudsters as they develop more innovative techniques. Moreover, network participation in these industry groups has been viewed by some as an attempt to reduce potential anti-competitive harms. If these efforts are cited as an opportunity for anti-competitive behavior, card networks may have little or no incentive to continue in existing or new joint efforts (*B&R Supermarket Inc. et al. v. Visa Inc. et al. Order 2016*).

Though not a surprise, exclusivity of joint ventures may be the spur for alleged anti-competitive behavior. While including a variety of stakeholders in the governance of a joint venture may not be a panacea, it could prevent the perception of improper conduct. At the same time, it is unclear whether certain behaviors themselves are deemed to be collaborative or anti-competitive. In the case of implementing chip cards, EMVCo and the EMV Migration Forum served vastly different roles in the migration process. Whereas EMVCo developed and managed EMV specifications, the EMV Migration Forum guided EMV's migration in the United States. This distinction was blurred somewhat in the current antitrust suit's complaint, which named EMVCo as a defendant and identifies the liability shift—a decision determined by the networks—as the trigger for anti-competitive behavior.⁷

Outlook for Payments Security

The concern that coordination by payments networks inherently is anti-competitive can have adverse effects on future upgrades in payments security. The shift from magnetic stripe technology to EMV chips was the first of what is expected to be a series of security improvements. Tokenization is on the horizon, potentially setting up another battleground for litigation.⁸ EMVCo's tokenization specifications, published in 2014, elicited strong reactions from groups like the Merchant Advisory Group and the Secure Remote Payment Council, which prefer open standards to proprietary ones (Woodward). Failure to resolve their differences prior to putting the standards into practice could lead to further accusations of anti-competitive behavior and potentially to litigation or legislation and regulation that would delay security improvements.

Conclusion

As continuous litigation suggests, there is a delicate balance between the benefits of the concentrated structure of payment card networks and the threat of anti-competitive behavior. Joint ventures, including EMVCo and the EMV Migration Forum, along with active participation from a range of other stakeholders, may be crucial to ensuring that payment security in the United States does not fall behind the rest of the world. At the same time, it is important to recognize that if coordinated efforts always are met with litigation, networks may have an incentive not to act, potentially undermining industry progress. Antitrust law exists to defend consumers. The constant threat of legal action, however, may result in antiquated security that is a detriment to the consumers the law seeks to protect.

Endnotes

¹The litigated exclusivity rule restricted a network member's ability to participate in other networks.

²The EMV standard now is managed by EMVCo, a consortium with control split equally among Visa, MasterCard, JCB, American Express, China UnionPay and Discover.

³Membership includes participants from global payments networks, financial institutions, merchants, processors, acquirers, domestic debit networks, industry associations and industry suppliers. The EMV Migration Forum transitioned to the U.S. Payment Forum in August 2016. The EMV Migration Forum had six membership levels: Global Payment Network, Principal Member, General Member, Industry Association Member, Government Member and Associate Member. While Principal Members and General Members were eligible for election to the Forum Steering Committee, the only membership level with a reserved seat on the Steering Committee was the Global Payments Network.

⁴Presently, the court has granted the motion to dismiss as to the issuing-banks and EMVCo. EMVCo's motion to dismiss was granted due to lack of specific allegations of EMVCo

conduct. However, since the case will proceed against the networks, evidence that shows EMVCo's complicity is still possible so the court will allow a motion to amend based on newly discovered evidence. Furthermore, it should be noted that while EMVCo was named as a defendant in the lawsuit, the EMV Migration Forum was not.

⁵Visa since has revised its debit routing rules.

⁶As previously stated, the merchants allege "the networks, the issuing banks through EMVCo conspired to shift billions of dollars in liability for fraudulent, faulty and otherwise rejected consumer credit card transactions from themselves to the Class, without consideration to, or meaningful recourse by, those merchants (the 'Liability Shift')." The author is not commenting on the allegation, but rather quoting the complaint.

⁷As previously noted, EMVCo's motion to dismiss has been granted. However, both EMVCo and the EMV Migration Forum are mentioned in the order as opportunities for networks to collude.

⁸The PCI Council defines tokenization as "a process by which the primary account number (PAN) is replaced with a surrogate value called a token" (DSS).

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