

THE ECONOMIC BENEFITS OF CREDIT CARD MERCHANT RESTRAINTS: A RESPONSE TO ADAM LEVITIN

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In Priceless?: The Economic Costs of Credit Card Merchant Restraints, Adam Levitin argues that credit card systems violate the U.S. antitrust laws by prohibiting merchants from surcharging credit card transactions and refusing to accept high-priced reward cards. If merchants could engage in these practices, he contends, they would effectively combat credit card system market power and drive down acceptance fees. This Essay criticizes Levitin's proposal, arguing that surcharging and selective refusal would be ineffective tools in the fight against anticompetitive credit card acceptance fees, because merchants are unlikely to increase their prices by the amount necessary to counteract anticompetitive overcharges without also stifling efficient card use.

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*In Priceless?: The Economic Costs of Credit Card Merchant Restraints,*¹ Adam Levitin identifies a serious anticompetitive problem in credit card markets—card systems overcharge merchants. He proposes a bold solution—eliminating the

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1. Adam J. Levitin, *Priceless?: The Economic Costs of Credit Card Merchant Restraints*, 55 UCLA L. REV. 1321 (2008) [hereinafter Levitin, *Economic Costs*].

credit card system rules that prohibit merchants from (1) selectively refusing to accept certain cards (the “honor-all-cards rule”) and (2) charging more for using a particular card (the “no-surcharge rule”).² Levitin contends that these rules force retailers to accept high-priced reward and corporate cards that provide no incremental benefits to the merchant³ and distort the payment systems market by shielding customers from the cost created by their payment method.⁴ As a result, consumers use credit cards even when other methods of payment would impose lower costs, and retailers raise their prices to pay the card acceptance fees.

Economists have long cautioned that eliminating these rules could inefficiently reduce credit card use because card systems compete for both consumers and merchants.⁵ In such a two-sided market, an efficient pricing structure must discriminate between the two customer groups based upon the cost of serving each group and their relative demand elasticities.⁶ Because merchant demand for credit cards is less elastic than consumer demand, an efficient pricing structure will place a larger cost burden on merchants.⁷ If surcharging were permitted, merchants could shift that cost to cardholders,

2. *Id.* at 1334–39.

3. *Id.* at 1347.

4. *Id.* at 1336.

5. See, e.g., Joshua S. Gans & Stephen P. King, *Regulating Interchange Fees in Payment Systems* 25 (Melbourne Bus. Sch., Paper No. 2001-17), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=286535&rec=1&srcabs=352220 (explaining that the no-surcharge rule “can play an important, socially desirable, role in eliminating the ability of merchants to use the choice of payment instrument as a means of practicing price discrimination. . . . [that] serves to distort the cost of transacting further away from its cost minimising [sic] level”); Zhu Wang, *Market Structure and Credit Card Pricing: What Drives the Interchange?* 37 (Payments Sys. Research, Fed. Reserve Bank of Kan. City, Working Paper 06-04 (Dec. 20, 2006)) (explaining that the no-surcharge rule can be welfare enhancing where it limits surcharging by merchants with market power); Julian Wright, *Optimal Card Payment Systems*, 47 EUR. ECON. REV. 587, 594 (2003), available at http://profile.nus.edu.sg/fass/ecsjkdw/EER_final.pdf (“When surcharging is allowed, merchants with monopoly power will exploit their power by setting a price to extract surplus from inframarginal cardholders.”).

6. MICHAEL L. KATZ, NETWORK EFFECTS, INTERCHANGE FEES, AND NO-SURCHARGE RULES IN THE AUSTRALIAN CREDIT AND CHARGE CARD INDUSTRY 34–35 (2001), http://www.rba.gov.au/PaymentsSystem/Reforms/CCSchemes/IICommissionedReport/2_commissioned_report.pdf; Margaret E. Guerin-Calvert & Janusz A. Ordovery, *Merchant Benefits and Public Policy Towards Interchange: An Economic Assessment*, 4 REV. NETWORK ECON. 384, 385 (2005), available at http://www.mejournal.com/artman2/uploads/1/guerin_calvert_RNE_dec05.pdf (“The network externalities that link merchants who accept cards and card-holders who use them compel a price/fee structure that will likely entail deviations from the cost-causality principles that call for prices to be closely linked to the underlying costs of providing direct benefits to either side of the market.”); Julian Wright, *The Determinants of Optimal Interchange Fees in Payment Systems*, 52 J. INDUS. ECON. 1, 17 (2004) [hereinafter Wright, *Determinants*].

7. See Steven Semeraro, *Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty*, 14 GEO. MASON L. REV. 941, 988 (2007).

thwarting the systems' abilities to price discriminate, and thereby reducing credit card volume below efficient levels.⁸

Levitin rejects this economic analysis for three reasons. First, he suggests that eliminating the rules might not reduce credit card use at all, because merchants would only surcharge or refuse high-priced cards. In turn, he argues, the systems would drop these cards, and retailers would accept all remaining cards without surcharging. The only real change would be that merchants would pay less to accept cards and would lower their retail prices accordingly.

Second, Levitin rejects the possibility that network externalities would inefficiently reduce credit card use. He contends that in modern, competitive payment system markets, volume shifts among payment systems are the efficient consequence of consumers more fully internalizing the costs of their payment choices. As a result, social welfare would not decline if consumers switched from using credit cards to other methods of payment, such as cash, checks, or debit cards.

Third, Levitin contends that, as a matter of antitrust law, the economic arguments against surcharging must be rejected. In most cases, the U.S. antitrust laws require a thorough economic analysis of a business arrangement, condemning only those restraints that, on balance, harm consumers. A narrow category of agreements, such as horizontal price fixing and market division, however, are condemned per se without probing economic analysis, because these practices virtually always harm consumers. Levitin believes that the merchant restraints fall within this narrow category.

This Essay exposes the flaws in each of Levitin's three arguments. Part I explains that merchants facing competitive conditions in their own retail markets cannot be expected to uniformly reject high-priced credit cards. Competition would likely induce many merchants to accept all cards to avoid driving customers elsewhere. Other retailers would continue to accept particular high-priced cards that are likely to be held by highly profitable customers. The merchants most likely to surcharge or selectively refuse expensive cards would be those with market power, and they would presumably not pass on all of their cost savings to consumers. Because merchants will vary in their use of surcharging, economic concerns cannot be avoided by assuming, as Levitin does, that high-fee cards will disappear and merchants will accept the remaining cards without surcharging.

8. See Katz, *supra* note 6, at 21, 58; Wright, *Determinants*, *supra* note 6, at 24. The efficient volume of credit card use is the volume that would maximize the joint benefit of cardholders and merchants taking account of the costs and benefits of credit cards and the available alternative payment methods to both consumers and merchants.

Part II shows that Levitin improperly assumes that forcing consumers to internalize the costs of their chosen payment system will generate efficient competition among these systems. Efficiency requires consumers to internalize the costs that they cause. In a two-sided credit card market, however, a card system cannot properly allocate costs between merchants and cardholders based on causation because many credit card system costs are jointly attributable to both customer groups. Shifting the burden toward consumers may thus cause them to switch to less efficient payment systems.

Part III explains that antitrust courts would not condemn the merchant restraints per se, but would instead strike them down only if a plaintiff could prove that the restraints harm consumers. Whether one views those restraints as vertical agreements between card systems and merchants or as horizontal agreements among the banks issuing Visa and MasterCard cards, a court would apply the rule of reason, which requires a full economic analysis of the effects of the restraint. A horizontal agreement among card systems, if proven, would be per se illegal. To prove such an agreement, however, an antitrust plaintiff must present evidence of an actual meeting of the minds among card systems. At most, Levitin shows that all of the card systems engaged in the same practices, which alone would be insufficient to sufficiently allege an antitrust conspiracy.

I. MERCHANTS WOULD NOT UNIFORMLY SURCHARGE TO ELIMINATE HIGH-PRICED CARDS

For surcharging to be efficient, merchants would have to tailor precisely their pricing schemes to undo the card systems' anticompetitive overcharges and simultaneously avoid shifting too much of the card acceptance cost to cardholders. Because credit cards benefit merchants by increasing consumer spending,⁹ Levitin contends that merchants would threaten just the right amount of surcharging by targeting only expensive rewards and corporate cards.¹⁰ Card systems would reduce merchant fees by eliminating these high-priced cards, and merchants would voluntarily continue to accept all remaining cards without surcharges.¹¹

Because merchants face different competitive conditions in their respective retail markets, however, a more likely outcome is one in which merchants would divide into roughly two camps: one group that would be

9. Levitin, *Economic Costs*, *supra* note 1, at 1348–49, 1353.

10. See *id.* at 1353–55; *id.* at 1391 (“Merchants like credit cards; they just do not like being forced to accept higher cost cards from which they receive no benefit.”).

11. *Id.* at 1391.

unable or unwilling to surcharge sufficiently to bring down card acceptance fees, and another in which the merchants would force fees below the optimal level. The first group—merchants in competitive markets—would fear that surcharging or refusing certain cards would drive consumers to their competitors who may continue to accept all high-priced cards or particular high-priced cards that would attract profitable customers. For instance, restaurants would likely continue to accept corporate cards that many business travelers are required to use. Or, neighborhood hardware stores might continue to accept the Home Depot rewards card with the hope of attracting more customers interested in home repair and remodeling.

The second group—merchants with market power—would likely place surcharges on more than just high-priced cards. Because credit cards cost more per transaction than other means of payment, such as cash or checks, merchants prefer that customers use a credit card only when they are unable to use an alternative payment method. In setting the surcharge, then, a merchant would discount the value of card use to the inframarginal consumer who would make the purchase with or without a card, but who would prefer to use the card.¹² These merchants would likely pass too much of the cost of card use onto customers, retaining at least some of the cost savings as profit. In the end, consumers could get the bad (higher card costs as a result of reduced rewards) without the good (reduced retail prices).

Even if all merchants limited surcharges to high-priced cards, the benefits would remain uncertain. If these cards provide no marginal benefit to merchants, as Levitin concludes,¹³ then merchants pay more solely as a result of the card systems' market power. If the majority of merchants refused to accept—or surcharged—high-priced cards, then they could force the card systems to eliminate these expensive cards. But the card systems would retain their market power and would likely respond by increasing fees for regular cards to replace this lost revenue. Card acceptance fees would flatten across all credit card types, but the total card fees would change very little. Unless merchants refused or surcharged credit cards other than just high-priced cards—which, of course, would risk the distortions predicted by two-sided market economics¹⁴—they may not reduce their card costs significantly.

12. Wright, *Determinants*, *supra* note 6, at 8. Legitimate reasons to use a credit card include the desire not to carry cash and to retain sufficient funds on one's person or in a checking account for emergencies in which a credit card would not be an acceptable means of payment.

13. Levitin, *Economic Costs*, *supra* note 1, at 1391.

14. See *supra* notes 5–8 and accompanying text.

II. INTERNALIZING COSTS AND EFFICIENCY ANALYSIS IN THE PRESENCE OF JOINT COSTS

Levitin acknowledges the economics of two-sided markets,¹⁵ but deems the externalities they predict to be unimportant because of competition among modern payment systems.¹⁶ “Any negative network externality” flowing from one network’s loss in size,¹⁷ he contends, “is offset by a positive one when cardholders or merchants switch payment systems”¹⁸ and “net social welfare remains constant.”¹⁹

The amount and size of transactions, however, are not independent of a customer’s payment system choice. As Levitin has recognized in earlier scholarship, customers using credit cards tend to spend more than they would if they were using another means of payment.²⁰ Consumers who switched from credit cards to other methods of payment would spend less and thus reduce the revenue pool from which merchants could draw to lower retail prices as card acceptance costs fell.

Levitin contends that a little less card use would do us good.²¹ Indeed, he believes that the merchant restraints are the means by which the card systems “forc[e] more card transactions than is efficient.”²² This overproduction argument is plausible, but it would be extremely difficult to prove. For instance, consider the classic example of smoking. Assuming that smokers do not fully internalize the health care costs associated with second-hand smoke, then they would likely purchase and consume an inefficiently high number of cigarettes. Even in such a seemingly clear case, however, serious debate can arise as to whether cigarettes are in fact overproduced given that those who smoke derive personal benefits from smoking and the healthcare costs that smoking imposes on society are uncertain.²³

Antitrust rarely intervenes in these scenarios because of the difficulties in (1) distinguishing actual inefficient overproduction from the growth

15. Levitin, *Economic Costs*, *supra* note 1, at 1363–66.

16. *Id.* at 1325, 1366 (declaring that two-sided market economic analysis “makes little sense in the current competitive environment”).

17. *Id.* at 1388.

18. *Id.* (“[W]hen consumers have a choice among competing networked products, there is no inherent value to the existence of any particular network.”).

19. *Id.* at 1387–88.

20. Adam J. Levitin, *The Antitrust Super Bowl: America’s Payment Systems, No-Surcharge Rules, and the Hidden Costs of Credit*, 3 BERKELEY BUS. L.J. 265, 288 (2005) [hereinafter Levitin, *Antitrust*].

21. *Id.* at 305–08.

22. Levitin, *Economic Costs*, *supra* note 1, at 1357.

23. See generally Jon D. Hanson & Kyle D. Logue, *The Costs of Cigarettes: The Economic Case for Ex Post Incentive-Based Regulation*, 107 YALE L.J. 1163 (1998).

in volume that flows from efficient competition, and (2) remedying the overproduction without causing inefficient underproduction.²⁴ Although credit card transactions could plausibly be processed more efficiently over a non-credit-card payment system network, Levitin has not persuasively demonstrated that this possibility is the reality. He has speculated that credit card use imposes externalities on society, including the market disruptions flowing from poor consumer credit decisions²⁵ and the potential to increase retail costs for non-credit-card using consumers.²⁶ But these externalities are highly debatable and require far more empirical evidence than can be found in the literature.²⁷ Would social welfare increase if consumers substituted other forms of consumer lending, such as payday loans, for credit card lending? Would currently unbanked consumers benefit more from (1) the lower retail prices that might follow reduced card acceptance fees, or (2) an entrée into the banking system and credit cards of their own?

Perhaps mindful of these concerns, Levitin effectively argues that antitrust law does not demand the perfect knowledge of the omniscient social planner. Rather, it mandates competition, confident that competing firms will allocate resources efficiently based on demand and production costs. The merchant restraints, Levitin claims, distort this competitive process by shielding cardholders from the costs rightly attributable to them and forcing merchants to pay them instead. If consumers do not “internalize the costs of their choice of payment system,”²⁸ he argues, their demand is artificially inflated and they engage in “more credit card transactions at higher prices than would

24. Wright, *Determinants*, *supra* note 6, at 22–23 (discussing the difficulties of identifying and remedying inefficient overuse of credit cards).

25. Adam J. Levitin, *Priceless?: The Social Costs of Credit Card Merchant Restraints*, 45 HARV. J. ON LEGIS. 1, 43–51 (2008) [hereinafter Levitin, *Social Costs*]; Levitin, *Antitrust*, *supra* note 20, at 305–08.

26. See Levitin, *Economic Costs*, *supra* note 1, at 1356; Levitin, *Social Costs*, *supra* note 25, at 34–36.

27. In his earlier scholarship, Levitin recognized the countervailing and uncertain effects of readily available consumer credit. Levitin, *Social Costs*, *supra* note 25, at 51 (“Although an abundance of credit has severe social externalities, it also has positive effects on economic growth because it enables greater investment in riskier, but potentially higher-yield projects.”). The same is true with respect to non-card user subsidization of credit use. Wright, *Determinants*, *supra* note 6, at 18 (“[O]ne cannot presume . . . that cash-paying customers necessarily pay more as a result of the existence of more expensive card-paying customers—one has to consider the additional benefits the cards provide as well.”); see also Marius Schwartz & Daniel R. Vincent, *Same Price, Cash or Card: Vertical Control by Payment Networks* 19 (Georgetown Univ. Dep’t of Econ., Working Paper 02-01, 2002), available at <http://www9.georgetown.edu/faculty/schwarm2/papers/CardsJan02.pdf> (explaining that under certain conditions, including where a card system has market power, if surcharging is permitted, the system’s “monopolistic charge to the merchant induces too few card transactions, hence a misallocation away from cards. With the [no-surcharge rule in place] and cardholder rebates, the pattern is reversed and misallocation again emerges, albeit in the other direction.”).

28. Levitin, *Economic Costs*, *supra* note 1, at 1324.

occur in a perfectly efficient market.”²⁹ Only if consumers bear “the full costs of their choice of payment system,”³⁰ he believes, will the market produce an efficient level of card use.³¹

This argument begs a critical question: What costs are properly attributable to cardholders? Ostensibly, a cardholder causes merchants to pay card acceptance fees. As Ronald Coase demonstrated in 1960, however, the concept of causing is not so easily cabined. In any two-party interaction, there is no natural cause of the costs arising when the parties interact, because those costs would not exist without the participation of both parties.³² Just as the costs of card use would not be incurred if the cardholder did not use the card, the cost would disappear if the merchant did not accept the card. There is no natural methodology for allocating cost in a two-sided market based on the cause of the cost; there are only efficient and inefficient allocations given governing economic principles.

One can, of course, push this Coasian insight too far. The fist is indeed at fault, not the nose or jaw, in most face-punching scenarios. Coase’s causal insight, however, is fully applicable to credit card transactions. The merchant accepts a brand of credit card at a particular price because it believes that it will earn higher profits than it would in a world in which it did not accept that card brand at that price. The benefits that lead merchants to accept cards extend well beyond the mechanics of acceptance and include, *inter alia*, increased customer spending power, greater fraud protection, and accounting efficiencies.³³ As economist Michael Katz explained, “card based transactions may have costs and benefits for both sides of the market simultaneously, [and] many costs are common.”³⁴ My nose may not in fairness share responsibility with your fist when you sock me, but card use is not a left jab at the merchant’s bottom line. A merchant fairly shares responsibility with the cardholder for the costs of card use.

At bottom, it may not be possible to allocate costs between cardholders and merchants based on who causes, or who benefits from, specific costs. Forcing cardholders to internalize some particular set of costs is just as likely to lead to the inefficient underuse of cards as it is to eliminate any anticompetitive overuse.

29. *Id.*

30. *Id.* at 1336.

31. See *id.* at 1357 (“[C]onsumers do not factor in costs when making their consumption decisions. Instead, they only weigh the relative benefits of different payment systems, a calculus in which credit card rewards play an outsized role.”); *id.* at 1385 (claiming that merchant restraints improperly “boost . . . credit cards by disguising consumer costs”).

32. R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 12–15 (1960).

33. Guerin-Calvert & Ordover, *supra* note 6, at 386, 396–407.

34. Katz, *supra* note 6, at 35.

Today, a cardholder may use a credit card without considering some of the costs flowing from that decision. This approach could be horribly inefficient if it led merchants to reject credit cards because they could not profitably bear the card acceptance costs. But this has not happened. The number of merchants accepting credit cards continues to grow, suggesting that the current system of allocating costs may be an efficient means of expanding retail sales.

III. MERCHANT RESTRAINTS DO NOT VIOLATE THE ANTITRUST LAWS PER SE

Levitin describes the honor-all-cards and no-surcharge rules as “naked restraints on trade”³⁵ that a U.S. antitrust court would condemn per se.³⁶ A naked restraint is one that has no plausible economic justification other than enabling the conspirators to exercise market power to the detriment of consumers; examples include horizontal price fixing, market allocation, and bid rigging.³⁷ Courts condemn these restraints without in-depth economic analysis, because the restraints entail no potentially efficiency-enhancing integration.³⁸ The rules prohibiting surcharging and selective refusal within a brand fail to meet this definition under any recognized antitrust rubric.³⁹ The remaining discussion shows that whether the merchant restraints are viewed as vertical agreements between card systems and merchants, horizontal agreements among card-issuing banks, or horizontal arrangements among card systems, they will not be condemned per se.

35. Levitin, *Economic Costs*, *supra* note 1, at 1392.

36. *Id.* To be sure, Levitin also advances a series of nuanced arguments suggesting that the merchant restraints would violate the rule of reason. *See id.* at 1393–99, 1401–04. Because the rule of reason requires an analysis of the economic effect of a challenged restraint, the success of these arguments would turn on Professor Levitin’s economic analysis, which is discussed *supra* at Part II.

37. The classic list of per se unlawful agreements is contained in *Northern Pacific Railroad Co. v. United States*, 356 U.S. 1, 5 (1958).

38. *See* *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2713 (2007) (“Resort to *per se* rules is confined to restraints, like those mentioned, ‘that would always or almost always tend to restrict competition and decrease output.’ To justify a *per se* prohibition a restraint must have ‘manifestly anticompetitive’ effects, and ‘lack . . . any redeeming virtue’” (citations omitted)); *Arizona v. Maricopa County Med. Soc’y*, 457 U.S. 332, 356–57 (1982) (explaining that the per se rule applies to horizontal price fixing by an unintegrated group of doctors, but would not apply to a true joint venture); *Nat’l Soc’y of Prof’l Eng’rs v. United States*, 435 U.S. 679, 692 (1978) (explaining that a restraint is per se illegal if its “nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality”).

39. Like any most-favored-nation or meeting-competition clause, these merchant restraints hold the potential for creating anticompetitive effects that outweigh their procompetitive benefit. But these types of arrangements must be evaluated under the rule of reason, which takes account of their full economic effect. They are not per se illegal. *See* LAWRENCE A. SULLIVAN & WARREN S. GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* § 8.6, at 487–90 (2d ed. 2006).

A. Vertical Agreements Are Evaluated Under the Rule of Reason

To the extent that the merchant restraints are vertical agreements between card systems and retailers,⁴⁰ the agreements are necessarily part of a legitimate supplier-customer relationship and as such are not naked. A court would thus analyze them under the rule of reason, which requires a thorough examination of a business arrangement to determine whether, on balance, it benefits or harms consumers.⁴¹

Under existing law, one potential vertical arrangement, a tie-in sale, arguably remains *per se* illegal. Where a seller conditions the sale of one product—the tying product—on the purchase of a distinct product that the customer could purchase elsewhere—the tied product—the linking of the two is said to be *per se* illegal when the seller has sufficient market power to force its customer to purchase both products.⁴² Levitin argues that the honor-all-cards rule improperly ties acceptance of high-priced cards to the merchant’s acceptance of regular credit cards.⁴³

The honor-all-cards rule is not *per se* illegal tying,⁴⁴ because antitrust condemns a tying arrangement on its face only when the seller links products

40. Levitin, *Economic Costs*, *supra* note 1, at 1401–02 (analyzing merchant restraints as vertical price-fixing agreements).

41. The U.S. Supreme Court recently held that virtually all vertical restraints are reviewed under the rule of reason. *Leegin*, 127 S. Ct. at 2710 (explaining that a vertical price fixing agreement does not have the same effect as a horizontal agreement to fix prices). The Court has long recognized that vertical restraints are not naked. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984) (explaining “various vertical agreements . . . hold the promise of increasing a firm’s efficiency and enabling it to compete more effectively. Accordingly, such combinations are judged under a rule of reason”).

42. *Jefferson Parish Hosp. v. Hyde*, 466 U.S. 2, 13–17 (1984).

43. Levitin, *Economic Costs*, *supra* note 1, at 1399.

44. Were a *per se* case to reach the Supreme Court today, this rule might well be overturned. It stands on a tenuous, nearly twenty-five-year-old, five-to-four decision. See *Jefferson Parish*, 466 U.S. 2. The Court recently acknowledged that “[m]any tying arrangements, even those involving patents and requirements ties, are fully consistent with a free, competitive market.” See *Ill. Tool Works, Inc. v. Ind. Ink, Inc.*, 547 U.S. 28, 45 (2006) (eliminating presumption of market power for patent holders). Lower courts and commentators have often made the same point. See *United States v. Microsoft Corp.*, 253 F.3d 34, 84 (D.C. Cir. 2001) (*per curiam*) (rejecting the application of a *per se* rule because of potential procompetitive benefit of product integration); *Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792, 796–97 (1st Cir. 1988) (*per Breyer, J.*) (explaining that the market power requirement for a *per se* tying claim is significant enough to screen out harmless ties); SULLIVAN & GRIMES, *supra* note 39, at § 8.3b, at 454 (“The [current] modified *per se* rule, which has evolved gradually from stricter *per se* treatment, substantially opens the inquiry for a court assessing the legality of a tying arrangement, allowing, for example, careful consideration of whether a product integration bundling should not be considered a tie because it is an efficient response to consumer demand.”); *id.* at § 8.3b, at 426, 434 (“Some industries involving high economies of scale may find it beneficial to discriminate among classes of users in a manner that maximizes output.”).

from two distinct markets.⁴⁵ This requirement ensures that a customer might have chosen to buy the tied product from a competitor were it not for the required tie.⁴⁶ That concern, however, simply does not arise in credit card markets for two reasons. First, no separate high-fee card market exists from which merchants might purchase services were it not for the existing systems' linking of all their cards. Second, and more importantly, even if a potential competitor began offering only high-fee reward cards, no competitive harm would flow from the honor-all-cards rule. A typical consumer of a tied product has no economic incentive to purchase a better or cheaper version of the tied product from a competitive source once it is forced to buy the tied product as part of a mandatory package. By contrast, the honor-all-cards rule does not reduce a merchant's incentive or ability to purchase lower-priced card acceptance services from a competing card system. The per se tying rule is therefore inapplicable, and the linking of card types would thus have to be assessed under the rule of reason.

B. Joint Venture Rules Are Assessed Under the Rule of Reason

To the extent Levitin argues that merchant restraints constitute an agreement among the banks that issue Visa and MasterCard branded cards,⁴⁷ the agreement would be horizontal, but not per se illegal. When competitors integrate their operations lawfully, as the banks have in creating the Visa and MasterCard brands, rules structuring the essential components of the venture are analyzed under the rule of reason.⁴⁸ The honor-all-cards and no-surcharge

45. See *Jefferson Parish*, 466 U.S. at 21 (“[A] tying arrangement cannot exist unless two separate product markets have been linked.”); *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 462 (1992) (explaining that there must be “sufficient consumer demand so that it is efficient for a firm to provide” each product separately).

46. *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 614 (1953); *Grappone*, 858 F.2d at 796 (“Only if the tie significantly reduces the opportunities to sell [the tied product], can the tie significantly increase the Seller's power in respect to [the tied product], and thereby (*i.e.*, by raising entry barriers) increase the Seller's power in respect to [the tying product]. And, insofar as tying impedes ‘competition on the merits,’ discouraging the search for innovation or efficiency, it does so in the tied product markets.” (citation omitted)).

47. Levitin, *Economic Costs*, *supra* note 1, at 1400.

48. *E.g.*, *In re ATM Fee Antitrust Litig.*, 554 F. Supp. 2d 1003, 1017 (N.D. Cal. 2008) (applying the rule of reason to challenge a horizontal agreement to set interchange fees because the agreement was integral to a lawful joint venture). The courts have applied similar reasoning in cases challenging a variety of jointly set rules by banks issuing Visa and MasterCard cards. See, *e.g.*, *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322 (S.D.N.Y. 2001), *aff'd*, 344 F.3d 229 (2d Cir. 2003) (applying the rule of reason to a joint refusal to deal with any bank issuing AmEx or Discover cards); *SCFC ILC, Inc. v. Visa U.S.A., Inc.*, 36 F.3d 958 (10th Cir. 1994) (applying the rule of reason to a rule prohibiting a competitive network from issuing Visa cards); *Nat'l Bankcard Corp. (NaBANCO) v. Visa U.S.A., Inc.*, 779 F.2d 592 (11th Cir. 1986) (applying the rule of reason to a jointly set interchange fee).

rules regulate the core relationship among merchants and the card systems. Those rules are thus ancillary to the banks' lawful joint venture and must be assessed under the rule of reason.⁴⁹

C. Circumstantial Evidence of an Antitrust Conspiracy
Among Card Systems Fails to Exclude the Possibility
of Independent Decisionmaking

Levitin charges the card systems with tacitly agreeing to adhere to the merchant restraints.⁵⁰ A conspiracy among card systems not to compete with respect to the terms offered to merchants would be a naked, horizontal agreement among unintegrated competitors that should be condemned per se.⁵¹ Because there is no evidence that the card systems agreed to impose these restraints, however, a conspiracy could be inferred only if the circumstantial evidence excluded the possibility of independent action.⁵² By way of illustration, a court might infer a price-fixing agreement from evidence of unexplained, parallel price increases, because if one firm unilaterally raised its price above the competitive level it would lose business to its competitors. The increase thus makes economic sense only if all competitors participate.

By contrast, the parallel practice of imposing the merchant restraints does not meet this standard. A single system prohibiting surcharging and

49. *Texaco, Inc. v. Dagher*, 547 U.S. 1, 7–8 (2006) (“Under the [ancillary restraints] doctrine, courts must determine whether the nonventure restriction is a naked restraint on trade, and thus invalid, or one that is ancillary to the legitimate and competitive purposes of the business association, and thus valid.”); SULLIVAN & GRIMES, *supra* note 39, at § 5.b, at 250 (“[T]here is a consistency [in each major case attacking a Visa or MasterCard member bank rule]: all three decisions recognized that the potential efficiencies of a joint venture required analysis under the rule of reason.”).

50. Levitin, *Economic Costs*, *supra* note 1, at 1400–01.

51. See *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 650 (1980) (per curiam) (holding per se illegal an agreement among independent competitive wholesalers with respect to credit terms offered to retailers).

52. The Supreme Court recently reiterated that parallel conduct alone cannot establish an antitrust conspiracy. See *Bell Atl. Corp. v. Twombly*, 127 S.Ct. 1955, 1964 (2007) (“The inadequacy of showing parallel conduct or interdependence, without more, mirrors the ambiguity of the behavior: consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market.”). The Court has explained that

antitrust law limits the range of permissible inferences from ambiguous evidence in a § 1 case. . . . [C]onduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy. . . . [A] plaintiff . . . must present evidence ‘that tends to exclude the possibility’ that the alleged conspirators acted independently.

Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 588 (1986) (citation omitted); see also *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 755–57, 764 (1984) (applying the same standard in a vertical agreement case).

selective card refusal would gain an advantage over other systems that did not prohibit these practices. The merchant restraints thus make independent economic sense, and an antitrust agreement could not be inferred solely from evidence that all systems employ similar restraints.

CONCLUSION

Attacking credit card system market power by enabling merchants to surcharge or selectively refuse high-priced cards would come with great risk. If merchants used their newfound power in a finely tailored way, then they could improve market conditions. As this Essay shows, however, quite plausible scenarios exist in which surcharging would harm consumers. Were surcharging permitted, the ultimate effects would be, at best, anybody's guess. Because alternative, less risky proposals for combating card system market power remain unexplored,⁵³ courts should be cautious in taking up Levitin's call to dispose of merchant restraints.

53. Alan S. Frankel & Allan L. Shampine, *The Economic Effects of Interchange Fees*, 73 ANTITRUST L.J. 627, 650–51 (2006) (suggesting that credit cards could access multiple systems and merchants could then select the network on which to process the transaction); Semeraro, *supra* note 7, at 997–98 (suggesting that merchants should be permitted to refuse cards on an issuer-by-issuer basis to stimulate competition on merchant fees).