PRELIMINARY ANALYSIS

The Differential Application of Rule 2.10(e) to Cooperative and Proprietary Payment Card Systems: Partial Exclusivity, Self-Enforcing Contracts, and the Stability of the Cooperative Form

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Visa is a non-profit supplier cooperative that provides two general categories of products and services to members that issue payment cards to the public.[1] Visa provides its members valuable intellectual property - its trademark, brand development and substantial advertising, and new product development - and an efficient network for processing card transactions. Membership is open to any entity that is eligible for federal deposit insurance and, through a variety of arrangements, cards can also be issued by, or on behalf of, non-banks such as General Motors and General Electric. Prior to 1977, Visa required its members to issue only Visa cards. Thus, issuers of Visa cards could not issue MasterCards and vice versa. In response to antitrust litigation and the refusal of the Antitrust Division of the Department of Justice to approve a continued Visa requirement of member exclusivity, Visa repealed its exclusivity requirement. MasterCard, like Visa an open membership non-profit supplier cooperative, never imposed an exclusivity requirement. The outcome was a virtually complete overlap between Visa and MasterCard membership: member firms typically issued both Visa cards and

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[1] For present purposes there is no need to distinguish between charge cards and payment cards. Both will be referred to collectively as payment cards.

MasterCards, a pattern referred to as duality.

In addition to the two cooperative systems, the payment card industry also includes two large proprietary card systems - American Express and Discover/Novus.[2] In the cooperative systems, each member can both issue cards to customers and service ("acquire") merchants, and each member is free to set the price and terms of the cards it issues and the fee (the "discount") it charges merchants; these decisions are made at the issuer, not the system level. In the proprietary systems, all issuing and acquiring services are carried out by a single for-profit entity that owns the entire system. Visa's (and MasterCard's) elimination of exclusivity does not extend to the two proprietary systems. Visa Rule 2.10(e), adopted in 1991, prohibits any member from issuing American Express or Discover cards. MasterCard has a similar rule.

The Justice Department has filed a complaint alleging that Rule 2.10(e) violates Section 1 of the Sherman Act by preventing Visa members from issuing American Express and Discover cards, thereby reducing inter-brand competition. This paper demonstrates the organizational efficiency of Visa's "partial" exclusivity rule - allowing members to issue the cards of the other cooperative card system, but not the cards of competing proprietary systems. Partial exclusivity results from the very nature of cooperative organizations. As will be developed later in the paper, the stability of a cooperative is extremely sensitive to the continued alignment of its members' interests. Issuing payment cards of more than one system creates the potential of opportunistic behavior by a member to favor itself at the expense of other members by shifting benefits from one system to the other. In the face of such behavior, the cooperative form of organization will be unstable. The problem is mitigated in connection with dual issuance of Visa cards and MasterCards because the cooperative associations' open membership

[2] Minor proprietary systems such as Diner's Club (owned by Citibank), Carter Blanche, and JCB will be ignored.

allows an effective self-enforcement system that polices opportunistic efforts of a member to benefit itself by shifting value from one cooperative system to the other. In contrast, self-enforcement is not possible if a Visa member also issues a proprietary card. Since much of the opportunistic behavior of concern can be expected to be non-verifiable - that is, incapable of proof to a trier of fact even if it is observable to the managers of the competing systems - explicit rules that deter such behavior are extremely difficult to devise. Thus, organizationally degrading opportunistic behavior that can be avoided when Visa members are allowed to issue the cards of another open cooperative like MasterCard, cannot be avoided when the additional card is that of a proprietary system like American Express or Discover.

Part I of this paper explores the fragile nature of cooperative organizations and, in particular, the critical need for the members to have consistent interests. Part II applies that analysis to Rule 2.10(e) by showing that a self-enforcing mechanism prevents opportunistic behavior when issuers of more than one payment card nonetheless issue only the cards of open cooperative associations, but that the mechanism cannot operate when one of the cards issued is proprietary. In this respect, Rule 2.10 (e), which allows dual issuance of the cards of a cooperative association but not those of a proprietary system, moderates the growing divergence of interests among Visa members. Part III builds on this analysis to demonstrate the growing intensity of conflicts of interest between large and small Visa members, and the resulting structural changes that threaten to fundamentally reshape Visa's organizational structure and that of the payment card industry itself.

I. Cooperative Associations: An Ownership Structure for Owners with Similar Interests

Large business organizations in the United States have a variety of different ownership structures. Most large U.S. businesses are publicly owned corporations; that

is, public holders of the corporation's common stock receive the residual profits and have the right to control the business - either by voting or by transferring their ownership and vote as in a tender offer. A smaller number of large businesses are family owned, with profits and control centralized in a small number of people related by blood or marriage. Cooperative corporations - businesses owned by their customers or suppliers - are the least familiar form of large business organization. For example, Ocean Spray is a producer cooperative, owned by the farmers who sell cranberries to the cooperative that, in turn, produces and markets cranberry juice and similar products. True Value Hardware is a supplier cooperative owned by the numerous local hardware stores that bear the True Value name and purchase their inventory from the cooperative. Visa (as well as MasterCard) is also a supplier cooperative, owned (that is, the residual profits, interest and control rights are held) by the issuers of Visa brand payment cards.[3]

In general, businesses have the ownership structure that economizes on organizational costs.[4] In particular, the appropriate ownership structure for a business activity reflects the costs of decision making: the mechanisms by which the firm decides how to conduct its business. For this purpose, the critical determinant is the similarity of the owners' interests. If the interests of the owners diverge substantially, it will be quite difficult for the business to make decisions, because those decisions can have distributional consequences: any important decision will favor some owners at the expense of others.[5] For example, where a business supplies owners in different

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[3] Visa is operated on a non-profit basis, with all fees set to provide only the funds necessary to promote the brand, create new products, or improve the network payment system. The effect of this arrangement, however, is to distribute the value created - the system's "profits" - as a payment in kind through better products and services to members. Since the members' use of the improvements are a function of their transaction volume, the arrangement operates to distribute "profits" based on the level of a member's participation in the network.

[4] See Henry Hansmann, The Ownership of Enterprise (1996); Eugene Fama & Michael Jensen, Agency Problems and Residual Claims, 26 J.L& Econ. 327 (1983).

[5] To be sure, even owners with identical interests can disagree concerning how best to pursue them, but so long as the members agree as to the goals, simple decision-making rules can resolve this problem. See Ronald J. Gilson & Bernard Black, The Law and Finance of Corporate Acquisitions 647-49 (2nd ed. 1995).

geographic locations, a decision concerning where to put warehouse facilities will affect the owners quite differently. The difficulty of decision making, if not ameliorated, results in delay and conflict that, at best, reduces the business's competitive capacity, at worst leads to the business's failure and, most commonly, gives rise to a change in ownership structure.[6]

Publicly owned businesses solve the need for similarity of interests among owners through a property of public ownership which financial economists refer to as "separation." So long as a business's decisions can affect an owner's wealth only by its impact on the value of the owner's stake in the business, all owners will share a common goal for the business: to maximize its value.[7] In that circumstance, an owner can have no distributional conflict of interest with other owners - by definition the owner can benefit only by an increase in the value of the business that is shared proportionately by all the owners. With widely held shares and an efficient stock market, this condition is essentially satisfied.

Stable family owned businesses solve the problem of assuring similarity of interests among owners through a private form of separation. So long as individual family members prefer to maximize the family's wealth rather than their personal wealth, a business decision can affect the individual family member only through its impact on the value of the business. In effect, the individual family member equates his interests and those of the family. Where individual family members have interests that differ from those of the family as an aggregate, internal conflicts typically result in a change in ownership structure.

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[6] A separate decision-making cost grows out of the owners' delegation of decision-making authority to professional management - what is typically referred to as agency costs. These costs affect all ownership structures where the owners do not manage the business themselves.

[7] See Harry DeAngelo, Competition and Unanimity, 71 Am. Econ. Rev. 18 (1981). See also Louis Makowski, Competition and Unanimity Revisited, 73 Am. Econ. Rev. 329 (1983); Louis Makowski & Lynne Pepall, Easy Proofs of Unanimity and Optimality without Spanning: A Pedagogical Note, 30 J. Fin. 1245 (1985).

Cooperative ownership, because it lacks a separation-like mechanism, is the most fragile ownership structure for large businesses. Cooperatives try to mitigate conflicts of interest between members through governance devices, like voting rules and board representation, and through pricing rules covering the provision of the cooperative's goods or services. Nonetheless, cooperatives remain inherently fragile organizations, because governance and pricing rules cannot completely eliminate conflicts of interest between members, who therefore retain an interest in exploiting the unavoidable gaps that voting, board representation, and pricing leave open. Cooperatives remain stable where members' interests do not diverge significantly, and where informal, self-enforcement mechanisms operate to close the gaps left by formal organizational mechanisms.

II. Opportunism and Self-Enforcement: the Difference Between Cooperative and Proprietary Systems

The functional significance of Rule 2.10(e) becomes apparent when we analyze how the potential for opportunistic behavior, created when a member of a non-profit open cooperative payment card system issues a second card, is dealt with in two different situations. In the first situation, the additional card is that of another non-profit open cooperative system, as when a Visa member issues a MasterCard under the present duality structure. In the second, the additional card is that of a proprietary card system, as would be the case if a Visa member issued an American Express or Discover card.

A. Dual Issuance Where Both Systems Are Open Cooperatives

When a member of an open cooperative payment card system issues the card of a competing system, the potential exists for the member to act opportunistically by shifting benefits from one system to the other. For example, assume that the dual card issuing member is the only member of the cooperative to issue the competing system's card. In this circumstance, the dual issuing member has an incentive to shift benefits to the competing system. The cost to the cooperative of the lost benefits is shared among all

members, with the dual issuing member bearing only its pro rata cost. The benefit to that member from the transfer, in contrast, is not shared with other cooperative members. For example, if the member transfers to the competing system valuable know-how developed by the cooperative, all members of the cooperative bear the competitive loss but only the member issuing the second card can share in the gain that accrues to the competing system. Alternatively, benefits can be transferred opportunistically if the dual issuer can block or delay the cooperative's introduction of a new product - like a commercial card - that the competing system already offers. Again, all members of the cooperative bear the competitive loss from not offering the new product, but only the member issuing the second card can share in the gain.

This incentive for opportunistic behavior can be constrained in two general ways. First, the cooperative system can draft detailed governance rules that explicitly prohibit the types of activities that might operate to transfer benefits should a member also issue a competing card. However, it is predictable that such an effort will not entirely succeed. The opportunities for misbehavior are too extensive and too variable to be anticipated and reduced to a comprehensive code of conduct. Moreover, monitoring member behavior to detect violations across so wide a range of conduct would be time consuming, expensive, and intrusive into the conduct of a member's business. Finally, many types of opportunistic behavior, even if actually observable by a monitor, will nonetheless not be verifiable - that is, provable to a tribunal at reasonable cost - and therefore not preventable by enforcing formal rules.[8] The cooperative may know what is going on, but be unable to prove it at a reasonable cost and with reasonable certainty of outcome. Efforts by a member to delay the cooperative's introduction or impede the success of a new product,

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[8] Gary D. Libecap & James L. Smith, The Self-Enforcing Provisions of Oil and Gas Unit Operating Agreements: Theory and Evidence, 15 J.L.Econ.& Org. 526 (1999), discuss the difficulties of contractually specifying all elements of misbehavior in an oil and gas unit operating agreement, essentially a project specific producers cooperative.

for example, cannot be prevented by rules, would be impossible to monitor effectively, and would be extremely difficult to verify - how could the cooperative distinguish between opportunistic efforts to block the product's introduction and good faith disagreement over business strategy?

Where the cooperative cannot by contract effectively deter all types of opportunistic behavior by a member that issues a competing card - where explicit rules necessarily will be incomplete - the second approach to constraining opportunistic behavior comes into play. The cooperative may simply prohibit the issuance of a competing card. Exclusivity is a common approach in franchise agreements, where the franchisee is often prohibited from owning a competing franchise for exactly these reasons.[9] And, it will be remembered, exclusivity was Visa's preferred response to the potential for this kind of opportunistic behavior, dropping its exclusivity rule only when the Antitrust Division refused to acknowledge that this common contractual response to individual opportunism in a collective effort did not violate the Sherman Act.

A final method for constraining opportunism - self-enforcing mechanisms - is available under limited conditions. A self-enforcing mechanism exists when the substantive structure of a contractual relationship causes it not to be in a party's self interest to behave opportunistically. The arrangement is referred to as "self-enforcing" because third party enforcement, for example by judicial action, is unnecessary - the parties do not behave opportunistically because they have no incentive to misbehave.[10]

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[9] Hansmann characterizes Visa and MasterCard as "essentially franchises." Hansmann, supra note 4, at 159. Hansmann's characterization is correct in the sense that Visa and MasterCard members offer branded products under license from a central organization. However, the range of potential opportunistic behavior by a member, and therefore the attraction of a prohibition of dual issuance, is even greater in the cooperative form than in a true franchise. In a cooperative, an opportunistic dual issuer participates in the cooperative's decision process and thereby can directly influence the cooperative's conduct, as by acting to delay the cooperative's introduction or impede the success of a new product. In a franchise arrangement, franchisees cannot directly participate in the franchiser's decision whether, for example, to introduce a new "fish sandwich."

[10] See generally Benjamin Klein, Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships, 34 Econ. Inquiry 444 (1996).

Visa members have been able to issue competing MasterCards despite the cooperative's inability to contractually prevent opportunistic behavior because of an effective self-enforcing mechanism that grows out of the organizational structure of Visa and MasterCard. This self-enforcing mechanism results not from the parties' prescient crafting of the relationship, but rather from the lucky coincidence that Visa and MasterCard are both open non-profit cooperative organizations. When all members of Visa may also issue MasterCards, a single Visa member who also issues MasterCards has no incentive to opportunistically transfer benefits between the competing systems.

To see this, assume that a Visa member who also issues MasterCards can transfer a benefit from the Visa system to MasterCard, again either by transferring an element of proprietary know-how that improves the competitive position of MasterCard at the expense of Visa, or by blocking or delaying Visa's introduction of a product already offered by MasterCard. However, the opportunistic Visa member can profit from its transgression only in its capacity as a MasterCard issuer. Because of the structure of MasterCard, all gains from the opportunistic behavior are shared among all MasterCard issuers.

Now consider what action other Visa issuers can take when they discover the dual issuer's misbehavior. Because MasterCard is an open cooperative, if the opportunistic behavior benefits MasterCard issuers at the expense of Visa issuers, other Visa members can take advantage of MasterCard's open membership and simply shift card issuances to MasterCard. This shift allows the other Visa members to share proportionately the benefits of the original dual issuer's opportunistic behavior. As a result, individual issuers can respond to other issuers' misbehavior simply by altering the mix of cards they issue; neither formal enforcement nor collective action is required. Put differently, when both card systems are open cooperatives, individual issuers, by shifting their card

issuances, can "free ride" on other issuers' misbehavior. And because such shifting prevents the original dual issuer from capturing any benefits from its misbehavior, it has no incentive to misbehave in the first place. Thus, the organizational structure of the open cooperatives results in a self-enforcing mechanism that prevents opportunistic behavior by dual issuers.

B. Dual Issuance When the Second Card System Is Proprietary

This elegant self-enforcement mechanism breaks down when the second card issued by a Visa member is that of a closed proprietary system. As in Section IIA, assume that a Visa member issues a second card and then improves the second system's competitive position at Visa's expense by blocking or delaying Visa's introduction of, or restricting the resources Visa devotes to, a new product (like a commercial card) that the second system already offers. This time, however, assume that the second card is that of a proprietary system, say American Express. So long as American Express limits the number of Visa members who are allowed to issue American Express cards, then self-enforcement will not operate and the opportunistic Visa member can profit from its behavior. The gain to American Express from the member's opportunism is shared only between the member and American Express based on the terms they negotiate concerning the member's participation in the American Express system. Because other Visa members cannot shift their card issuances to American Express and thereby share proportionately in the competitive benefits to American Express from the transfer, the portion of the opportunistic gain received by the dual issuer from American Express cannot be competed away. Because Visa members cannot offset their losses by shifting card issuances to American Express, the incentive for the dual issuer to behave opportunistically remains. Because neither explicit contracting nor a self-enforcing mechanism can prevent this behavior, the only remaining strategy is to prohibit Visa

members from issuing the cards of proprietary system. This is what Rule 2.10(e) accomplishes.

It is apparent that American Express contemplates precisely the structure that drives the foregoing analysis. In American Express CEO Harvey Golub's talk to the Credit Card Forum, he expressly urged Visa banks to object to Visa's introduction of new products that competed with existing American Express products.[11] And in the question period following the talk, Golub stressed the remaining elements of the structure. First, Golub made explicit that American Express contemplates doing business with only a small number of Visa banks.[12] Thus, the vast majority of other Visa members would not be able to shift issuance to American Express in response to one member's opportunistic behavior in blocking or delaying Visa's introduction of products that compete with American Express, a necessary condition for the operation of the self-enforcement mechanism. Second, Golub stressed that the terms of any Visa member's issuance of American Express cards would be individually negotiated between that member and American Express, and likely would differ from member to member. Thus, the contemplated structure anticipates that the advantage brought to American Express by a dual issuing Visa member, including benefits opportunistically transferred from Visa, would be shared between the member and American Express based on particularized negotiations.

Thus, a self-enforcing mechanism operates to prevent opportunistic behavior by Visa members who issue MasterCards, that cannot operate if a Visa member issues the cards of a proprietary system like American Express. Rule 2.10(e) draws precisely this

[11] "[A]s a Visa member, I would question how it is in my interest for the association to fund the development and sales of corporate and purchasing card systems, travelers cheques, [and] Visa Travel Money." Harvey Golub, Freedom of Choice: Opening Up the Marketplace for Card Issuers (speech before the Credit Card Forum, May 2, 1996).

[12] "[I] do not expect that there would be large numbers of [banks]. . . ." Golub, supra note 11.

distinction, and is critical to maintaining the cooperative form of the Visa organization. As developed in Section I above, cooperative organizations are the most fragile of large U.S. business forms, in that a cooperative can operate successfully with a narrower range of conflicting interests among its owners than other business forms. The partial exclusivity imposed by Rule 2.10(e) - prohibiting Visa members from issuing a proprietary card while allowing members to issue the cards of the other open cooperative system - functions to allow only those dual issuances that do not imperil Visa's cooperative structure.

III. The Fragility of Cooperative Organization: Implications for the Current Structure of the Payment Card Industry

To this point we have developed two themes. First, cooperatives are uniquely sensitive among organizational forms for large businesses to conflicts of interests among their owners. Thus, cooperatives are stable across a much narrower range of divergent membership interests than publicly owned corporations. Second, Rule 2.10(e)'s partial exclusivity principle operates to minimize divergent membership interests by allowing dual card issuance when self-enforcement polices a multiple card issuer's conflict of interest (the case of multiple issuance of open cooperative system cards), but prohibiting multiple card issuance when self-enforcement cannot operate (the case of multiple issuance of proprietary system cards). In this section, we return to the critical role of divergent membership interests in the stability of cooperatives in light of the impact of the enormous changes in the structure of the banking and payment card industries on the extent of the existing cooperative members' conflicts of interest and, in turn, on the stability of the cooperative organizations themselves. It appears likely that these changes in industry structure have dramatically increased the conflicts of interest among cooperative members. They already have led to significant changes in organizational and industry structure that can be expected to accelerate. In short, today's industry structure

of competition at the system level between two large cooperative organizations marketing the Visa and MasterCard payment cards, and two smaller proprietary payment card systems is unlikely to remain in place even over the short-run. Changes that presage both a shift in the character of system level competition and dramatic changes in the cooperative form of Visa and MasterCard are already on the horizon.

That Visa began as a cooperative is hardly surprising. The critical challenge facing the payment card industry at the inception was to rapidly expand its consumer base and thereby rapidly expand its merchant base and vice versa. Giving a large a number of banks the incentive to issue Visa cards to their customers by organizing as a non-profit cooperative reflected the overwhelming alignment of interests among all issuers at that time: the most important task was to create the network. The creation of the network benefited all members; interests would conflict only after the network was in place. Thus, the evolution of the payment card industry placed the cooperatives within that organizational form's limited range of sustainable conflict of interests through the 1980s and early 1990s, when the industry was buffeted by a number of extraordinary events.

First, the industry experienced the appearance and enormous growth of the monoline banks, such as MBNA, whose sole or primary business is the issuance of credit cards. By 1997, cards issued by monoline banks represented 16 percent of total payment card charge volume, and constituted 5 of the 50 largest Visa and MasterCard issuers.[13] This growth, facilitated by Visa's open membership and efforts to establish a single national brand, came at the expense of Visa's traditional bank members.

Second, the industry experienced the emergence and enormous growth of monoline card issuers who were not banks at all, but industrial companies for whom card issuance was thought to provide synergies with their existing businesses. By 1997,

[13] David S. Evans & Richard Schmalensee, Paying with Plastic: The Digital Revolution in Buying and Borrowing 210 (forthcoming, MIT Press, 1999).

General Motors and ATT were the eighth and ninth largest payment card programs (including American Express and Discover).[14] Again, traditional bank members were the losers.

Third, the banking industry experienced a dramatic increase in concentration. For example, Bank of America was acquired by NationsBank, joining the ninth and tenth largest bankcard issuers. The result has been that the largest banks, and the largest issuers of Visa and MasterCards, have become relatively more significant compared to other bank issuers.

These changes in the character of the members of the Visa and MasterCard cooperatives, together with the maturation of the networks, have dramatically increased the conflict of interests among cooperative members. Harvey Golub made reference to this phenomenon in a speech to the Credit Card Forum in which he urged Visa banks to demand the right to issue American Express cards by explicitly highlighting the growing conflict of interests among Visa members.[15] Golub argued that Visa's promotion of the Visa brand came at the expense of member bank promotion of their own cards. The goal of Visa, Golub argued, was a system level brand that would make it difficult for consumers even to tell which bank issued a particular Visa card. System level branding, Golub continued, works to the significant disadvantage of large bank issuers who seek to differentiate their products from those of other issuers. Golub further argued that Visa subsidies to particular co-branded products and their advertising of such products worked only to the advantage of the issuers of those cards, and amounted to an involuntary transfer payment by other members.

Nor are these concerns over conflicts of interest limited to the CEO of American Express who, presumably, has his own agenda. Large Visa issuers have begun to

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[14] Id. at 209, 229 (Table 9.2). ATT sold its credit card operations to Citibank in early 1998.

[15] Golub, supra note 11.

advance precisely the same concerns. Beginning in the fall of 1997, the largest bank issuers of payment cards, representing almost 40 percent of Visa and MasterCard U.S. volume, began discussions concerning how Visa might be restructured to more closely reflect their interests. These discussions based the case for change on the conflict of interests between large and small cooperative members. NationsBank, for example, complained that the cooperatives had favored small members over large members by treating all members the same, with the result that the newer monoline banks were allowed to gain significant market shares at the banks' expense.[16] NationsBank also complained that by working to establish the Visa and MasterCard brands and by conducting product development at the system level, the cooperatives impeded development of individual bank brands. The result, NationsBank claimed, was a significant barrier to large banks' efforts to differentiate their products, which has led to competition based largely on price and to shrinking profitability. Finally, NationsBank complained about Visa subsidies of particular banks' efforts to compete with MasterCard, which benefited banks differentially.

Citibank, the largest bank card issuer, advanced the same concerns. Given the maturity of the network, Citibank argued that continued brand development by Visa and MasterCard primarily aids smaller banks at the expense of larger banks who wish to establish their own brands and differentiate their products.[17] Indeed, Citibank forcefully advocated reducing the cooperative brands to mere acceptance marks, thereby largely eliminating competition at the system level in favor of product differentiation and competition at the issuer level. In particular, Citibank objected to product development

[16] NationsBank Outline Presentation Concerning the Proposal Developed by the Visa Issuers Working Group.

[17] Citibank, Payment Systems, Feb. 5, 1998.

by the cooperatives because such products then were available to all members, and thereby increased the ability of smaller issuers to compete.

This rapid escalation of the intensity of conflicts of interest within the cooperative card systems has already begun to alter the competitive and organizational landscape of the payment card industry. First, duality has begun to deteriorate. Over the past several years, issuers have come to emphasize the issuance of either Visa cards or MasterCards. More recently, the associations themselves have encouraged this development. Citibank's new arrangement with MasterCard requires Citibank to issue exclusively MasterCards subject to a transition period. Similarly, Visa's Partnership Program provides substantial fee reductions for members who agree to issue at least 90 percent Visa cards. At present, issuers representing 50 percent of Visa's volume have committed to this program. This trend toward issuer specialization can be expected to further weaken duality by interfering with the self-enforcing mechanism, described in Section II, whose operation has prevented opportunism by issuers of both Visa cards and MasterCards. Should a large Visa issuer who is not part of the Partnership Program shift benefits from Visa to MasterCard, Visa Program members are contractually prevented from responsively shifting their issuances to MasterCard. Thus, the Partnership Program interferes with the central element of the self-enforcing mechanism's policing of dual issances of Visa cards and MasterCards. It is plausible that this outcome may lead Visa to extend a version of Rule 2.10(e) to MasterCard as well, thereby returning to something close to the pre-1977 exclusivity regime.

More important, the distinction between system level and issuer level responsibilities that has figured so prominently in analysis of the payment card industry has begun to erode. While the members have always been the locus of price competition, the clearly expressed goal of the largest Visa and MasterCard issuers is to reduce system

level activity and thereby shift the arena of competition even further towards the issuer level, to the significant disadvantage of smaller competitors. Thus, Citibank's goal is to reduce the system brand to an acceptance mark, with competition in product development, brand promotion, and innovation all occurring at the issuer level. MasterCard and, to a lesser extent, Visa already have taken steps in this direction. In connection with Citibank's agreement to establish an exclusive relationship with MasterCard, MasterCard has undertaken to change its governing rules to allow Citibank to issue only "brand on the back" cards on which the cooperative brand is relegated to the back of the card - like an acceptance mark - and the bank's name is the sole feature on the front of the card and, presumably, in the bank's advertising. Visa, in its partnership arrangement with Bank of America, has committed "to address and resolve" the issue of Visa's approval of " `mark on back' proposal ... ." I am advised that Visa has resolved the issue for the present by permitting a limited test of "mark on back" debit cards.

Finally, and most significantly for present purposes, the increased intensity of conflicts of interest has already resulted in significant changes in the structure of the cooperatives. Within Visa, the discontent of large issuers has resulted in changes in the cooperative's governance structure to favor large issuers. In May 1998, Visa reduced the size of its board of directors from 17 to 13, and allowed high volume members to have up to two directors thus restricting representation of smaller members. Similarly, in its agreement with Citibank, MasterCard agreed that Citibank could terminate its exclusive relationship with MasterCard if the cooperative did not alter its voting rights rules to increase Citibank's influence in the organization.

These structural changes, however, extend far beyond the cooperatives' internal governance rules. In its agreement with MasterCard, Citibank also can terminate its exclusive relationship if, prior to December 1, 1999, the MasterCard board of directors

has not approved a commercially reasonable plan to convert from a cooperative to a traditional stock corporation which, presumably, will facilitate an initial public offering of the new corporation's stock and further reduce the influence of smaller members. Thus, the increasingly intense conflict of interest between large and small members has led to a commitment on the part of MasterCard to propose the elimination of the cooperative organization form entirely.

Whether or not such a development would be beneficial to the future of the industry is beyond the scope of this paper. However, MasterCard's recent commitment reflects a predictable "next stage" in the dynamic development of a network industry. Cooperative ventures flourish early in an industry's history when the overriding need is to establish the network and differences between members are submerged in the common goal. A cooperative form works extremely well under those circumstances. Once the network is established - that is, once the network externalities from the addition of new cardholders and merchants decline - differences between members reemerge and, when these differences are amplified by technological changes, conflicts of interest ultimately move beyond the range that the cooperative form can tolerate.[18] Other ownership structures then arise.

Support for this dynamic account of ownership structure in the payment card industry - coincidence of interests while building the network, divergence of interests once the network is established - can be found in the apparently similar pattern in another network industry, that of securities exchanges. Both the New York Stock Exchange and NASDAQ, currently non-profit cooperatives, have announced their intention to convert to stock corporations and undertake public offerings. Reportedly, the motivation for this

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[18] For example, Citibank stresses Visa's "change over time - [its] move from concentration on uniform acceptance to a marketing company [focusing on] advertising [and] product development. Association decisions do not reflect the interests of the institutions that provide the bulk of the industry revenue." Citibank, supra note 17.

change in organizational form is the increased conflict of interest between large and small members growing out of rapid technological change, especially the emergence of electronic trading and after hours trading as important competitive forces.

IV. Conclusion

Cooperative organizations are fragile entities, whose ownership structure can tolerate only a limited range of conflicts of interest among members without becoming unstable. Rule 2.10(e)'s dictate of partial exclusivity - allowing members to issue cards of other non-profit open cooperative systems but not those of proprietary systems - operates to allow dual issuance only under circumstances in which any Visa member's ability to shift its card issuance acts as a self enforcement mechanism to prevent conflicts of interest. Thus Rule 2.10(e) is best understood as an efficient support for Visa's cooperative form of organization.

In all events, understanding the importance of homogeneity of members' interests to the ongoing stability of a cooperative organization strongly suggests that the historical organizational structure of the cooperative payment card systems is and will continue to be under increasing pressure. The combination of the maturity of the payment card network and rapid changes in the banking industry has caused a dramatic increase in the intensity of conflicts of interest among Visa and MasterCard members. The resulting instability has already caused changes in the governance features of the cooperatives and, in the case of MasterCard, has led to an agreement committing MasterCard to propose eliminating the cooperative form in favor of a traditional stock corporation. From this perspective, the cooperative form of organization appears to be only a stage in the development of a network based industry, which in the payment card industry appears to be mutating rapidly as the industry itself undergoes rapid change. It seems clear that,

when the turmoil of transition subsides, the industry will have taken on an organizational form that better tolerates more intense conflicts of interest among participants.