Five Antitrust Tips for FinTech In-House Counsel

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The last year has seen customers and merchants adopt FinTech (financial technology) services at an accelerating rate. Features like tap-and-pay, online money transfers, and buy-now-pay-later have gone from novelties to the mainstream.

As startups develop the technologies that people use to bank and transact digitally, traditional financial institutions (and even FinTech unicorns) are surveying the market for services they can bolt on to their products or offer to their payment networks and clientele. These various players collide at a jam-packed intersection of transactions, M&A, and collaborations.

In this frenzy, business considerations can sometimes win out over legal ones. R&D, product rollout, and scaling become top priorities. But in an increasingly complex legal and regulatory climate, that luxury can be fleeting, especially when it comes to the antitrust laws.

If there is a lesson to be learned from the preceding generation of startups turned "Big Tech," it is that significant antitrust risk can lay beneath the surface of fast-growing technology markets. Should these risks go ignored, the hangover effect can include protracted government investigations, big fines, and costly class action lawsuits.

Fortunately, FinTech in-house counsel can head off major problems with five simple tricks for issue-spotting and mitigating antitrust problems without derailing the business plan.

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TIP #1

Antitrust scrutiny grows with market share—as a rough rule of thumb, pay closer attention when crossing the 30 percent threshold, go on high alert at 50 percent.

Antitrust Basics

It is not unlawful to have a big market share. Antitrust laws recognize that it is often the reward for healthy competition. But having market power does impose special risks and obligations on a company when it comes to acquisitions and dealings with customers or suppliers.

Market power is the ability to raise prices or lower output beyond the levels that would exist under competitive conditions. In practice, that is often determined largely by reference to market shares.

Market power is unlikely to be found with market shares below 30 percent. Some courts have found market shares above 30 percent as sufficient, especially where market conditions—such as high barriers to entry—confer effective control over price or output. But a company generally does not enter the antitrust red zone until around the 50 percent mark and sometimes even higher.

The relevant market in which shares should be calculated largely comes down to what buyers perceive as adequate substitutes. In its recent challenge of Visa's proposed acquisition of Plaid, the Department of Justice (DOJ) defined a relevant market for "online debit transactions."[1] The question of how to define a relevant market and calculate market shares is a fact-intensive inquiry. But enforcers can define quite narrow markets, sometimes to the surprise of businesspeople who may view their competition much more broadly in the ordinary course.

Bottom-line

Market share often drives antitrust risk. Market definition is fact-specific, so avoid being optimistically overbroad when using market shares as an antitrust risk screen.

FinTech Perspective

In FinTech, market shares could be calculated based on revenues, users, accounts, or any measure of growth. The relevant market could be defined by reference to certain categories of customers or merchants,[2] and online channels could be carved out from brick-and-mortar.

A niche such as "buy now, pay later" could potentially comprise its own payments market. Two-sided transaction platforms (such as payments) could also be considered a single market. Think creatively when considering potential antitrust markets because the enforcers will.

[1] Complaint, *United States v. Visa Inc. and Plaid Inc.*, Case No. 3:20-cv-07180 (N.D. Cal., Nov. 5, 2020), available at https://www.justice.gov/opa/press-release/file/1334726/download.

[2] When the U.K.'s competition authority reviewed PayPal's acquisition of mobile payments provider iZettle, for example, it defined a relevant product market for the "supply of omni-channel solutions to smaller merchants." https://assets.publishing.service.gov.uk/media/5cffa74440f0b609601d0ffc/PP_iZ_final_report.pdf.

TIP #2

Build-or-buy decisions and acquisitions of nascent rivals are becoming riskier—buyers beware and sellers prepare in the current regulatory climate.

Antitrust Basics

Most in-house counsel know that combining with a close rival can invite government scrutiny. But acquisitions of small rivals, and even potential rivals, can spell serious trouble, too.

Regulators are closely scrutinizing acquisitions of "nascent" rivals in technology markets. The concern is that such deals can entrench dominant incumbents by preventing a marginal rival from becoming a major one. Overlap in adjacent or vertically positioned markets, for example, may cause regulators to ask whether head-to-head competition would soon emerge absent a merger. In a recent FinTech enforcement action, the DOJ challenged Visa's acquisition of Plaid because its pay-by-bank debit service posed a "significant threat to Visa even at its nascent stage."[3]

Bottom-line

Authorities are targeting deals that eliminate nascent or potential competition. The heightened deal risk should inform how buyers and sellers identify and negotiate their M&A.

FinTech Perspective

Acquisitions involving recent or even potential market entrants should be closely screened for regulatory risk, even where existing market shares are marginal. In-house counsel should make sure they know what their own company has in the works and that due diligence uncovers what the other side to the deal is up to as well.

Getting a deal cleared is as much about what happens in the run-up to a merger filing as it is about good advocacy before the regulators during their review of the deal. Company records, especially those that inform the decision of management and the board, can weigh heavily on the government when deciding whether to challenge the deal.

A FinTech anticipating an exit by acquisition will want to avoid overstating its position (and potential) in an emerging market, the presence of barriers to entry, or the closeness of its rivalry with market incumbents. Acquirers should be cautious about framing a potential acquisition as a "build-or-buy" proposition, which could leave regulators with the impression that entry is imminent but-for the transaction.

When negotiating such deals, allocating antitrust risk should be top of mind. Sellers are in an especially vulnerable situation that may require walking away to find another suitor if adequate contractual protections cannot be secured. In a fast-moving technology market, a seller whose deal is derailed by authorities might wake up from a protracted government review to a different competitive landscape and a deep-pocketed rival that has just looked under its hood.

[3] *See infra* N. 1.

TIP #3

Benign joint ventures and collaborations can become problematic as markets evolve—regularly reevaluate them to ensure ongoing compliance with the law.

Antitrust Basics

Joint ventures and collaborations among competitors that have facially anti-competitive aims such as price-fixing or market allocation are *per se* unlawful. But the vast majority of cooperative efforts are not set up that way. They violate antitrust laws only if proven harmful to competition when also considering their potential pro-competitive effects on the market.

A joint venture or other collaboration among competitors can be found to harm competition when it exercises market power to eliminate head-to-head competition or exclude non-participating rivals. The general approach to measuring market power applies (see above).

Harm to competition is generally seen as higher prices or lower output, though authorities are increasingly looking at the loss of innovation and lessening of data-privacy protection as additional competitive harms in technology markets. Pro-competitive effects are the opposite: lower prices, higher output, and improved quality. That could include developing and launching a new product, lowering costs, or improving the quality of a product.

A joint venture's legality is not fixed at the time of its foundation. It is an ongoing assessment based on prevailing market conditions. A joint venture among rivals that is competitively benign when set up at a market's nascent stage can become a problem as it or its members grow in significance in a consolidating market. At the same time, the pro-competitive justifications for competitor collaborations can dissipate as markets mature. As a pro-competitive joint venture becomes more anti-competitive, antitrust risk increases.

Bottom-line

Competitor collaborations can fuel growth, but they can also carry antitrust risk. A regular antitrust check-up, and recalibration where necessary, can ensure ongoing compliance.

FinTech Perspective

Joint ventures and collaboration are commonplace in FinTech. But fluid markets mean that in-house counsel need to make sure the reasons that originally made those collaborations antitrust compliant still hold true under prevailing market conditions.

The DOJ and FTC antitrust guidelines on competitor collaborations offer a useful hypothetical.[4] A small consortium of banks form a joint venture to create an ATM network. But as the new ATM network gains market share and more banks join the venture, its practice of imposing exclusivity on participating banks is reassessed "under present circumstances" to determine if its potential to exclude rivals is harming competition. Modern-day analogies could include a joint venture among banks to roll out a payment network.

Joint ventures that have experienced mission creep expanding into new products and markets also pose risks. For example, a partnership between a FinTech upstart and a bank for payment processing could be a purely vertical relationship with clear pro-competitive benefits and minimal anti-competitive potential. But the FinTech may expand into other services, such as offering deposit accounts, that put it in competition with the bank. As rivals, their collaboration as well as any exchanges of competitively sensitive information are viewed in a new light.

Since many joint ventures fall somewhere in the middle of an antitrust grey area, changes in market conditions do not have to spell the end of the collaboration. It can be enough to restructure it, for example, by narrowing the scope of products covered, restoring pricing and marketing autonomy of its members, and tightening up information firewalls.

[4] Antitrust Guidelines for Collaborations Among Competitors, FTC and DOJ (April 2000), available at https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf.

TIP #4

Exclusivity can be critical for take-off, but it can create new risks mid-flight—don't go on autopilot when dealing with customers, suppliers, and trading partners.

Antitrust Basics

Most exclusive deals are lawful. To violate the antitrust laws, they must be shown to harm competition when netting out any ways in which they benefit competition. As with joint ventures, the focus is usually on the effects on price and output.

Generally, for antitrust risk to arise, a firm (or group of firms) with market power must use exclusivity to substantially foreclose its rivals by locking up key customers or suppliers, with little or no pro-competitive benefits to show for it. Market power is the same as discussed above.

Market foreclosure is fact-specific, with the analysis typically beginning (though not ending) with the percentage of customers or suppliers locked up by the exclusivity. At least 30-40 percent market foreclosure is usually required, though new FTC leadership could push to lower the bar.[5]

Bottom-line

Exclusivity can play a big part in successfully going to market, but it can create problems as the market consolidates. Reevaluate the antitrust risk as market conditions change.

FinTech Perspective

Exclusive deals can be critical to developing and going to market with a new product or service. A FinTech looking to launch a new digital payments service may ask a merchant to commit not to deal with rival services. An e-commerce platform could ask the same of the FinTech. If either has market power and the ability to substantially foreclose rivals from the market, antitrust alarms should go off.

Such arrangements tend not to trigger meaningful antitrust risk at the early go-to-market stage. Valid pro-competitive justifications can include sharing R&D costs, quality control, the need for a steady flow of users to go to market, securing access to a critical input, or ensuring a return on investment after incurring large fixed costs. As for anti-competitive effects, market power and market foreclosure are much less likely to be present in an emerging sector with numerous nascent players and ambiguous market share levels.

But circumstances can change as the sector matures, rivals drop out, and the market consolidates around a few major providers or downstream partners. At the same time, the go-to-market justifications for exclusivity may no longer hold under prevailing conditions. In-house counsel will want to reevaluate multi-year contracts with key suppliers, customers, or trading partners to flag exclusivity clauses that require a closer look under the antitrust laws.

[5] Some advocate for the FTC to rely on its untapped powers to target "unfair methods of competition" under Section 5 of the FTC Act by pursuing exclusive deals even in cases where there is no market power, for example.

TIP #5

There is generally no antitrust duty to deal with a rival—but know the narrow exceptions and stay tuned for developments in this evolving area of the law.

Antitrust Basics

A common adage of antitrust law is that companies, even ones with a significant market share, are free to choose who to deal with. There generally is no "antitrust duty to deal" with a rival.

But there are some narrow exceptions for a monopolist that cuts off a pre-existing relationship to exclude a rival from the market or withholds a rival's access to an "essential facility" needed to compete. Although the law in this area is not well-settled, such a claim probably requires showing that there has been a profitable prior course of dealing that the monopolist has terminated with no or little objective justification other than to exclude a rival from competing in the market.

Courts hearing antitrust cases in the coming years could carve out additional areas for imposing an antitrust duty to deal, particularly in technology markets. Government authorities and private plaintiffs have brought major antitrust cases against the largest technology platforms that, if successful, could lead to broader duties to share APIs, provide interoperability, or grant access to essential online infrastructure. But for now, courts rarely impose an antitrust duty to deal.

Bottom-line

Generally, companies of any size can deal with whomever they please. But those that hold the keys to an "essential facility" or seek to cut off a profitable relationship could face a limited duty to deal with rivals.

FinTech Perspective

Most FinTech players have not achieved a "dominant" market position, which as a matter of practice would likely require shares exceeding 50 percent (and possibly well over that) and control over market prices or output. But this could change over time. A FinTech operating in a narrowly defined market segment or a joint venture among several rivals that turns into a market standard could grow into a dominant position as the antitrust laws define it.

Crossing the dominance threshold requires more caution when terminating dealings with rivals, especially if the relationship is profitable and the change cannot be explained with legitimate business objectives. In-house counsel will want to consider any "essential facility" that their FinTech could be deemed to control: a critical API, an essential database, or a platform that serves as a gateway to customers.

When cutting off a rival, the decision should be documented internally and messaged externally in a manner that is consistent with its pro-competitive rationale. On the flip side, smaller FinTechs looking to maintain access to a critical input from a larger rival might want to look to antitrust to shield them from being cut off.

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