

# UIC John Marshall Journal of Information Technology & Privacy Law

---

Volume 1  
Issue 1 *Computer/Law Journal*

Article 15

---

1978

## Ownership and Control of Electronic Funds Transfer Systems in the United States, 1 *Computer L.J.* 501 (1978)

Eric David Horodas

Follow this and additional works at: <https://repository.law.uic.edu/jitpl>



Part of the [Computer Law Commons](#), [Internet Law Commons](#), [Privacy Law Commons](#), and the [Science and Technology Law Commons](#)

---

### Recommended Citation

Eric David Horodas, Ownership and Control of Electronic Funds Transfer Systems in the United States, 1 *Computer L.J.* 501 (1978)

<https://repository.law.uic.edu/jitpl/vol1/iss1/15>

This Article is brought to you for free and open access by UIC Law Open Access Repository. It has been accepted for inclusion in UIC John Marshall Journal of Information Technology & Privacy Law by an authorized administrator of UIC Law Open Access Repository. For more information, please contact [repository@jmls.edu](mailto:repository@jmls.edu).

# OWNERSHIP AND CONTROL OF ELECTRONIC FUNDS TRANSFER SYSTEMS IN THE UNITED STATES

by  
*Eric David Horodas\**

## INTRODUCTION

"[T]he rights and responsibilities of users and providers of financial services are in flux. Serious value judgments must be made with respect to what services shall be offered, by what institutions, and through what means."<sup>1</sup> Any proposed framework for the development of an electronic funds transfer system should make provision to accommodate diverse arrangements for transfers of value. Any such system must provide for more than just the transactions that current systems accomplish. It must possess the "capacity to accommodate new needs, to treat different transactions differently, and to interconnect the various payment mechanisms into a system."<sup>2</sup> These qualities must be protected and encouraged by a framework established to control the development of electronic funds transfer systems. It is widely agreed that this goal will best be accomplished by a flexible, responsive operational structure which promotes evolutionary growth.<sup>3</sup>

In a labor and paper-intensive business such as banking, the computer can, and is, revolutionizing the relationships between the ordinary consumer and his financial institution. Technology offers the promise of lower costs, faster service and, though some may ar-

---

\* B.A., University of Rochester, New York, 1975; J.D., New York University, 1978. Mr. Horodas is admitted to practice in the State of New York and is currently a member of the Law Department of Metropolitan Life Insurance Company.

1. Brandel & Gresham, *Electronic Funds Transfer: The Role of the Federal Government*, 25 CATH. U.L. REV. 705, 705 (1976).

2. Brandel & Gresham, *Electronic Payments: Government Intervention or New Frontier for Private Initiative*, 29 BUS. LAW. 1133, 1136 (1974).

3. *Id.*

gue to the contrary, lower error rates.<sup>4</sup> The computer, however, is not the panacea for all problems plaguing the banking industry. Instead, it provides the potential for more competitive, flexible banking in the retail sector. This changing technology is of concern to lawyers, policymakers, and all segments of society. An examination of the current rules under which the financial community operates is required if one is to understand the necessity for change.

"Competition is the cornerstone of our national economic policy. This is because competition offers the most effective way of assuring that suppliers respond quickly to actual demands of customers, with prices based on the cost of providing service."<sup>5</sup> Competition within the financial community is vigorous. Commercial banks compete among themselves to service the cash needs of big business. Savings banks, savings and loans, and commercial banks compete to attract deposits and, more recently, to develop checking account services. There is also stiff competition among banks, savings and loans, and credit companies for mortgages and for a share of consumer credit generally. The questions that arise from the advent of new technology in the financial industry concern the effects of such technology on that industry. How will competition among the various classes of institutions, and among the institutions themselves, be affected? If the computer threatens to reshape the financial industry, will the new structure be socially desirable, *i.e.*, will it promote the needs of, and service the greatest number of, users at the least possible cost? Indeed, is it even socially desirable to preserve competition?

The last question, in the context of the economic and legal system of the United States, must be answered by a resounding yes. Competition is a spur to technological development, efficiency and innovation. Competition lowers the ultimate cost to consumers and responds rapidly to felt needs. Furthermore, if something can be done on a competitive basis as a matter of economics, then the anti-trust laws say that it should be done competitively.<sup>6</sup> Nevertheless, the existence of great risks may justify some restrictions on competition in order to provide security to those embarking on electronic funds transfer (EFT) ventures. Economies of scale may justify competition-threatening combinations of financial institutions because of the high costs of technology.<sup>7</sup>

---

4. Baker, *Antitrust and Automated Banking*, 90 *BANKING L.J.* 703, 703 (1973).

5. Baker, *Access to Larger Computer Systems*, (remarks prepared for the International Conference on Computer Communication, Washington, D.C., Oct. 25, 1972).

6. Baker, *supra* note 4, at 704.

7. Ubell, *Electronic Funds Transfer and Antitrust Laws*, 93 *BANKING L.J.* 43, 44 (1976).

It is generally agreed that the computer technology necessary to implement EFT terminal systems now exists.<sup>8</sup> It is predicted that within the next ten years, roughly twice the computer capability will be available at half the present cost, resulting in a greater diffusion of technology.<sup>9</sup> Common carrier communication costs are also likely to drop fifty per cent during that same period.<sup>10</sup> Competition is likely to increase with specialized carriers providing high speed, reliability technology suited to computer-computer communications.<sup>11</sup> Furthermore, computer architecture is being decentralized. So-called "ring-networks" are being developed in which the computer hardware is geographically distributed. This allows the user to purchase only a component of a physically distributed, intercommunicating system rather than buying its own facility or sharing a jointly-owned facility.<sup>12</sup> One of the developers of the ring system, Professor Farber of the University of California at Irvine, places banking at the head of the list of possible users.<sup>13</sup>

The ultimate question is what type of organization should or must exist to promote efficiency in EFT systems? Should the federal government own and operate a national payments system? Should it be in the hands of a quasi-public corporation along the lines of a public utility? Or should the choice be left entirely to the private sector? If left to the private sector, how much input should the government have? How will current antitrust laws affect its development? Even if in a negative way, is it appropriate to alter the antitrust laws or provide an exemption for electronic funds transfer systems? The remainder of this article will deal with these issues and suggest alternative solutions to the problems presented.

## I. THE ROLE OF GOVERNMENT

One of the structural alternatives for electronic funds transfer systems is ownership by the Federal Reserve System. Federal agencies have already taken steps to establish government owned and operated components of electronic funds transfer systems. The Federal Reserve System operates automated clearing houses (ACH's)

---

8. See Baker, *Whatever Happened to the "Checkless Society"?*, 7 U. MICH. J.L. REF. 481 (1974); Baxendale, *Commercial Banking and the Checkless Society*, 1 RUTGERS J. COMPUTERS & L., Fall 1970, at 88-89.

9. Withington, *Beyond 1984: A Technology Forecast*, DATAMATION, Jan. 1975, at 54.

10. *Id.*

11. *Id.*

12. Ubell, *supra* note 7, at 47.

13. Farber, *A Ring Network*, DATAMATION, Feb. 1975, at 46.

on behalf of banks,<sup>14</sup> check clearing services,<sup>15</sup> "Fed-wire,"<sup>16</sup> and the associated Culpepper Message Switching Center.<sup>17</sup> The Federal Home Loan Bank Board provides general, computerized record keeping and transaction recording services to aid member savings and loan associations.<sup>18</sup>

The progress of these agencies was slowed markedly as a result of protests by the Justice Department, the White House Office of Telecommunications Policy, and private industry.<sup>19</sup> The protestors felt that government entry might foreclose private initiative, causing artificial distortions in the market forces. They believed that the development of electronic funds transfer systems by private industry would best serve the needs of a broad user population because it would promote maximum efficiency, flexibility, diversity, specialization (where necessary) and innovation.<sup>20</sup> Private enterprise, it was claimed, possessed the necessary range of financial and technological capabilities not likely to be found in a single institution—particularly governmental.<sup>21</sup> The public could thereby express its needs and desires through its free-market dollar "votes."

There is a consensus that only with great luck could government planners possibly anticipate all future problems and opportunities to be encountered in designing such a system.<sup>22</sup> Once created, a government monopoly would be slow to change and extremely difficult to displace. Those who operated the system would have little or no incentive to innovate because there would be no limitation on resources and little reward for cost reductions.<sup>23</sup>

---

14. See Homrighausen, *One Large Step Toward Less-Check: The California Automated Clearing House System*, 28 BUS. LAW. 1143, 1143-46 (1973). In 1972, the Federal Reserve Bank of San Francisco began performing data processing and communications functions for the automated clearing house facility established by the California Automated Clearing House Association. *Id.*

15. Brandel & Gresham, *supra* note 1, at 730.

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.* at 732. See Brandel & Gresham, *supra* note 2, for a discussion of many of the issues raised by private institutions opposed to intervention by the Federal Reserve System. See also Comments of the United States Department of Justice in the Matter of Proposed Amendment of Regulation J and Related Issues Before the Board of Governors of the Federal Reserve System, May 14, 1974.

20. Brandel & Gresham, *supra* note 1, at 732-33.

21. *Id.* at 732.

22. *Id.*

23. *Id.* at 734. Government bureaucracy, in contrast to the private sector, does not generally reward successful risk-taking. Furthermore, regulators tend to give greater weight to the dangers posed by innovation and upheaval to their careers and often conclude that these dangers outweigh enhanced efficiency and service.

Several arguments have been advanced in support of ownership of EFT systems by the Federal Reserve System. First, it is claimed that the Federal Reserve must own the system because of the critical importance of monetary policies affected by electronic funds transfers.<sup>24</sup> On the other hand, the Federal Reserve Board already has adequate regulatory authority to accomplish whatever monetary policy objectives it desires, whether the system is mechanical or electronic.<sup>25</sup> What the Board needs is information, not operational control.<sup>26</sup>

Second, it is said that the Federal Reserve must operate electronic payment systems as a public utility to protect small financial institutions from being "squeezed out" of the use of technical innovation due to their lack of capital necessary to create new systems.<sup>27</sup> Sophisticated technical and marketing programs, however, have already benefited small banks. National BankAmericard, Inc. and Interbank Card Association give smaller banks access to a large share of consumer credit.<sup>28</sup> Furthermore, cooperative ventures may include small banks. For example, the privately owned California and Georgia Automated Clearing House Associations allow small member banks to offer pre-authorized payroll deposits and automatic bill payment.<sup>29</sup> Indeed, smaller institutions with creative and aggressive management may be able to exploit new technology faster than large banks. The City National Bank of Columbus, Ohio, a small, local bank, for example, has set up point-of-sale terminals in retail stores and "Bank 24" centers around the city.<sup>30</sup>

Third, it is said that the private sector is not responding to the need for movement into the electronic era.<sup>31</sup> However, there is currently no foreseeable crisis in the nation's payment systems which would justify government intervention in the form of ownership or operation.<sup>32</sup>

---

24. Brandel & Gresham, *supra* note 2, at 1137. The Federal Reserve Board feels that "float" hampers efforts to control the nation's money supply and favors EFT as a method of eliminating "float." See *Fed's Changes in Regulation J Are Pointed to Electronic Transfers*, Am. Banker, Dec. 1, 1972, at 4. But EFT will dramatically reduce float regardless of who owns and operates EFT.

25. Brandel & Gresham, *supra* note 2, at 1137.

26. *Id.*

27. *Id.*

28. *Id.* at 1138.

29. See Homrighausen, *supra*, note 14, for a full description of the California Automated Clearing House Association.

30. Brandel & Gresham, *supra* note 2, at 1138-39; Payment Sys. Newsletter, Jan. 1973, at 3, 4.

31. Brandel & Gresham, *supra* note 2, at 1137.

32. *Id.* at 1139.

The opponents of government ownership also fear that the Federal Reserve Board, if the proprietor of EFT systems, would lose its perspective as a regulatory body.<sup>33</sup> Its roles would merge and, more importantly, it would tend to lose exposure to the conflicting points of view that regulation and competing institutions pose.<sup>34</sup>

In summary, the arguments for government ownership are weak, while those against government ownership are strong. The federal regulators may most effectively achieve their legitimate goals by encouraging private electronic funds transfer system initiatives. As two commentators recently concluded:

Governmental subsidization of EFT facilities would render it difficult, if not impossible, for private industry to compete in the provision of those services. This artificial restriction on competition would severely curtail innovation in the development of services and technology, and virtually insure that electronic payment systems would configure themselves to a public utility model, regardless of the benefits, or lack thereof, to the public.<sup>35</sup>

If the government is not to own electronic funds transfer systems, what then is the role of government in the development of such systems? The Justice Department has called for a "hands-off" approach to government involvement in the development of electronic payment systems.<sup>36</sup> The Justice Department believes that unfettered competition will provide the necessary incentives for the maximum effective utilization of present systems and the development of better systems.<sup>37</sup> It also feels that too much government intervention will "freeze" the market: investors are less likely to risk capital developing EFT systems; private businessmen will fear the strict regulation of private competition; and, any comprehensive system of regulations will be based solely on speculation.<sup>38</sup> Governmental agencies should, therefore, maintain flexible monitoring of EFT development, while allowing the day-to-day decisions to be made by the dynamics of the marketplace.<sup>39</sup>

---

33. *Id.* at 1140.

34. *Id.*

35. Brandel & Gresham, *supra* note 1, at 734-35.

36. Baker, *Competition, Monopoly and Electronic Banking*, in THE ECONOMICS OF A NATIONAL ELECTRONIC FUNDS TRANSFER SYSTEM 47 (Fed. Res. Bank of Boston Conf. Ser. No. 13, 1974).

37. Comments of the United States Department of Justice in the Matter of Proposed Policy on Access To Federal Reserve Clearing and Settlement Facilities, No. 20, at 106 (1975).

38. Weber, *A Public Policy Overview of Electronic Funds Transfer Systems*, 25 CATH. U.L. REV. 687, 695-96 (1976). See also note 37 *supra*.

39. *Id.* at 695-96. The Justice Department concluded that excessive government control in the preliminary stages is premature and that any extensive system of regulation would, necessarily, be based on speculation.

Nevertheless, because banking is so heavily regulated already, Congress and various regulatory agencies can have a tremendous impact on determining: (1) the organizational structure of the industry; (2) the types of institutions which will be permitted to enter the field; (3) the range of permissible activities of these institutions; (4) the rights and obligations of the purveyors of these activities; and (5) the rights of consumers.<sup>40</sup>

The government will exert a major influence on the types and rates of innovation and development of EFT systems. Statutes and regulations, however, must be flexible enough to permit innovation. Some risk-taking must be encouraged, with the recognition that failure is inevitable. Different institutions should be permitted to take different routes, since only in that manner can it be shown which methods are best. Statutes and regulations, which are neither overly-restrictive nor threaten government monopoly, will best promote these goals.

Congress can control the access of institutions to electronic payment systems and the range of their permissible activities. Federal law already defines the powers of federally chartered banks,<sup>41</sup> savings and loan institutions,<sup>42</sup> and credit unions.<sup>43</sup> Federal law also regulates certain activities of state-chartered—but federally insured—banks<sup>44</sup> and savings and loan organizations,<sup>45</sup> as well as members of the Federal Reserve<sup>46</sup> and Federal Home Loan Bank systems.<sup>47</sup>

Absent a complete prohibition of any specific class of financial institutions from offering electronic payment services, the lack of the authority of one class of institutions to offer one or more consumer services or to establish new locations at which to offer its services will affect that class's ability to compete, and perhaps preclude that class from offering electronic payment services at all.<sup>48</sup> The traditional powers available to the various classes of financial institutions were defined long before the birth of the electronic era. In the past few years, various regulatory agencies have begun to expand these powers, including *inter alia*:

1. granting to savings and loan organizations third-

---

40. Brandel & Gresham, *supra* note 1, at 706.

41. 12 U.S.C. §§ 21-215b (1976).

42. *Id.* §§ 1464-68 (1976).

43. *Id.* §§ 1751-90 (1976).

44. *Id.* §§ 1811-31 (1976).

45. *Id.* §§ 1724-30 (1976).

46. *Id.* §§ 221-522 (1976).

47. *Id.* §§ 1421-49 (1976).

48. Brandel & Gresham, *supra* note 1, at 708.



party payment powers;<sup>49</sup>

2. expanding the consumer lending powers of savings and loans;<sup>50</sup>

3. authorizing savings and loans to use remote service units;<sup>51</sup>

4. permitting telephone transfers of funds from savings accounts to checking accounts;<sup>52</sup> and,

5. allowing preauthorized transfers from savings to checking accounts to cover over-drafts by depositors in commercial banks—in effect, authorizing NOW accounts.<sup>53</sup>

These new powers create either the possibility of related electronic services or transitional vehicles for entry into electronic payments systems. A further breakdown of the traditional barriers between the various financial institutions in the services they provide may be desirable so that all classes of institutions may maintain a competitive posture in electronic banking activities.

These changes, however, have thus far been done in a piecemeal fashion. The reduction in distinctions among services offered by different types of financial institutions has been inconsistent with the policies underlying their original creation. Institutions such as savings and loans and credit unions were intended to fulfill narrowly defined functions and were given certain benefits, *e.g.*, allowed to pay higher interest rates.<sup>54</sup> If the fundamental distinctions among classes of financial institutions are to be eliminated, policymakers need to re-examine whether different treatment of these different classes should be continued. The blurring of distinctions between these classes is largely due to the changing financial environment of the American business community: the concentration of productive capacity in larger, multistate industry, geographic mobility of workers, and technological change.<sup>55</sup>

---

49. 12 C.F.R. § 545.4-1(3) (1976) allows federal associations with home offices in New England states to allow the owner of a savings account on which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third-parties.

50. *Id.* §§ 545.9.1, 584.2-1(b)(1)(4), 584.2-1(b)(1)(5) (1976). This may eventually lead to the authority to engage in credit card activity.

51. *Id.* § 545.4-2 (1976). This regulation allows federal associations to place remote service units in stores, offices and transportation terminals and to participate in the establishment and maintenance of such remote service units with any other financial institution insured by the Federal Savings and Loan Insurance Corporation or the Federal Deposit Insurance Corporation.

52. *Id.* § 217.152 (1976).

53. 43 Fed. Reg. 20001 (1978).

54. Regulation Q, 12 C.F.R. §§ 217.1-217.6 (1976).

55. Brandel & Gresham, *supra* note 1, at 711.

The basic issue, then, is which existing statutes and regulations should be modified in light of the changing financial needs of our nation and the evolution of EFT systems? Underlying this issue are the questions of the extent to which the public wants to preserve, modify or eliminate the distinctions between existing financial institutions, and the extent to which it wants non-financial institutions to enter the electronic payments field, either through regulated activities, or in a non-regulated, free market environment.

The Report of the National Commission on Electronic Funds Transfers (NCEFT)<sup>56</sup> regrettably failed to answer these questions. The Commission was composed largely of industry representatives.<sup>57</sup> As a result, the Final Report focused more on the perceived needs of currently regulated institutions, than on the proper, future structure of the financial industry and the needs of the public.<sup>58</sup> Congress or the President should impanel a new commission to examine and report on the deeper, public policy questions which were given little consideration by the NCEFT.

## II. THE ROLE OF A QUASI-PUBLIC CORPORATION

An alternative structure for ownership and operation of a national electronic payments system is a quasi-public corporation. Three arguments presented in favor of federal government control: (1) ownership by a quasi-public corporation would insure access by small banks unable to devote sufficient capital to developing their own system;<sup>59</sup> (2) some public incentives are needed, since the private sector has not taken the initiative;<sup>60</sup> and, (3) if ownership and control of the system is relegated to a quasi-public corporation, the federal agencies charged with overseeing financial institutions would not lose sight of their role as regulators.<sup>61</sup>

The creation of a quasi-public corporation is not, however, a satisfactory solution. At the beginning, it would lack the combination of prior experience, technical expertise, and communications facilities necessary to successfully undertake development of a major EFT project. The problems facing the United States Postal Service

---

56. EFT IN THE UNITED STATES, THE FINAL REPORT OF THE NATIONAL COMMISSION ON ELECTRONIC FUNDS TRANSFER (1977) [hereinafter cited as FINAL REPORT].

57. Of twenty-six Commission members, only five were truly representatives of the public interest.

58. The remainder of the Commissioners, as a reading of the FINAL REPORT will reveal, seemed unable to put aside their respective special interests in reaching their conclusions.

59. Baker, *supra* note 4, at 713.

60. Brandel & Gresham, *supra* note 2, at 1139.

61. See notes 33-34 *supra* and accompanying text.

provide ample evidence of the inability of a new quasi-public corporation to overcome the burdens of bureaucratic operation and the monopolistic posture inherited from its predecessor.<sup>62</sup> Public utilities have historically been slow to innovate and often have offered only mediocre public service;<sup>63</sup> they stifle technology through laws and regulations merely to protect themselves from competition.<sup>64</sup> Most significantly, there is no need in this instance to create a cumbersome, quasi-public corporation, since private enterprise is capable of developing and implementing an electronic payments system, if such a system is demanded by the public.

### III. THE ROLE OF PRIVATE INDUSTRY

The arguments in favor of private ownership and control of electronic payments systems are persuasive. Private enterprise is characteristically innovative, flexible and competitive. Competition, in turn, is usually the most effective spur to development of a new technology responsive to the needs of the marketplace.<sup>65</sup> Competition rewards the innovator and penalizes the laggard with a minimum of government interference.<sup>66</sup> Private industry has the financial and technological capacity to develop and implement an EFT system.<sup>67</sup> The vast complexity of the system alone forecloses the possibility that any one institution will develop, construct and operate all of the necessary components.<sup>68</sup> It will take the independent, and then combined, decisions of many organizations to commit the substantial resources necessary to develop such a system.<sup>69</sup> Such development, if it occurs at all, will be governed by the rules of economic competition and cooperation.

Nevertheless, there are dangers which must be avoided in implementing such a system, including, *inter alia*, (1) diminished competition resulting from overly inclusive sharing arrangements,<sup>70</sup> and (2) the inability of many institutions to develop their own systems, resulting in a denial of access to an EFT system within their market and the competitive disadvantages that necessarily flow from that

---

62. Brandel & Gresham, *supra* note 2, at 1147.

63. Baker, *supra* note 4, at 714.

64. *Id.*

65. *Id.* at 713.

66. *Id.*

67. Brandel & Gresham, *supra* note 2, at 1147.

68. *Id.*

69. *Id.*

70. More institutions sharing one system than is economically necessary to maintain the system.

denial.<sup>71</sup>

Given the high costs and substantial risks involved in implementing complex electronic payments systems, some joint action or cooperation among financial institutions is necessary for the ownership and operation of EFT systems. The antitrust laws, however, will have a restraining effect on the extent to which certain banks, or groups of banks can act together. Such multiple, financial institution conduct is subject to scrutiny under section 7 of the Clayton Act.<sup>72</sup> That section prohibits any corporation engaged in commerce from acquiring any part of the stock or capital of another corporation or joining together with another corporation, where the effect of which may be substantially to lessen competition or tend to create a monopoly in any line of commerce.<sup>73</sup>

In *United States v. Philadelphia National Bank*,<sup>74</sup> the Supreme Court held that section 7 of the Clayton Act<sup>75</sup> applies to bank mergers, despite the fact that banking is a regulated industry, and, that the Bank Merger Act<sup>76</sup> does not immunize otherwise approved mergers from challenge under the federal antitrust laws.<sup>77</sup> Since the fundamental purpose of section 7 is to "arrest the trend toward concentration . . . before the consumer's alternatives disappear through merger,"<sup>78</sup> the Court found that commercial banking is not immune from the anticompetitive effects of undue concentration simply because it is subject to a high degree of regulation or because it deals in intangibles of credit and services rather than in the manufacture or sale of goods.<sup>79</sup> Competition among banks was found to exist at every level—price, variety of credit arrangements, convenience of locations, service charges and investment advice.<sup>80</sup>

---

71. See FINAL REPORT, note 37 *supra*.

72. Section 7 of the Clayton Act, *as amended*, 15 U.S.C. § 18 (1976) provides in part:

No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

73. See *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 590-91 (1957); *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 170-71 (1964).

74. 374 U.S. 321 (1963).

75. 15 U.S.C. § 18 (1976).

76. 12 U.S.C. § 1828(c) (1976).

77. 374 U.S. at 352.

78. *Id.* at 367.

79. *Id.* at 368.

80. *Id.*

In response to *Philadelphia National Bank*, Congress amended the Bank Merger Act in 1966.<sup>81</sup> The amendment added a "convenience and needs" defense to any antitrust claims asserted against commercial bank mergers.<sup>82</sup> However, as the United States Supreme Court noted in *United States v. Phillipsburg National Bank and Trust Company*,<sup>83</sup> the antitrust standards of *Philadelphia National Bank* "were preserved in the Bank Merger Act of 1966."<sup>84</sup>

In the context of electronic funds transfer systems, section 7 would apply where two or more banks formed a joint venture to own and operate the EFT facilities. Such sharing arrangements cannot be so over-inclusive as to eliminate potential competitors from the market, and will be tested under the criteria set forth in *United States v. Penn-Olin Chemical Company*.<sup>85</sup> The United States Supreme Court held in *Penn-Olin* that Clayton Act § 7 applies in situations where two existing corporations form a third corporation to engage in a new enterprise, *i.e.*, a joint venture.<sup>86</sup> The test of whether the joint venture is illegal is whether either party to the agreement could have entered the market on its own.<sup>87</sup> It is not necessary to establish that more than one of the venturers would have entered the market. One need inquire only whether the joint venture ". . . eliminated the potential competition of the corporation that might have remained at the edge of the market, continually threatening to enter."<sup>88</sup> The Court found that potential competition, as a substitute for actual competition, may still restrain producers from overcharging those to whom they sell.<sup>89</sup> It only need be shown that there is a "reasonable probability" of one firm entering the market with the other remaining outside as a potential competitor.<sup>90</sup> Thus, a joint venture in the EFT area would be prohibited if it foreclosed any prospect of competition between the banks that have joined together to operate the electronic payment facilities.<sup>91</sup>

Those who support joint ventures may argue that the costs of system development are too high and the value of individual trans-

---

81. Bank Merger Act of 1966, 12 U.S.C. § 1828(c) (1976).

82. *Id.*

83. 399 U.S. 350 (1970).

84. *Id.* at 358.

85. 378 U.S. 158 (1964).

86. *Id.* at 168-70.

87. *Id.* at 173-74.

88. *Id.* at 173.

89. *Id.* at 174.

90. *Id.*

91. *Id.* at 173. The Court proscribed the joint venture between two competing entities, stating that "this joint venture may well foreclose any prospect of competition between Olin and Pennsalt. . . ." *Id.*

actions are so low that universal participation is necessary to achieve rational economies.<sup>92</sup> Further, there also exists a major risk of consumer non-acceptance. Closer examination of the considerations relevant to these systems, however, negates some of these claims. If the relevant market area is defined too narrowly, the costs may indeed be too high and the value of transactions too low. Yet, there is no reason to believe that various regions could not support systems competing in multiple markets. Innovation is resulting in drastic reductions in the cost of technology, thereby requiring progressively smaller commitments of resources.<sup>93</sup> If transaction volume turns out to be insufficient to support a system devoted exclusively to electronic funds transfers, the system could be adapted to perform other tasks, *e.g.*, inventory control, payroll and general bookkeeping for bank customers. Lastly, a grandiose project may simply be too ambitious when a smaller, less costly system could adequately serve the bank customers' needs.<sup>94</sup>

The degree of risk involved and the extent of front-end capital investment may, however, justify initial cooperation in developing interbank communications systems, particularly since such systems have never been successfully implemented.<sup>95</sup> In *United States v. Jerrold Electronics Corporation*,<sup>96</sup> the Court held that where a firm enters a new industry, and its reputation and the growth of the entire industry are at stake during the developmental period, some restraints on competition are permissible.<sup>97</sup> However, the Court also held that anti-competitive restrictions may become unreasonable at the point when the firm and/or the product become well-established in the market.<sup>98</sup> Over-inclusive sharing arrangements, which might tend to substantially lessen competition, may be tolerated at the outset. As consumer acceptance increases, however, and the cost of technology decreases, the legitimacy of these same joint venture agreements will be analyzed under the test of *Penn-Olin*.<sup>99</sup>

Large EFT joint ventures will be examined by the courts, not only to determine whether they lessen competition within the banking industry, but also to decide whether they have resulted in verti-

---

92. Bernard, *Some Antitrust Issues Raised by Large Electronic Funds Transfer Systems*, 25 CATH. U.L. REV. 749, 751 (1976).

93. See text accompanying notes 8-13 *supra*.

94. Rose, *Antitrust and EFT: Competition, Not Regulation* (paper prepared for delivery before Conf. on Developing Legal Issues Concerning Electronic Funds Transfer Systems, Wash., D.C., Mar. 4, 1976).

95. Ubell, *supra* note 7, at 78.

96. 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961).

97. *Id.* at 555.

98. *Id.* at 556-58.

99. 378 U.S. 158, 173-74 (1964).

cal integration in the computerized, financial communications industry, foreclosing competition from independent computer firms.<sup>100</sup> Independent computer companies which already provide non-financial communications may stand ready to enter the EFT field, but be excluded by large EFT joint ventures which deal exclusively with their own members. These independent companies may, in fact, have several advantages over joint ventures. For instance, they may be able to provide services more cheaply and efficiently than the financial institutions; they may be able to spread their fixed costs over a larger number of services, including non-financial services; they may adapt more easily to advancing technology; they may provide specialized services that financial institutions cannot afford to provide; and, they may be able to combine electronic funds transfer services with non-financial services to generate entirely new capabilities, *e.g.*, communications systems for all intercorporate dealings.<sup>101</sup>

The United States Supreme Court in *Brown Shoe Company v. United States*<sup>102</sup> found this type of vertical integration prohibited by section 7 of the Clayton Act.<sup>103</sup> Under *Brown Shoe*, large EFT joint ventures would violate section 7 if they deprived independent computer companies of a fair opportunity to compete and the result was a substantial lessening of competition and increased tendency toward monopoly in the EFT industry.

Those institutions least likely to be able to develop electronic payment systems are small, local financial institutions servicing customers within a relatively small geographic market. These institutions, however, have several alternatives available to them.<sup>104</sup> First, small banks may choose to forego participation in electronic funds transfer systems completely, and stress better, humanized services for customers with a distaste for dealing with machines. They could also form joint ventures with other, similarly situated banks to offer automated teller machines and point-of-sale terminals. The economies of scale needed to develop such a system may be sufficient justification for the joint venture,<sup>105</sup> if it can be shown that none of the venturers would have entered the market on its own.<sup>106</sup> Lastly, small banks may purchase access into one of the competing systems operated by large banks in their area. Although the question of ac-

---

100. Bernard, *supra* note 92, at 751-52.

101. *Id.* at 752. See also Rose, note 94 *supra*.

102. 370 U.S. 294 (1962).

103. *Id.* at 317.

104. Baker, *supra* note 4, at 715.

105. Ubell, *supra* note 7, at 78.

106. *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 173-74 (1964).

cess is beyond the scope of this article, smaller banks are somewhat protected by the antitrust laws in this area as well. Where the operator of an electronic payments system has a natural monopoly in a market, competing institutions must be given the opportunity of membership in the system or access to it upon payment of reasonable fees in a non-discriminatory manner.<sup>107</sup> Furthermore, where an electronic payments system is not a monopoly, but has the market power to become one, it may not deny membership to an institution in a discriminatory manner, solely because that institution competes with one or more members of the system.<sup>108</sup>

There are numerous other legal problems which will arise out of EFT joint ventures.<sup>109</sup> Many of them are clear, *per se* violations of the antitrust laws. For example, the venture may not fix prices, directly or indirectly,<sup>110</sup> and may not engage in group boycotts or refusals to deal,<sup>111</sup> tying arrangements<sup>112</sup> or territorial or market restrictions.<sup>113</sup> None of these are issues which affect the basic structure of the financial community or their ability to offer electronic payments services. They are doctrines well-established in the law of antitrust and should not be modified with regard to the banking industry.

#### IV. CONCLUSION

The financial industry is at a turning point. Fundamental changes in our economy and the way Americans do business are underway. To adequately serve the needs of all customers, from the largest corporations to the smallest individual depositor, members of the financial community must adapt to these changes without losing sight of their origins and the functions that they are intended to perform in society. They must offer efficient, useful, low-cost services based on the actual demands of their customers. While the precise, operational configuration that will best serve the public interest is still unclear, it is clear that the banking industry must have the potential to innovate, expand and adapt.

Electronic funds transfer systems may be the vehicle with which the banking industry will keep pace with society. EFT policy

---

107. *United States v. Terminal R.R. Ass'n*, 224 U.S. 383, 410-11 (1912).

108. *Associated Press v. United States*, 326 U.S. 1, 21 (1945).

109. Murray, *EFTS and Antitrust—Some Reflections on the Possibilities*, 37 U. PRR. L. REV. 673 (1976).

110. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940).

111. *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 212 (1959).

112. *International Salt Co. v. United States*, 332 U.S. 392, 396 (1947).

113. *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). *But see* *Continental TV, Inc. v. GTE Sylvania*, — U.S. —, 97 S. Ct. 2549 (1977).



is, however, in grave danger of becoming a disorganized mass of inconsistencies. Acceptable, effective legislation is required. Such legislation must deal with the basic structure of the banking industry, the extent to which banks and other financial and non-financial institutions can offer electronic banking, and the extent to which this new electronic banking industry will be subject to the antitrust laws.

If one thing is clear, it is that the structure which is ultimately developed should be as competitive and flexible as possible. Competition promotes efficiency, innovation, low-cost, and responsiveness. As recently stated:

. . . competitive ferment is far more likely to produce a payments system that is sensitive to the needs of its intended users—because these entities will not continue any service unless that service receives public acceptance and will strive to develop new services that will be accepted.<sup>114</sup>

---

114. Brandel & Gresham, *supra* note 2, at 1149.