THE CAPITAL ONE FINANCIAL-DISCOVER FINANCIAL SERVICES MERGER: A TEST FOR THE BIDEN MERGER AGENDA?

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EXECUTIVE SUMMARY

The proposed merger of Capital One Financial and Discover Financial Services is the largest in the banking and financial services sectors since the 2000s. The proposed merger signals a fundamental shift in the motivation for consolidation in banking and credit card services since the last swath of mergers. That is, acquisitions by the top credit card payment processing networks and card issuers over the last 15 years have focused on building out digital payment technology "ecosystems" in the migration to digital financial services.

The merger affects a number of important markets, ranging from banking to credit card purchasing and lending, and even digital payments ecosystems where Capital One-Discover will compete with newer market entrants. The impact on consumer credit card lending is getting particular attention. Credit card debt has skyrocketed since 2021 and the cost of that debt weighs heavily on working-class Americans. Any post-merger threat of higher credit card interest rates and fees, or a degradation in non-price benefits such as card rewards programs, therefore, will get very close scrutiny by regulators.

With many cooks in the regulatory "kitchen," including the Federal Reserve Bank (FRB), Office of the Comptroller of the Currency (OCC), and U.S. Department of Justice (DOJ), the $35 billion Capital One-Discover merger will be under the microscope. But it comes at a time when updated bank merger guidelines from OCC and DOJ are far from finalized. This leaves the 1995 bank merger guidelines and, potentially, questions about if and how the DOJ might apply the new 2023 Merger Guidelines to the transaction.

PPI's analysis unpacks major competition questions that are likely to surface in the DOJ's antitrust review of the credit card side of the Capital One-Discover merger. These issues range from a loss of competition and enhanced market power in credit card purchasing and lending, to vertically combining a credit card issuer with a payment processing network, and how the merger affects competition in digital payments ecosystems.

A major takeaway from PPI's analysis, which is based on publicly available data, is that the Capital One-Discover merger is unlikely to present a clear-cut case of a merger that is likely to "substantially lessen competition or tend to create a monopoly" under Section 7 of the Clayton Act. This applies under existing banking guidelines followed by the DOJ and the new 2023 Merger Guidelines, should the government use them to guide an analysis of the competitive effects of the Capital One-Discover merger.

Challenging a merger in federal court that does not trigger, or strongly trigger, the thresholds in the merger guidelines would raise the government's burden of proof. The DOJ would need to make a particularly strong case for anticompetitive effects in order to fend off rebuttal evidence from Capital One-Discover that the merger is pro-competitive. These dynamics increase the Biden DOJ's risk of losing in a litigated merger case, an outcome that could set a poor precedent at a time when strong merger enforcement will be particularly important in policing a new wave of consolidation in the financial services sector.

Please read on for PPI's analysis of the Capital One-Discover merger and what it means for antitrust enforcement, consumers, and the financial services sector.

I. THE MANY COOKS IN THE BANK MERGER KITCHEN

The proposed merger of Capital One Financial and Discover Financial Services ("Capital One-Discover"), announced in February 2024, is the largest in the banking sector in some time.[1] The merger proposal signals a shift in the motivation for consolidation in banking and credit card services since the last swath of mergers in the 2000s. That is, acquisitions by the top credit card networks and card issuers over the last 15 years have focused on building out payment technology ecosystems to support the migration to digital banking and lending platforms.[2] Other motivations for the Capital One-Discover merger are also in play, such as vertically integrating to reduce costs and gain more direct access to consumers and merchants.[3]

The surge of attention to a Capital One-Discover tie-up comes as no surprise. Aside from its $35 billion price tag, it is the first merger to combine a top ten national U.S. bank with a credit card network. Moreover, American consumers held over $1.1 trillion in outstanding balances as of the first quarter of 2024, a level that has skyrocketed since early 2021, so there is particular attention to the potential effect of the merger on credit card interest rates and fees.[4]

There are many cooks in the banking and financial services merger kitchen. The Federal Reserve Bank (FRB), Office of the Comptroller of the Currency (OCC), and U.S. Department of Justice (DOJ) all have the authority to review the deal.[5] Depending on their statutory mandates, the agencies will evaluate the effects of the merger based on a range of competition and non-competition factors, including on local communities and the resilience and stability of the banking system, or systemic risk.[6]

Both OCC and the DOJ have issued proposals soliciting comments on new bank merger guidelines.[7] While the 1995 bank merger guidelines are still relevant for DOJ reviews, it is apparent

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[1] "Capital One to Acquire Discover," Capital One, February 20, 2024, https://investor.capitalone.com/news releases/news-release-details/capital-one-acquire-discover.

[2] Based on acquisitions by company top credit card issuers and banks, sourced from Crunchbase.com.

[3] "Capital One-Discover Investor Presentation," CapitalOne, February 20, 2024, https://ir-capitalone.gcs-web.com/static-files/cfa11729-0aec-43dc-b531-200e250c8413; *Press Release- Capital One to Acquire Discover*, CapitalOne, last visited May 29, 2024, https://ir-capitalone.gcs-web.com/news-releases/news-release-details/capital-one-acquire-discover.

[4] Matt Schulz, "2024 Credit Card Debt Statistics," LendingTree, May 14, 2024, https://www.lendingtree.com/credit-cards/study/credit-card-debt-statistics/.

[5] "Meeting between Federal Reserve Board Staff and Representatives from Rise Economy and its Member Organizations," Federal Reserve 1, April 2, 2024, https://www.federalreserve.gov/foia/files/capone-discover-comments-meeting-summary-20240523.pdf.

[6] Michael J Hsu, *Acting Comptroller of the Currency Michael J. Hsu Remarks at Brookings "Bank Mergers and Industry Resiliency,"* OCC 2, September 5, 2022, https://www.occ.gov/news-issuances/speeches/2022/pub-speech-2022-49.pdf.

[7] Office of the Comptroller of the Currency, U.S. Department of the Treasury, Notice of Proposed Rulemaking: Business Combinations Under the Bank Merger Act, Docket, F.R. 10010, February 13, 2024, https://www.occ.gov/news-issuances/federal-register/2024/89fr10010.pdf; U.S. Department of Justice, "Antitrust Division Banking Guidelines Review: Public Comments Topics & Issues Guide," December 17, 2021, https://www.justice.gov/atr/antitrust-division-banking-guidelines-review-public-comments-topics-issues-guide.

from agency messaging that the DOJ intends to broaden its scope in evaluating bank mergers.[8] These changes are likely to align with the new 2023 Merger Guidelines, issued last year by the DOJ and Federal Trade Commission.[9] The ultimate question for antitrust, of course, is whether the merger is likely to "substantially lessen competition or tend to create a monopoly" under Section 7 of the Clayton Act,[10] potentially leading to higher credit card interest rates and fees, and degraded nonprice benefits such as rewards programs.

PPI's analysis focuses on how the DOJ might analyze the Capital One-Discover merger based on existing bank merger guidelines and the 2023 Merger Guidelines. The merger raises a number of competition issues. These include horizontal consolidation, or eliminating competition in the markets for credit card purchasing and lending where both firms compete. Another potential concern is vertical, or integrating a credit card issuer and payment network in adjacent markets. A third issue is how the merger might affect competition in broader digital payments "ecosystem" markets.

II. BACKGROUND ON ANTITRUST REVIEW OF THE CAPITAL ONE-DISCOVER MERGER

The central inquiry in an antitrust review is identifying how a merger changes incentives for how firms in a market compete. The 2023 Merger Guidelines state that the antitrust agencies "...begin the analysis of a proposed merger by asking: how do firms in this industry compete, and does the merger threaten to substantially lessen competition or tends to create a monopoly?"[11]

This inquiry focuses on changes in competitive incentives. These can result from any number of merger-related effects: (1) the loss of head-to-head competition, (2) facilitating coordination on price and non-price terms among the remaining competitors in a post-merger market(s), (3) increased incentives to foreclose rivals from markets, and (4) entrenching a dominant position.[12] As illustrated by merger challenges such as Spirit-JetBlue and UnitedHealth Group-Change Health, a harmful loss of competition can threaten higher prices, lower wages, lower quality and innovation, and a loss of choice in sellers or buyers.[13]

The DOJ's analysis will be informed by confidential information obtained from the merging parties and other market participants. This includes assessing the "relevant" product and geographic markets in which the merging companies compete, changes in pre- to post-merger market shares and concentration, altered incentives to compete, and any evidence that the merger would reduce or eliminate incentives to exercise market power as a result of cost savings or other consumer benefits (i.e., "efficiencies").

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[8] "DOJ's Top Antitrust Official Turns Spotlight on Broadened Scope of Bank Merger Enforcement," Cooley, September 11, 2023, https://www.cooley.com/news/insight/2023/2023-9-11-dojs-top-antitrust-official-turns-spotlight-on-broadened-scope-of-bank-merger-enforcement.
[9] U.S. Dept. of Justice & Fed. Trade Commission, Merger Guidelines, December 18, 2023, ["2023 Merger Guidelines."]
[10] 15 U.S.C. § 18.
[11] 2023 Merger Guidelines, *supra* note 9, Section 1.
[12] 2023 Merger Guidelines, *supra* note 9.
[13] United States v. JetBlue Airways Corp., Complaint, Case No. 23-10511 (D. Mass. March 7, 2023); and U.S. and Plaintiff States v. UnitedHealth Group, Inc. and Change Healthcare Inc., Complaint, Case 1:22-cv-00481 (D.D.C, Feb. 24, 2022).

Two issues are likely to generate close scrutiny by the DOJ in evaluating the Capital One-Discover merger under the bank merger guidelines or the 2023 Merger Guidelines, should the Antitrust Division seek to apply them in this case. One is the markets that are affected by the merger. The DOJ will assess what products or services consumers can turn to to avoid increases in interest rates or fees, or the loss or degradation of card benefits. Substitutes for credit card purchasing or lending could include cash payments, debit cards, personal loans, withdrawals from an IRA, salary advances, peer-to-peer loans, or "buy now, pay later" services.

The unique features of credit cards, however, are likely to make them a distinct market in the Capital One-Discover context. The scope of those markets is likely to be national, as opposed to the smaller geographic markets that will emerge when regulators evaluate the banking side of the merger. For consumers that do not run credit card balances, annual fees, reward programs, and other perks can factor significantly into how to pay for products and services and which card to choose from an array of competitive alternatives. For consumers that do borrow on their cards, interest rates play a major role in their choice of card(s).[14] Many consumers hold multiple credit cards, just as they buy different brands of products and services they view as close substitutes.

A second major issue is likely to be how the Capital One-Discover merger changes incentives to compete. For example, does the merger eliminate strong head-to-head competition in credit card purchasing and lending, or facilitate anticompetitive coordination among the remaining rivals? Will the merger create strong incentives to frustrate rival credit card issuers (i.e., banks) access to Discover as a payment network or frustrate rival payment networks (e.g., Visa and Mastercard) access to Capital One as a card issuer? Would a combined Capital One-Discover have stronger incentives to entrench a dominant position in the provision of an array of products and services in digital payment ecosystems, to the detriment of smaller players that may be gaining a foothold?

The role of market concentration and market share thresholds will play a central role in guiding regulatory decisions to challenge the Capital One-Discover merger. The bank merger guidelines establish thresholds that determine whether the FRB and DOJ will look more closely at the potential competitive effects of a merger. This threshold is a change in market concentration of greater than 200 HHI points and post-merger concentration in excess of 1800 HHI.[15]

The 2023 Merger Guidelines establish thresholds beyond which a merger is presumed to substantially lessen competition or tends to create a monopoly. One threshold is a change in market concentration of more than 100 HHI points, and a post-merger concentration market share of greater than 1800 HHI. A second is an increase in concentration of more than 100 HHI points and a post-merger share of higher than 30%.[16]

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[14] Ashwin Vasan and Wei Zhang, "Americans Pay $120 Billion In Credit Card Interest and Fees Each Year," CFPB, January 19, 2022, https://www.consumerfinance.gov/about-us/blog/americans-pay-120-billion-in-credit-card-interest-and-fees-each-year/.

[15] "Bank Merger Competitive Review -- Introduction And Overview," U.S. Department of Justice, Antitrust Division, 1995, https://www.justice.gov/atr/bank-merger-competitive-review-introduction-and-overview-1995.

[16] 2023 Merger Guidelines, *supra* note 9, Section 2.1.

III. POTENTIAL IMPACT ON COMPETITION IN CREDIT CARD MARKETS

A. All Credit Card Lending Markets

Capital One and Discover compete in the markets for all credit card purchasing and lending.[17] While the government's analysis could reveal different markets affected by the Capital One-Discover merger, we can get a "ballpark" sense of its impact from publicly available data. For example, in the market for credit card lending, the merger combines a fourth-ranked Capital One with a fifth-ranked Discover, based on outstanding credit card loan volume.[18]

The merger would slot the merged company into the first place, with a 25% market share, just above JP Morgan Chase. These two players would have shares between 20-25% and four additional firms would have shares between about 9-15%. The merger would increase market concentration by about 290 HHI points, for post-merger concentration of about 1720 HHI.[19] The Capital One-Discover merger, therefore, does not trigger the thresholds under the bank merger guidelines or either of the two major thresholds under the 2023 Merger Guidelines.

B. Non-Prime Credit Card Lending Markets

The DOJ may consider narrower credit card markets affected by a Capital One-Discover merger, such as the non-prime market, which is between the prime and subprime markets, for consumers with lower credit scores and more risky credit management profiles. These consumers cannot access the lower interest rates offered to those with less risky credit profiles.[20] Both Capital One and Discover serve the non-prime credit card lending market, where some commentators note that the merger could raise interest rates and fees, thus widening gaps in wealth and income, particularly for at-risk communities.

Should it be considered a distinct relevant market, non-prime credit card lending would feature Capital One in first place and Discover in fifth place.[21] The merger increases Capital One's market share to about 30% (still in first place), followed by four additional firms with shares ranging from about 8-15%. The merger would increase market concentration by about 390 HHI points, for a post-merger concentration of about 1680 HHI. The Capital One-Discover merger does not trigger the bank merger guidelines threshold or the 2023 Merger Guidelines threshold for a high post-merger market concentration. It could, however, trigger the threshold for changes in concentration and market share under the 2023 Merger Guidelines.

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[17] *Press Release- Capital One to Acquire Discover*, *supra* note 3.

[18] *Capital One-Discover Investor Presentation*, *supra* note 3, at 8.

[19] The HHI statistic, or measure of market concentration is calculated as the sum of the squared market shares for all competitors in the market. The change in market share can be calculated, shorthand, as 2 x (share for merging firm A) x (share of merging firm B).

[20] "Credit Score and Financing – Super vs. Prime vs. Near Prime vs. Sub Prime," UCFS, November 17, 2021, https://www.ucfs.net/credit-score-consumer-financing/.

[21] *The Anticompetitive Effects of the Proposed Capital One-Discover Merger*, Americans for Financial Reform Education Fund 9-10, April 22, 2024, https://ourfinancialsecurity.org/wp-content/uploads/2024/04/AFREF-Capital-One-Discover-Merger-Comment-4-2024.pdf.

In addressing the potential impact of the merger on non-prime credit card lending, the DOJ will need to consider a number of factors. One is whether there is a distinct market for non-prime credit card lending. The boundaries across prime and non-prime credit card lending markets may be fluid, as consumer credit scores or credit management behaviors ebb and flow. Information obtained by the DOJ on the mobility of consumers across non-prime and prime markets and the criteria banks use to identify non-prime consumers will inform if, and how, a market for non-price is relevant to the merger.

A second issue is the combined 30% market share threshold in the 2023 Merger Guidelines that is triggered by the Capital One-Discover merger. The market share is right “at” the threshold, while the change in concentration exceeds the threshold. This threshold is designed, in part, to flag mergers that could create a dominant firm as a result of eliminating a head-to-head rival. To determine if this would put upward pressure on interest rates or fees, the DOJ would assess the potential diversion of revenues between Capital One and Discover in the event one raised interest rates to determine if they are close rivals. It is not clear from public data, however, that the two companies compete head-to-head. Both firms price non-prime credit cards at different interest rates and offer different non-price benefits.

C. Credit Card Purchasing Markets

In the market for credit card purchases, the merger combines third- and sixth-ranked Capital One and Discover, respectively, by purchase volume. The combined company would retain its position as the third player, with a market share of about 20%, behind JP Morgan Chase and American Express. These three players have shares between about 19-27% and four other players have shares between 3-13%.

The merger would increase market concentration by about 140 HHI points, for a post-merger concentration of about 1990 HHI. The merger would, therefore, not trigger the bank merger guidelines threshold. But it does exceed the 2023 Merger Guidelines’ threshold for an increase in concentration and post-merger level of concentration. Again, this threshold violation is on the margin of what the DOJ might consider a presumptively harmful merger.

In light of PPI’s analysis, the impact of the merger on competition in credit card purchasing and lending under the bank merger guidelines and the 2023 Merger Guidelines is mixed. Of the three product markets evaluated by PPI, which may not be exactly those that the FRB and DOJ define, the merger would trigger the thresholds in only two of six scenarios, depending on the guidelines applied. Moreover, these are marginal threshold violations, outcomes that are likely to present questions for the DOJ.

Decisions to litigate merger cases in federal court necessitate strong evidence of a violation of Section 7 of the Clayton Act. Without such evidence, it will be harder for the DOJ to fend off rebuttal evidence from the merging parties as to why the benefits from their merger are likely to eliminate any incentives to exercise market power to raise interest rates or fees, or degrade benefits for card holders. A loss for the Biden DOJ could set a poor precedent on banking mergers, particularly in light of previous losses in litigated cases, and at a time when antitrust will be particularly important in policing a new wave of consolidation in the financial services sector. [22]

IV. THE POTENTIAL FOR STRATEGICALLY LIMITING COMPETITION FROM RIVALS

The Capital One-Discover deal is the first major vertical merger to combine a credit card payment network and a bank credit card issuer. This integration is a strong motivation for the merger. Capital One-Discover cite various benefits of integration, including dealing directly with merchants, economies from vertical integration, such as coordination between card issuing and card payments, increasing volume by becoming the network for other banks, and eliminating the extra markup on card payment services.[23]

Discover is currently a "closed" network that serves as both the card issuer and card processing network.[24] In other words, there are no banks that currently issue Discover cards. Capital One reportedly issues both Visa and Mastercard credit cards, both of which maintain "open" payment processing networks by permitting banks to issue credit cards in their networks.[25] The merger would combine Capital One's credit card issuing services with Discover's payment processing network.

In contrast to eliminating competition as a result of a horizontal combination, the question for a vertical merger is whether Capital One-Discover would have stronger incentives to use their market position to restrain competition in a related market. This could include denying competitors access to its card issuing and payment network services, sharing competitively sensitive information on rivals, or raising barriers to entry. The effect of these strategies, if successful, would be to limit competition, thus raising interest rates and fees, or degrading other non-price terms of services such as rewards programs.

The vertical effects of a Capital One-Discover merger will also be a case of first impression for the DOJ. The 2023 Merger Guidelines are the first to include significant and complex guidance on how the antitrust agencies will analyze vertical mergers. The DOJ is likely to ask if Capital One-Discover will have stronger incentives to cut off or limit rival payment networks' access to Capital One as a card issuer or rival card issuers' access to Discover as a payment network. If competitors are unable to compete as effectively because of limited, higher cost access or a loss of bargaining power, then they could lose customers to Capital One-Discover, with higher interest rates and fees, and fewer benefits to follow.

The DOJ may also consider a scenario where if Capital One-Discover maintain an "open" system of doing business with other credit card issuers, and even payment processing networks, the

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[22] Diana L. Moss, "Taking Stock of Merger Enforcement Under the Biden Administration," Progressive Policy Institute, March 14, 2024, https://www.progressivepolicy.org/wp-content/uploads/2024/03/PPI_Merger-Enforcement_V3.pdf.
[23] *Capital One-Discover Investor Presentation*, *supra* note 3, at 8.
[24] Andrew Sjogren, "Understanding Card Processing Networks for Beginners," Spreedly, August 10, 2023, https://www.spreedly.com/blog/card-processing-network.
[25] "Are Capital One Cards Visa or Mastercard?," January 17, 2024, https://www.capitalone.com/learn-grow/money-management/is-capital-one-visa-or-mastercard/.

company could gain visibility into rivals' competitively sensitive information.[26] This could include information on promotional plans and anticipated product improvements and rollouts. This could undercut rivals' ability to compete, or even facilitate coordination through the exchange of information on competitors' strategies among fewer firms in the market.

These questions will attract antitrust scrutiny if the DOJ concludes that Capital One and Discover have significant shares in their respective markets and/or that markets are highly concentrated. Foreclosing competition by limiting or cutting off rivals' access to important inputs or distribution is not a costless strategy. It would require that Capital One-Discover earn enough revenue from anticompetitively higher consumer interest rates and fees, on a larger customer base, to more than make up for the revenues lost from cutting off rivals.[27] Past litigated vertical mergers such as Comcast-NBC Universal and AT&T-Time Warner have exposed the fraught nature of this analysis.

Neither company appears to have sufficiently high market shares to wield this type of market power. Indeed, the 2023 Merger Guidelines state that the antitrust agencies will "...generally infer, in the absence of countervailing evidence, that the merging firm has or is approaching monopoly power in the related product if it has a share greater than 50% of the related product market."[28] With a 25% market share for Capital One and 5% for Discover, meeting this criteria would be a "reach." Based on PPI's analysis, therefore, it appears that the merger does not materially strengthen incentives to foreclose competition.

V. BROADENING THE SCOPE TO COMPETITION IN DIGITAL PAYMENTS ECOSYSTEMS

A major motivation for the Capital One-Discover merger is to create a "global payments technology company" and "leading digital bank provider."[29] This transformation requires migrating to cloud technology and modernizing the Capital One-Discover data ecosystem. Research shows that digital ecosystems grow largely through acquisition, as opposed to organically.[30] The "buy vs. build" decision is highly relevant to transitioning from a traditional business network to a digital business ecosystem, which could exceed the bounds of firms' internal R&D capability.

M&A activity by Capital One over the last 15 years confirms this. The company has acquired a number of small assets in fintech, software, web and mobile apps, and data analytics, artificial intelligence, and machine learning.[31] To be sure, Capital One's strategy to build out a payment technology platform appears similar to what other major credit card issuers such as JPMorgan Chase and payment networks, Visa and Mastercard, have also been pursuing.

[26] 2023 Merger Guidelines, *supra* note 9, Section 2.5.
[27] *United States v. AT&T Inc.*, No. 17-02511-RJL, 150-154 (D.D.C. June 12, 2018).
[28] 2023 Merger Guidelines, *supra* note 9, Section 2.5.A.1.
[29] *Press Release- Capital One to Acquire Discover*, *supra* note 3.
[30] Diana L. Moss and David Hummel, "Anticipating the Next Generation of Powerful Digital Players: Implications for Competition Policy, American Antitrust Institute, January 18, 2022, https://www.antitrustinstitute.org/wp-content/uploads/2022/01/NextGenDigitalAAIReport.1.18.22-1.pdf.
[31] Crunchbase, *supra* note 3.

The payments ecosystem dimension of the Capital One-Discover deal could get scrutiny from DOJ. It falls in the ambit of the 2023 Merger Guidelines which explain that the agencies will scrutinize ecosystem transactions "....where an incumbent firm that offers a wide array of products and services may be partially constrained by other combinations of products and services" from rivals.[32] With more technology, products, and services, Capital One-Discover may well compete at the ecosystem level. The DOJ would, therefore, assess how the merger changes incentives to compete in ways that could entrench a dominant market position, at the expense of smaller players. But based on publicly available data, it is likely not the case that the merger company would achieve a dominant market position post-merger.

VI. "OPEN" VS. "CLOSED" PAYMENT NETWORKS AND MERGER-RELATED BENEFITS

There are myriad reasons why firms merge and an equal number of reasons why mergers fail. Strategic management research highlights how the deck is stacked against mergers in delivering on claimed benefits from increasing scale and reducing costs or improving a business model to innovate or compete better.[33] For example, the most recent failure, AT&T-Time Warner, was unwound in less than three years after consummation when the companies decided that the content was not where the value proposition was, after all.[34]

While claims about the benefits of a merger make good fodder for shareholder presentations, these motivations do not factor into decision-making except in litigated merger challenges. Once the government has made its case for why a merger is anticompetitive, the burden shifts to the merging parties to offer evidence of procompetitive efficiencies. The stronger the government's case for why a merger violates Section 7 of the Clayton Act, the harder it is for merging parties to provide a defense to their merger.

At the time they announced their merger, Capital One and Discover had not provided detailed estimates of claimed benefits from the merger. While cost savings and network benefits are estimated at about $2.7 billion from 2025 to 2027, elusive revenue or consumer benefits, such as higher quality or expanded product offerings, had not been estimated at all.[35] Under the 2023 Merger Guidelines, Capital One-Discover would bear the burden of showing that any claimed efficiencies meet a series of rigorous tests.

The 2023 Merger Guidelines require, as did the 2010 Horizontal Merger Guidelines, that claimed efficiencies be verified, cannot be achieved without the merger, and are not the result of anticompetitive changes in terms of trade with competitors.[36] However, the new guidelines put

[32] 2023 Merger Guidelines, *supra* note 9, Section 2.6.A.
[33] Scott A. Christofferson et al, "Where Mergers Go Wrong," McKinsey & Company, May 1, 2004, https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/where-mergers-go-wrong.
[34] Diana L. Moss & John Bergmayer, "Strategic Consolidation, Market Power, and Efficiencies in the Media/Entertainment and Distribution Markets: Implications for Antitrust Reviews of Proposed Mergers," American Antitrust Institute, September 2, 2021, https://www.antitrustinstitute.org/wp-content/uploads/2021/09/AAI_PK-Ltr-on-Warner-Media-Disc_9.2.21.pdf.
[35] *Capital One-Discover Investor Presentation*, *supra* note 3, at 24.
[36] U.S. Dept of Justice & Fed. Trade Commission, Horizontal Merger Guidelines, August 19, 2010, at Section 4.

more emphasis than past guidelines on an additional factor,[37] namely that efficiencies cannot accrue solely to the merged firm. Rather, they must prevent the risk of a substantial lessening of competition, which is a particularly high bar. Scaling that bar could occur under a limited number of scenarios.[38]

For example, public documents reveal that Capital One-Discover intends to maintain an open card processing network, or allow other banks to issue cards on the Discover network.[39] If the merged company decides otherwise, it would shift all credit card customers to the Discover network and stop issuing Visa and Mastercard credit cards. While this would eliminate the markup Capital One pays on Visa and Mastercard fees, thus reducing costs, the merged company would risk losing customers to competing card issuers. With a much smaller share of the payment network market, Discover does not have the same brand recognition as Visa and Mastercard, not all merchants accept the card, and it is not accepted outside the U.S.

A more likely event, at least in the near term, is that Capital One deploys its existing customer base, together with Discover's network technology to exploit economies of scale and coordination in retaining an "open" system. The merger could potentially restructure the payment processing oligopoly. If Capital One-Discover steals shares from Visa and Mastercard post-merger, for example, it would deconcentrate the card processing network market. PPI analysis reveals, moreover, that the distribution of market shares across the payment networks would be more "even" than what exists at present.[40]

If this scenario were to play out, the Capital One-Discover merger could result in a market structure in the credit card payment network market that is more conducive to competition, disrupting the Visa-Mastercard duopoly that has prevailed for some time. This works against any theory that eliminating Discover as a disruptive, or "maverick," firm would facilitate anticompetitive coordination. Certainly, the Visa-Mastercard duopoly in credit card payment networks appears not to have been disturbed by Discover, at least on the basis of publicly available information.

This argument could carry significant weight in a contested proceeding involving Capital One-Discover. They would likely be viewed as a strong rebuttal to any allegation that the Capital One-Discover merger is presumptively anticompetitive in some markets, especially if it is based on a marginal violation of the 2023 Merger Guidelines thresholds.

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[37] 2023 Merger Guidelines, *supra* note 9, Section 3.3.
[38] *Id*. See also Congressional Research Service, *Capital One-Discover Proposed Merger: Systemic Risk and Market Competition Considerations*, CRS Reports 1, February 29, 2024, http://crsreports.congress.gov/product/pdf/IF/IF12607/2.
[39] *Press Release- Capital One to Acquire Discover*, *supra* note 3.
[40] *Capital One-Discover Investor Presentation*, *supra* note 3, at 9.

VII. CONCLUSION

The proposed merger of Capital One Financial and Discover Financial Services is the largest in the banking sector in some time. The merger affects a number of markets, from banking to credit cards, and potentially, digital financial services. The impact on consumer credit card lending is getting attention. Credit card debt has skyrocketed since 2021 and the cost of that debt weighs heavily on working class Americans. Any threat of higher consumer interest rates as a result of the merger, therefore, should get close scrutiny by regulators.

The Capital One-Discover merger could test the Biden Administration's merger control agenda in the financial services sector. This is true under the existing bank merger guidelines, and the 2023 Merger Guidelines, should the Antitrust Division apply them, formally or informally. PPI's analysis, based on publicly available data, unpacks the major competition questions that will surface in an antitrust review of the credit card end of the deal. These range from a loss of competition in credit card purchasing and lending, to linking up a credit card issuer with a payment processing network and building out a digital financial ecosystem.

PPI's analysis indicates that these issues are likely to test the DOJ on whether to contest a merger that is not clearly presumptively harmful. Mounting a challenge to a merger under these circumstances raises the bar for the government in making its case for illegality and rebutting claims that the merger will result in pro-competitive effects. These dynamics increase the risk of a loss in a litigated merger case for the Biden Administration that could also set a poor precedent at a time when antitrust will be particularly important in policing a new wave of consolidation in the banking and financial services sector.

ABOUT THE AUTHOR
Diana Moss is Vice President and Director of Competition Policy at the Progressive Policy Institute. From 2015-2023, Dr. Moss was President of the American Antitrust Institute. An economist, her work spans the economic, policy, and legal analysis of antitrust enforcement and sector regulation, with industry expertise in digital technology, energy, agriculture, airlines, telecommunications, media, and health care.