

K&LNG Alert

DECEMBER 2006

Antitrust & Competition

LICENSOR OF CREDIT DATA ALGORITHM SUES CREDIT REPORTING AGENCIES FOR FORMING JOINT VENTURE TO DEVELOP NEW ALGORITHM

On October 11, 2006, Fair Isaac Corporation (“Fair Isaac”), a leading developer of credit scoring algorithms, filed suit in a Minnesota federal district court against three national credit reporting agencies and their joint venture in credit scoring algorithm development, VantageScore Solutions, LLC (“VantageScore”). These three national credit reporting agencies have historically made licensed use of the Fair Isaac algorithm to generate consumer credit scores, which, because of their reliance on a common score range, serve as the standard measurements of consumer creditworthiness in the lending industry. In its complaint, Fair Isaac alleges that the defendants have engaged in antitrust violations, trademark infringement, and deceptive trade practices. Fair Isaac's complaint merely presents allegations to which the credit reporting agencies have not had an opportunity to respond. On their face, these allegations include unlawful disparagement and the use of the terminology likely to confuse consumers about the differences between the defendants' products and Fair Isaac's. Whether the allegations are well-founded or not, however, the complaint illustrates that, to avoid antitrust claims, competitors who form a joint venture are well advised to ensure that their joint venture generates pro-consumer efficiencies that the competitors cannot achieve individually.

CONSUMER CREDIT DATA AND CREDIT SCORING

Credit scores constitute the most important parts of the consumer profiles used by many financial institutions to assess risk for loan origination, account management, prescreening, and other purposes. Fair Isaac, according to the Complaint, is a leading developer of credit scoring algorithms that has traditionally worked in conjunction with

each of the three national credit reporting agencies to produce credit scores from two separate categories of proprietary information: reported consumer data and credit scoring algorithms. The credit reporting agencies each separately compile aggregate credit data about American consumers from creditors and public records. Applying credit scoring algorithms licensed from Fair Isaac to their aggregate credit data, each of these agencies has traditionally generated its own consumer credit scores. Fair Isaac claims that, because each credit reporting agency possesses different aggregate consumer data, it has formulated for each agency different credit scoring algorithms that are tailored to how each agency collects, organizes, and summarizes its data. However, all credit scores produced through use of Fair Isaac's scoring algorithms fall within a standardized FICO score range, which runs from 300 to 850. Lenders, consumers, and resellers usually buy from the credit reporting agencies' credit scores prepared using the Fair Isaac scoring algorithm, along with credit reports containing the aggregated credit data, but Fair Isaac has recently begun selling these scores to consumers directly through its Web site.

In March 2006, the three national credit reporting agencies created a joint venture, VantageScore, which prepares a credit scoring algorithm that is an alternative to Fair Isaac's algorithm. VantageScore licenses use of a single common algorithm to each of the three credit reporting agencies. Because of their use of the VantageScore algorithm, the agencies can now offer both the VantageScore and the FICO score for sale to financial institutions. According to the Fair Isaac complaint, the agencies have contend-

ed that their customers can obtain more consistency, accuracy, and objectivity in any given consumer's credit scores using VantageScore because of the application of a common algorithm to each of the three sets of aggregated credit data. On the other hand, in its complaint Fair Isaac claims that the agencies' creation of VantageScore and their actions in relation to this joint venture illegally harmed competition in the markets for aggregated consumer credit data and credit scoring algorithms, infringing Fair Isaac's trademarks, and resulted in a number of deceptive and unfair trade practices.

FAIR ISAAC'S TRADEMARK AND DECEPTIVE TRADE PRACTICES CLAIMS

Fair Isaac claims that the defendants infringed its trademarks under both federal and Minnesota law. Pointing to its allegedly federally-registered trademarks on the FICO credit score range running from 300 to 850, Fair Isaac argues that VantageScore's use of a partially overlapping numeric range violates federal and state trademark law, in light of the supposed likelihood that consumers would be confused by the similarity in credit scores between the two different systems. Fair Isaac also contends that the defendants engaged in unfair competition through false advertising and deceptive trade practices. To support this argument, Fair Isaac asserts that the defendants marketed the joint venture by claiming that VantageScore provides greater consistency, accuracy, and objectivity, and enjoys acceptance among lenders.

FAIR ISAAC'S ANTITRUST CLAIMS

Fair Isaac alleges that the three national credit reporting agencies, through VantageScore, have violated federal antitrust law. The complaint defines two product markets: (i) the market for aggregated consumer data and (ii) the market for credit scoring algorithms. Fair Isaac argues that the three national credit reporting agencies control the entire market for aggregated consumer credit data. In addition, Fair Isaac contends that credit scores cannot be produced without access to aggregated credit data. Without access to these data, credit scoring algorithms allegedly have no

value. Furthermore, both the aggregated consumer credit data market and the credit scoring algorithm market are allegedly characterized by high barriers to entry, given the substantial costs associated with either obtaining or licensing use of a sufficiently comprehensive and adequately catalogued set of aggregate consumer credit data.

Fair Isaac alleges that the joint venture agreement among the three national credit reporting agencies constitutes an unreasonable contract in restraint of trade and thereby violates Section 1 of the Sherman Act. To determine whether an agreement unreasonably restrains trade, courts usually employ a "rule of reason" analysis that weighs the likely procompetitive features of the agreement against its probable anticompetitive effects. Given the relationship between the two defined markets and the high barriers to entry associated with these markets, Fair Isaac contends that the joint venture agreement among the national credit reporting agencies increases their opportunity and incentive to raise prices and reduce output of their credit score products. Fair Isaac further argues that the joint venture agreement inhibits future innovation in the methods used to generate credit scores by encouraging the credit agencies to share with one another information regarding any innovations in credit data collection or storage, and by increasing market concentration in the two defined markets. Fair Isaac further describes the joint venture as an attempt by the three agencies to eliminate third-party vendors of credit scoring algorithms. Alleging that the joint venture leaves only two competitors, VantageScore and Fair Isaac, in the credit scoring algorithm market, Fair Isaac claims that the joint venture places it at an inherent disadvantage, given the dependence of the credit scoring process upon the essential input of aggregated consumer credit data. Fair Isaac asserts that the joint venture agreements provide no offsetting benefits to consumers.

Furthermore, Fair Isaac argues that the joint venture diminishes potential future competition in the aggregated consumer credit data market. Fair Isaac claims that, by eliminating competition in

the credit scoring algorithm market, the creation of VantageScore allows the credit reporting agencies to preclude the development of alternative scoring methods which use substitute data sources, such as debit card record information. According to the Fair Isaac complaint, the agencies would have little incentive to depart from their reliance on aggregate consumer credit data in the credit scoring process. As a result, Fair Isaac contends that substitute data sources are unlikely to become full-fledged competitors to aggregated consumer credit data if the agencies succeed in driving other algorithm providers out of the market.

Fair Isaac further claims that the formation of the VantageScore joint venture violates Section 7 of the Clayton Act, which prohibits mergers and joint ventures that may substantially lessen competition. The complaint argues that the joint venture reduces competition by joining competing sources of credit data in a single provider of credit algorithms. Fair Isaac claims that the VantageScore joint venture allows the agencies to directly and indirectly exchange information crucial to competition among the joint venturers, including cost and price data. Furthermore, Fair Isaac claims that the joint venture forces potential competitors to enter both the aggregate consumer credit data market and the credit scoring algorithm market, which significantly increases barriers to entry and reduces future competition in these markets.

Fair Isaac presents two other claims under Section 2 of the Sherman Act, alleging that the defendants both attempted to monopolize and conspired to monopolize the credit scoring algorithm market. Fair Isaac argues that the three national credit reporting agencies are trying to eliminate third-

party vendors of credit scoring algorithms. Accordingly, Fair Isaac claims that these agencies have initiated discriminatory and exclusionary acts as part of an intentional attempt to monopolize the latter market that threatens a dangerous probability of success.

CONCLUSION

The Fair Isaac complaint may provide an incomplete picture of the facts surrounding the formation of VantageScore and the nature of the credit scoring product markets. A recent New York Times article presents a different view on this dispute through its description of VantageScore as an emerging challenger to Fair Isaac's dominance in the credit scoring algorithm market. The article concludes: "No one likes monopolies; competition is praised because it offers choice and usually lowers prices. That's what will happen for the real consumers of credit scoring -- the lenders." Damon Darlin, "The Credit Game Is Getting a Second Scorekeeper," *New York Times*, July 8, 2006, at C6. Ultimately the issue in the antitrust litigation, if it proceeds, will be whether credit providers and credit consumers are better served by the prior market structure or by the new joint venture.

Thomas A. Donovan
tdonovan@klng.com
412.355.6466

Daniel R. Miller
daniel.r.miller@klng.com
412.355.8688

If you have questions about this topic or would like more information on Kirkpatrick & Lockhart Nicholson Graham LLP, please contact one of our lawyers listed below:

LONDON

Neil Baylis 44.20.7360.8140 nbaylis@klnng.com
Laura Harcombe 44.20.7360.8186 lharcombe@klnng.com

PALO ALTO

William N. Hebert 650.798.6771 whebert@klnng.com

NEW YORK

Douglas F. Broder 212.536.4808 dbroder@klnng.com

PITTSBURGH

James E. Scheuermann 412.355.6215 jscheuermann@klnng.com
Thomas A. Donovan 412.355.6466 tdonovan@klnng.com



**Kirkpatrick & Lockhart
Nicholson Graham LLP**

www.klnng.com

BOSTON • DALLAS • HARRISBURG • LONDON • LOS ANGELES • MIAMI • NEWARK • NEW YORK • PALO ALTO • PITTSBURGH • SAN FRANCISCO • WASHINGTON

Kirkpatrick & Lockhart Nicholson Graham (K&LNG) has approximately 1,000 lawyers and represents entrepreneurs, growth and middle market companies, capital markets participants, and leading FORTUNE 100 and FTSE 100 global corporations nationally and internationally.

K&LNG is a combination of two limited liability partnerships, each named Kirkpatrick & Lockhart Nicholson Graham LLP, one qualified in Delaware, U.S.A. and practicing from offices in Boston, Dallas, Harrisburg, Los Angeles, Miami, Newark, New York, Palo Alto, Pittsburgh, San Francisco and Washington and one incorporated in England practicing from the London office.

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

Data Protection Act 1988—We may contact you from time to time with information on Kirkpatrick & Lockhart Nicholson Graham LLP seminars and with our regular newsletters, which may be of interest to you. We will not provide your details to any third parties. Please e-mail london@klnng.com if you would prefer not to receive this information.

© 2006 KIRKPATRICK & LOCKHART NICHOLSON GRAHAM LLP. ALL RIGHTS RESERVED.